Embargo: 00:01 hours Wednesday 1 February 2012

INDUSTRIAL POLICY TO BOOST JOBS:
New research suggests that government grants should target smaller firms

Government subsidies aimed at revitalising economically disadvantaged regions of Britain – such as the 'Grants for Business Investment' scheme and its predecessor, 'Regional Selective Assistance' – should be targeted on smaller firms. That is the conclusion of a new study by the Centre for Economic Performance (CEP) and the Spatial Economics Research Centre (SERC).

The research finds that grants to small firms (under 150 employees) to invest in poor areas of Britain can significantly boost jobs while grants to larger firms are a waste of taxpayer money.

The researchers analysed the impact of expenditure on the Regional Selective Assistance programme over a 20-year period. They had access to every grant and examined every manufacturing plant in England, Wales and Scotland – over 2.3 million observations – before and after receiving government support.

Because European Union law changed over this 20-year period, some parts of Britain became eligible for subsidies and others saw their grants disappear. This enabled the research team to work out the impact of investment subsidies on firm performance. The results suggest a large effect of grants on recipients:

- An investment subsidy of 10% created 7% more jobs a year in the area at a cost of under £5,000 per job.

- The increase in employment came from lower unemployment rather than just shifting jobs around between areas or firms. About half of the increase came from growth in existing firms and half from fewer net plant closures.

- These effects are usually missed by existing research because the firms and areas that receive these grants are the 'losers' – those that would otherwise perform badly without government assistance.

- The positive job effects on jobs and investment were confined to smaller firms – for example, those with fewer than 150 employees.

- On the downside, there was no effect on firm level productivity and by subsidising larger inefficient firms in business at the expense of better entrants; this could lower longer-run productivity.

Professor John Van Reenen comments:

> 'Why do subsidies seem to work for small firms but not large firms? It may be that larger firms are manipulating the system and just pocketing the subsidy or it may simply be that grants have a bigger effect on small firms as they are much more cash-strapped.'

Professor Henry Overman adds:

> ‘If the government is to have these investment subsidies, it seems clear that targeting smaller firms would be much more cost-effective’.

Dr Ralf Martin notes:

> ‘While there is a positive effect on employment, the government also needs to be aware that the scheme probably slows down productivity growth by helping less productive firms to grow.’

ENDS

Notes for editors: ‘The Causal Effects of an Industrial Policy’ by Chiara Criscuolo, Ralf Martin, Henry Overman and John Van Reenen, Centre for Economic Performance Discussion Paper No. 1113 is available here:
http://cep.lse.ac.uk/pubs/download/dp1113.pdf

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