

SUMMARY OF REPORT

# INCENTIVES/SCHEMES FOR RISK RELIEF FOR INNOVATIVE PUBLIC PROCUREMENT



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By Erland Skogli and Rune G. Nellemann



## Preface

This report reviews the political mechanisms currently used to promote innovation through public procurement in Norway, evaluates the public innovation system as a whole, and recommends new mechanisms to promote innovation through public procurement, both public procurement *of* innovation and public procurement *for* (increased) innovation in the public sector. The recommended mechanisms are based on the current system in Norway, and systematic research on several key countries' innovation policies in addition to leading theory on innovation and innovation through public procurement. The project was conducted on behalf of the Norwegian Ministry of Climate and Environment and the Ministry of Trade, Industry and Fisheries.

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Erland Skogli  
Project manager  
Menon Economics

## Summary

This report evaluates whether there is a need for new or modified programs to stimulate innovation through public procurement, with a particular focus on climate-friendly and low-emission innovation. Menon Economics has conducted this study on behalf of the Norwegian Ministry of Industry, Trade and Fisheries and the Ministry of Climate and Environment.

The report is based on the following six key questions from our clients:

1. Is there a need for new or modified programs/policy instruments that contribute to providing incentives/risk relief to promote innovative public procurement?
2. Are there any arguments in favor of a separate program/instrument for **climate-friendly** innovative public procurement, as compared to a general program/instrument?
3. Are there sectors or industries with a special need for incentive/risk relief schemes/instruments with regards to innovation potential and barriers?
4. Proposals for modified/new programs/policy instruments where applicable
5. How can prospective new schemes/instruments supplement and work together with existing instruments and infrastructure?
6. On what administrative level should new measures be introduced (governmental and/or municipal)?

The study will answer questions about new or modified instruments both for innovative public procurement in general and climate-friendly innovative public procurement in particular.



Innovative public procurement



Climate-friendly innovative public procurement

In this report, the two areas have been treated separately where appropriate. Sections that deal exclusively with climate-friendly innovative public procurement are to be found under headings in **green colour**. The rationale for both areas largely builds on the same arguments, and is therefore treated jointly.

## Scope of the study

The topic of innovation and innovation policy, climate and climate policy, and public procurement and public procurement policy is very comprehensive. The scope of this study has therefore been limited to the areas of «innovative public procurement» and «climate-friendly public procurement». The latter is partially a sub-area of the first, since climate-friendly public procurement often entails an innovative public procurement where minimizing the climate footprint is the objective. The study does not focus on SME-policy (small and medium-sized enterprises), innovation in business and industry as such, or other ways of achieving/implementing policies within the above-mentioned policy areas.

## There is a need for new or modified schemes/public policy instruments for innovative public procurement

How can innovative public procurement contribute to achieving innovation and climate policy targets in an efficient way in Norway? What concrete changes in existing schemes can we envisage, and what kind of new schemes could be appropriate?

In this study, we have found three biases/deficiencies within the existing schemes that are relevant to innovative public procurement in general and climate-related innovation in particular:

1. Existing policy instruments, both those aimed at innovation in general and those meant to stimulate climate-friendly/low-emission innovation, are not very well suited to public procurement. This is still the case despite the fact that efforts to integrate environmental, climate-related and innovation objectives into public procurement practice have been ongoing for several years now. The new EU-Directive and related changes in Norwegian legislation might open up new opportunities.
2. The few existing schemes that can actually be said to be aimed at innovative and climate-friendly public procurement have traditionally been targeted at suppliers and the provision of risk relief for these. This study however shows that it is the public procurer's perceived risk which is the biggest barrier to innovation through procurement today.
3. Instruments should differentiate to a larger degree between «recreational sports» on the one hand, i.e., lifting the degree of innovation for all types of procurements, and «top-level sports» on the other hand, i.e., advanced procurement of technology and solutions with an ambitious level of innovation height.

Our study is based on this two-part classification of innovative public procurement:

1. Public procurement **for** innovation: Involves facilitating and not hindering innovation in all types of procurement. Low threshold, not very advanced, «recreational sports».
2. Procurement **of** innovation: Procurement of advanced solutions that often require research and development. Higher threshold, relevant to a small proportion of public procurement, «top-level sports».

Within these two areas, we look at different alternatives for the use of public policy instruments and potential changes to existing schemes.

Suggestion for public procurement **for** innovation:

We find that Norway's National Program for Supplier Development («LUP») is a well-functioning existing policy instrument for *innovation in procurement* that can be scaled up further from the present level (LUP receives NOK 10 million via the national budget in 2016). It is, however, the Norwegian Agency for Public Management and

eGovernment (Difi) which has the formal responsibility for measures aimed at reducing general barriers to innovation through public procurement. In order to achieve the goal of lifting many more public procurements and the total procurement volume “up a few notches” and trigger more innovation through a focus on functional specifications and dialogue with suppliers, it is necessary to increase the scope of the program. In combination with Difi’s existing information and competence-building activities, LUP is a scheme that could be scaled up considerably beyond what was approved in this year’s national budget (separate budget item of NOK 10 million). It is for example possible to envision that activities could be increased ten-fold in the long run (to up to NOK 100 million). We also recommend that LUP be maintained as an independent actor, while Difi is given a mandate and funding to further develop its methodological framework and advisory function for the public sector.

Suggestion for public procurement of innovation:

A new scheme based on the widely used American SBIR (Small Business Innovation Research)<sup>1</sup>-model would be suited to strengthening a national, cross-sectoral effort within public *procurement for innovation*.

