

Lectio Praecursoria: Business subsidies and bureaucratic behaviour

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The dissertation, which has been examined on 15th of December 2001, has as its central theme the business subsidies policy implemented in Finland during the 1990s by the Ministry of Trade and Industry (the KTM in Finnish). The KTM happens to be the major distributor of subsidies to firms in the country, with over 50% of all subsidy appropriations distributed through its units and agencies.

By business subsidies I refer to direct transfers of money from the KTM to a firm, usually of Small or Medium size (that is SMEs) and in the Manufacturing sector. These moneys are grants, meaning that the recipient firm does not have to return them to the ministry. They are used to partly finance investments, for example for the purchase of machinery and equipment, for development and marketing projects in Finland and abroad, for labour and training costs, and so forth.

To give you a rough idea of the amounts involved, for the period 1995 to 1999 over 6.5 billion Finnmarks were spent for business subsidies towards SMEs by the KTM, and at least 7 billion Finnmarks are estimated to be spent for the period 2000 to 2005. That is approximately 1.2 billion Finnmarks per year and the figure does not include subsidies for high-tech investments. Note also, that the aforementioned amounts do not come exclusively from the Finnish budget but include moneys coming from the European Union as well, mainly through the so called 'Structural Funds'.

We should not consider these amounts as exceptionally high. Finland compared to other EU countries ranks last in business subsidies spending. For instance, in 1998 and excluding those for agriculture, subsidies towards the Manufacturing sector were just under 0.9 percent of the overall yearly government expenditures, where the respective EU average was 2.3 percent.

The figures I just mentioned are ofcourse

approximations because they depend on how one calculates the subsidy amounts, but in any case you can see that Finland spends on subsidies proportionally much less than its EU colleagues. Nevertheless, they still constitute a burden to the yearly budget.

Before I discuss in more detail the dissertation itself and some of its results, I would like to say a few words of a wider scope which will hopefully assist you in comprehending better the logic behind the dissertation.

A simple assumption that I would like bring forward is that most citizens, tax payers that is, think and behave rationally. Hence, they would like to see that their tax moneys are spent by their democratically elected government effectively and efficiently in whatever policies the government adopts and finances. Put it differently, citizens, tax payers would like to have an account of these policy expenditures.

If a policy proves inefficient, the citizens would want it altered so it can become efficient; or maybe they would rather see those funds shifted to other policies; or they would even like some of those funds to be returned indirectly to them through lower taxes.

In a representative democracy, the notion of accountability is needed by others as well. Think, for instance of a system where we have as members the Citizens, the Parliament, the Government, the Ministries, the local units of the ministries and the final target of an adopted policy.

When the policy is voted by the Parliament and appropriations (money that is) are reserved for it, between each of these aforementioned members of the system evolves a so called Principal - Agent relationship.

This relationship is more common in economics and contract law where it is formally described and defined. Here, I would like to use it informally, as a conceptual framework to explain

the needs that arise within such a system.

In this relationship, the Principal delegates some of his own operations as well as the promotion and safeguarding of his interests to the Agent because it is practically impossible to do all this himself due to time, information or resource constraints.

In our system, the relationship is of dual direction in some cases and of one direction in some others. What do I mean by dual direction? The Parliament for example can be thought of as an Agent of the citizens by whom it is elected, but also as a Principal of the Government whom it controls. In turn the Government could be a Principal of its Ministries but an Agent of the Parliament, and so forth.

At the two ends of the system we have one-directional relationships. The citizens are only Principals of the Parliament and the final targets of the policy can only be Agents of the ministry and its units.

Because of this relationship, the need for accountability we just discussed comes into the picture. Simply put the Principal at all levels would like to know how his assignments, how his orders have been carried out by his Agent. He wants to know whether the Agent has exercised the delegated powers given to him, whether he has exercised his duties properly.

To have this accountability substantiated, the Principal must conduct some evaluation, he must research systematically, find out what has happened and then pass some judgement on the policy in question.

Assuming as stated earlier that the Principal thinks and behaves rationally, these decisions and judgements are optimised only if the Principal possesses valid, reliable and comprehensive information on how the policy has fared; that is whether it did well or not, what were its weaknesses, what were its strengths, and so forth.

How is this reliable information produced? It is produced through sound methods with which the Principal can gather data and methods with which he can analyse the data gathered. This to me, is a fundamental issue.

Evaluations however are not conducted for the sake of accountability only. For example, the organizations and their public officials that are involved in the planning and implementation of policies, whether acting as Principals or Agents, would also want some feedback which would

assist them in improving their on going policy operations or the planned operations for the future.

Closing this introduction, let me now discuss the dissertation itself. To reiterate, the dissertation is a collection of three studies whose central theme is the business subsidies policy implemented in Finland during the 1990s by the ministry of Trade and Industry or KTM. The main purpose was to examine whether the policy was effective and efficient and at the same time explain the rationale behind it. In that sense, I also tried to address the accountability and improvement policy issues I referred to just now.

The first study measured econometrically the impact of business subsidies on the growth of value added of firms. The results indicated that the impact was positive but extremely low considering the amount of subsidies spent. This in turn raised questions on the effectiveness and efficiency of the business subsidies policy currently in force.

The second study surveyed other evaluation studies of business subsidies that were conducted in Finland and abroad. The methods found in the surveyed studies were associated with the results produced. When primary data were utilised (estimates of impacts were taken directly from the subsidised firms through interviews or questionnaires) the results were positive. On the contrary, when secondary data were used to measure impact (data was gathered from documents) and scientific methods of analysis were applied, the results leaned more to the negative side.

