Spatial Economics Research Centre

Thursday, 2 February 2012

Government grants to small firms

I wrote yesterday about our research showing that government grants to smaller firms in economically disadvantaged areas of Great Britain *can* increa employment, but that grants to larger firms are wasted.

I confess to being surprised by this result. My starting position was that *all* this money was wasted because firms would have gone ahead and done th investment even if they hadn't received the money. Our results suggest that this is not the case, at least for smaller firms.

Does this mean the government should be providing much more support to smaller firms in disadvantaged areas? Personally, I don't think our results should be interpreted in that way. The programme that we studied, RSA, was targeted at firms that served national or international markets. I suspect that this is one of the reasons why we do not detect much displacement (where jobs at supported firms just replace jobs at nearby unsupported firms). However, many smaller firms serve local markets and I would expect support to those firms to mostly generate displacement. Findings from preliminar work on another government scheme (Local Enterprise Growth Initiative) support this assertion. Specifically, we are finding that support from LEGI, which mostly went to small firms serving the local economy, *only* generated displacement (and that over quite small distances). There appears to have been no impact on overall activity so money to both small and large firms was 'wasted'.

Further, as discussed yesterday, RSA didn't seem to have much effect on productivity, so it increases the employment share of weaker firms. Such firm are vulnerable to future shocks so its not clear whether this represents a long term solution. Our analysis also ignores the impact that taxation to fund t scheme might have on firms located outside of eligible areas.

In short, as usual, careful empirical evaluation cannot necessarily answer all the questions about a policy and more research is needed. But one centra message does emerge: *If* the government is to have these type of investment subsidies, it seems clear that targeting smaller firms would be much mor cost-effective.

Posted by Prof Henry G. Overman on Thursday, February 02, 2012

3 comments:

Ian Bright said...

Thank you for the information.

Is it possible to suggest that the research may also support the argument that small firms in these depressed areas would benefit from improved banking facilities? Or put it another way, are banks missing an opportunity to make profitable loans to small businesses in these areas?

2 February 2012 at 16:27

Prof Henry G. Overman said...

Ian,

The difference between large and small firms might arise because small firms are credited constrained OR because government can monitor small firms effectively and grants lower the cost of funds (see the paper for more details)

Either way, we don't say anything about whether or not banks could make a PROFIT from lending to these firms. Government gives the money to the firm. Banks would need to be paid back.

2 February 2012 at 16:55

Ian Bright said...

Professor, many thanks for your reply.

2 February 2012 at 17:16

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