In short, SBIR (Small Business Innovation Research - USA and the Netherlands) and SBRI (Small Business Research Initiative - UK) are schemes where different participating specialist ministries channel a selection of larger, advanced procurements from their subordinate agencies (or on ministry level) through a small «secretariat» (the program’s organization), which participates in the process. The process can be organized in the form of a number of national innovation competitions, *government challenges*, as is the case in both the UK, the US, the Netherlands and now also in Sweden (within climate/environment).

Such a scheme should draw on expertise from the existing range of instruments targeted at the industrial sector and from the National Program for Supplier Development; potentially also on expertise and funding from Innovation Norway’s so-called IRD/PRD-scheme<sup>2</sup>. The IRD/PRD-scheme is mostly aimed at suppliers, and not at public procurers<sup>3</sup>. Thus, it has limited effect when it comes to remedying the biggest challenge for innovative procurement: public procurers’ risk aversion. We propose to incorporate PRD in a new SBIR (Small Business Innovation Research)-like scheme where it will have a better chance to come into its own.

The new scheme should, as in the US and in other countries that have copied it, be built up in the form of a national innovation competition:

- Procurement projects from participating ministries and associated subordinate agencies are channeled through a national innovation competition.

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<sup>1</sup> SBIR; *Small Business Innovation Research*. The scheme has been exported to a number of countries from the US, including to the UK and the Netherlands. The scheme’s title and its focus on small enterprises do not necessarily have to be relevant for the adaptation and implementation of such an initiative in Norway. This will require further clarification. The brand new strategy for the Norwegian Armed Forces for example states that this part of the public sector will focus explicitly on innovative SMEs in their procurement in the coming years. See <http://www.anskaffelser.no/nyhet/2015-11-18/forsvaret-satsar-pa-innovative-smb>. [available in Norwegian only]

<sup>2</sup> The IRD/PRD-contract (*Industrial/Public Research and Development Contract*) is a binding agreement between one or more innovative Norwegian SMEs and a pilot customer which can be a private company (foreign or Norwegian) or a public entity. See <http://www.innovasjon norge.no/no/finansiering/forsknings--og-utviklingskontrakter/Arrangementer/ifuofu-information-in-english/> for more information.

<sup>3</sup> Innovation Norway’s information pages on the scheme do not provide any information aimed at public procurers.

- Sectoral focus and dimensioning according to the participating ministries'/agencies' and municipalities' wishes and ambition level.



**Figure: Illustration – Opportunity for an SBRI (Small Business Research Initiative)/SBIR (Small Business Innovation Research)-like instrument in Norway**

The selection of suppliers/proposals for innovation could be made through a scheme like SBRI (Small Business Research Initiative) and Innovate UK, for example based on selection methodology and best practice from the Research Council of Norway (as practiced for the major innovation programs such as Arena, Centres for Research-based Innovation (SFI), etc.).

The scheme could be financed through cost-sharing of participating ministries and the local government sector, or via a separate budget item in the national budget, for example under Innovation Norway.

### **Evaluation and proposal for increased commitment to climate and low-emission innovation through public procurement**

The market failure related to climate-friendly and low-emission innovation, or rather the lack of this type of innovation, is often even more pronounced than for innovation in general (more details in the full report). This justifies strengthened public incentives and risk relief aimed at suppliers of climate and low-emission solutions, and at public procurers.

#### *Proposal for climate-friendly innovation in procurement (PPI), «recreational sports»*

With regard to innovation in procurement and the creation of favourable framework conditions for increased focus on climate and low-emission solutions in general in all types of public procurement, it would be appropriate to reinforce efforts in this field. This already constitutes one of three key areas for the National Program for Supplier Development (LUP) as well as a separate area within Difi's activity within public procurement. The implementation of the new EU-directives providing improved opportunities to set climate-related/low-emission

requirements<sup>4</sup> in public procurement in general requires significant effort in the form of information and knowledge dissemination. LUP's and Difi's activities within the field need to be scaled up in order to realize more of this potential.

*Proposal for climate-friendly procurement of innovation*

In Norway, it would be a possibility to focus part of the scheme targeted at procurement for innovation on climate-friendly and low-emission innovation, just like in several other countries (including Sweden).

With regards to climate-friendly and low-emission innovation, there is no doubt that this is a desirable goal for society as a whole that fits well with a scheme for *procurement for innovation*. Admittedly, there already are dedicated instruments for this type of innovation, but it would make sense to complement and reinforce these. Innovation Norway's Environmental Technology Program and several of Enova's schemes could work in concert with a national innovation competition along the lines of SBIR (Small Business Innovation Research)/SBRI (Small Business Research), and might be partially integrated. The Environmental Technology Program is not aimed at public procurement, while Enova only targets this to a limited degree. Overlap between the schemes seems therefore unlikely.

For a program concerning the procurement of climate-friendly and low-emission innovation that is intended to make a significant contribution to Norway's transition to a low carbon society, it would be natural to have broad participation from the most relevant sectors and ministries such as the Ministry for Climate and Environment, the Ministry of Transport and Communication, the Ministry of Local Government and Modernisation, the Ministry of Petroleum and Energy, the Ministry of Trade, Industry and Fisheries and the local government sector.

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<sup>4</sup> Current regulation stipulates that when planning each procurement, environmental consequences of the procurement must be taken into consideration (provision introduced in 2001).