The classic rationale for business subsidies is that governments use them as instruments to correct market failures, to redistribute society's resources to business sectors or regions that are lagging behind socio-economically, or to stabilise even and stimulate the economy in case of economic recessions.

However, if impact studies on business subsidies suggest some ineffectiveness and inefficiency why is such policy still adopted? The classic rationale may not be a sufficient justification if society's resources are indeed wasted with such a policy.

The third study attempted to answer this question by approaching the problem not from the demand side (the recipient firms) but from the supply side (the organization designing and distri-

buting the subsidies to firms). It tested whether the behaviour of the KTM's civil servants, when distributing business subsidies to firms, was in line with William Niskanen's 1971 bureau budget maximising theory.

The theory basically says that all of us, irrespective of whether we work in the private or public sector, behave in such a way as to maximise primarily our own benefits, our so called 'utility function'. In the public sector the civil servants can not do so through profit maximisation, as their colleagues in the private sector can. What they can do though, is try and maximise the amount of money that passes through their organization (be it, ministry, agency, regional unit). Niskanen calls all those organizations bureaux. Niskanen claimed that when the budget of their bureaux is maximised, those people (the civil servants) satisfy their personal utility function indirectly through higher status, prestige, power, more personnel, travel, job security etc.

Let us put Niskanen's theory in a subsidies policy context. Could we argue that at least one reason for the continuous adoption of such a policy, despite its suggested ineffectiveness and inefficiency, is because of Niskanen's theory? This would suggest that budget maximising bureaucrats managed to secure and have at their disposal levels of subsidies higher than the true demand for subsidies by the targeted recipient firms. And in turn, maybe inefficiencies could have occurred because these subsidies were spent repeatedly on firms that had no real need for them, but still got them because they were simply available.

The empirical analysis in the third study produced evidence supporting Niskanen's theory, but only on some accounts.

To recap, what I attempted to do with these three studies was first to evaluate the business subsidy policy in Finland by measuring its impact on the Value Added growth of the targeted firms. I also made a literature review of similar studies conducted in Finland and abroad. Finally I tried to explain the suggested ineffectiveness of the policy utilising the bureau budget maximisation theory as argued by William Niskanen.

I believe that this dissertation contributes to the administrative science and to the public policy evaluation debate in several ways. First, it advances the understanding of the business subsidy policies adopted in Finland because all three stu-

dies describe and analyse empirically different aspects of business subsidies policy. If a policy decision maker takes into account the results generated from the empirical analysis, the understanding of how the policy is implemented increases and hopefully any flaws found could be corrected. At the end of the second and third studies there is also a section with recommendations on how to improve the evaluation and implementation of the business subsidy programs in Finland.

Second, the presentation of the research methods themselves within the studies, is important. I have noticed that the utilisation of such methods is still not extensive, at least for business subsidy programs. Hence, it would be beneficial for the policy decision maker, the policy planner and the policy implementer to be aware of the different methodological tools with which one can conduct policy analysis.

However, and I want to emphasise this, no method for policy analysis is flawless. The awareness of such statement, made me include in each study a section that lists some limitations in the relevant analyses. This will hopefully give a balanced approach as to what are the most appropriate methods in analysing business subsidy programs.

Finally, although Niskanen presented his bureau budget maximising theory some thirty years ago, I find it relevant even today. To my knowledge no study in the past has attempted to analyse and explain the business subsidies policy in Finland utilising Niskanen's theory. In that respect the third contribution of the dissertation is that it tests empirically a well known theory for the first time.

It would be unjust at this point not to mention something about the organization under scrutiny today, the Ministry of Trade and Industry. During the last few years, when it comes to business subsidies policy at least, the KTM has been moving with great strides in improving its operations.

An updated database system has been operational for a couple of years now with data on project applications and applicant firms. In fact, data has been gathered in electronic format since the end of the 1980s. A big advantage that the KTM has, is that the hardware and software infrastructure of gathering, monitoring and analysing the whole operation is in place. Information on app-

lications are fed on a daily basis to these databases which are maintained both regionally and centrally.

When it comes to evaluation, frequent studies are being commissioned to outside evaluators and numerous reports are being published all the time. This enhanced evaluation activity is also due to the obligations imposed by the National legislation and the European Union, since Structural Funds are also spent in Finland. Also, training of the KTM personnel on evaluation issues is practised continuously. Very recently, a comprehensive guide on how to conduct evaluations was even published. Finally, budgetary discipline and better planning has occurred because of the four year framework budgeting rule in force since 1996.

However, I believe there is still room for improvement. The key problem, as I see it, is the existence of information asymmetry on the impacts of business subsidies policy.

The increase of our understanding of what is happening at bottom level can occur only through evaluations which utilise optimal data gathering and optimal data analysis methods. With those, we can consequently produce valid and reliable results on the impacts of this policy.

I would argue that the KTM has still to reach this stage.

These valid and reliable results should then be disseminated to the responsible decision makers and planners, but not only; all other interested parties should be informed as well. With all other parties I refer to the Principals and Agents in the system I described earlier, but especially I refer to the Principal of principals, the public.

Perhaps then we will come closer to achieving information symmetry and thus have better conditions for fair judgements and for decisions which would create a truly efficient and effective business subsidies policy.

Because, with information symmetry we may end up less prone to influences from different interest groups and narrow political considerations which, to some, are two of the biggest factors behind the proliferation of such subsidy programs.