Effectiveness of business support in creating jobs in the regions

Executive summary

The SAO carried out an audit with the purpose of analysing how government support to businesses has contributed to the creation of new jobs. The audit covered the start-up aid and infrastructure support of the Enterprise Estonia Foundation (EEF), the start-up aid for the unemployed of the Labour Market Board (LMB) and business loan guarantees of KredEx provided in 2002. The support from EEF and KredEx examined by the auditors had not been granted before, so we thought it was important to assess the initial implementation of these forms of support and the need for any adaptations furthering the desired goals of the government. The effectiveness of implementing the support was examined in four counties – Ida-Viru County, Jõgeva County, Valga County and Pärnu County.

The national enterprise policy aims to foster business initiative and the creation of new jobs and to improve the competitiveness of Estonian businesses, making these aims subject to the principles of balanced regional development. Since business initiative is the lowest in regions with the highest unemployment rate, the development plans should give priority to supporting such regions. In the context of decrease in the overall number of jobs in the business sector, the importance of small and medium-sized enterprises (SMEs) in employment is growing and therefore the government has considered it necessary to support the establishment of new SMEs and the activities of the existing ones. According to the national development plan, the business sector measures constitute one of the basic instruments for implementing the national action plan for employment.

Main audit findings, proposals of the SAO and responses from the Ministers

Objectives pursued by supporting businesses lack transparency

The eight different development plans concerning similar problems, target groups, objectives and measures do not, however, give a clear indication of what the government is trying to achieve by supporting businesses. The problem common to all development plans is the permanently high unemployment rate in Estonia, which varies from county to county. Since there are many objectives pursued by the government and there are no clear choices, the implementing units distributing business support interpret the objective of business support differently. This has led to a situation where funds are used for business support, but the importance of job creation is not stressed when granting the support.

According to the implementing units and the Minister of Economic Affairs and Communications, sustainable jobs with high added value call for efficient businesses employing modern technologies and having diverse export channels, which implies that there is a need to strike a balance between the number and the quality of jobs. The SAO agrees with this position, but stresses that advanced technological development often means a decrease in the number of jobs, not an increase. The analysis has led to the conclusion that it has been difficult to achieve simultaneously the increase in the number of new jobs and the development of innovative businesses by means of support and that the expected results have not been obtained, considering these objectives separately. According to the Minister of Economic Affairs and Communications, the measures of the EEF will be adapted to give preference to projects involving exports and the introduction of innovative technology as regards the start-up aid and infrastructure support.

Proposals of the SAO

The primary responsibility for the setting and implementing of objectives lies with the Ministries, which distribute support to businesses through the implementing units established by the government. To ensure that the objectives are not ambiguous and that these can be implemented without controversy and transparently, the government must refer to uniform principles when defining those objectives and therefore the SAO recommends the Minister of Economic Affairs and Communications:

- to define justified, achievable, compatible and measurable objectives for supporting businesses;
- determine the types of support or measures facilitating the achievement of the desired results and to analyse the suitability of the current measures for the creation of new jobs, considering the possibilities of avoiding the duplication of start-up aid provided by the LMB and the EEF and the concentration of competencies as regards the making of decision concerning the award of aid.

Responses from the Ministers

The Ministers agreed to the need of defining the objectives of business support in more transparently. The Minister of Economic Affairs and Communications made a proposal to merge start-up aids provided by the LMB and the EEF in order to avoid duplication. As a result, the unemployed could apply for start-up aid from the EEF. The Minister of Social Affairs argued in his response that the labour market support or start-up aid is first of all an employment service aimed at fostering the professional development of individuals.

Support is not granted on the basis of uniform assessment criteria

Business support has been granted rather on the basis of the quality of the business plan than the creation of new jobs, but there is no uniform methodology applied by all implementing units for assessing the quality of business plans. The SAO finds that for this reason the quality of decision-making varies and the relationship of the supported ideas with the actual business environment is weak.

Also, no uniform methodology is currently applied in the assessment of the competition situation. There is no single position on the county-specific priorities of awarding support or the proportions of public aid (in individual sectors and regions). This has favoured the concentration of aid awards in popular sectors, thus jeopardising the sustainability of jobs created in the same sector.

Proposal of the SAO

The SAO believes that the economical and efficient use of public funds necessitates the application of uniform principles in the evaluation of business plans and therefore we recommend the Minister of Social Affairs and the Minister of Economic Affairs and Communications:

- to define, for the purpose of implementing the specified objectives, unambiguously and without overlaps and controversy the criteria to be used by the implementing units as a basis for granting support, including for analysing business plans and assessing the competition situation.

Responses from the Ministers

The Minister of Social Affairs agreed to the need of establishing more detailed criteria for analysing business plans. According to the response from the Minister of Economic Affairs and Communications, criteria for analysing business plans will be laid down, but the proportionate distribution of support amounts between sectors is not reasonable.

The government has failed to determine the procedure for measuring the effectiveness of support

New jobs created with the help of support

The government has not specified the number of new jobs giving entitlement to the assessment "good result". The businesses benefiting from support in counties covered by the audit undertook to create, on the average, 4 new jobs per one supported project and this has been done. However, the number of planned and effectively created new jobs depends largely on the type of support. Businesses benefiting from the loan guarantee of KredEx have created the highest number of new jobs. Considering the assessments by implementing units as to the probability of projects being successful and the planned average number of new jobs per project, broken down by types of support, the number of jobs actually created, after making provision for the risk coefficient, is still smaller than expected. This applies both to the support from the EEF and the LMB.

Sustainability of supported projects

The government has not specified the acceptable share of unsuccessful projects and whether and which region-specific exceptions are permitted. 20 % of the businesses visited by the SAO are no longer active or have temporarily suspended their activities after one year after receiving the support, whereby the share of inactive businesses is the highest (32 %) amongst the recipients of the LMB start-up aid and the lowest (5 %) amongst the beneficiaries of loan guarantees. The implementing units do not know exactly which businesses are actually inactive, but they believe that the share of unsuccessful projects is 1 to 3 % in the case of the LMB start-up aid, about 10 % in the case of the EEF support and 5 % in the case of the KredEx loan guarantee.

Cost of created jobs

The calculations made by the SAO show that the cost of jobs created with the help of different types of

support varies. However, the government's expectations as to the average cost of a created job and the methods for determining this cost have not been defined. Neither has it been determined whether:

- the average cost of a created job may vary for different types of support and what is the permissible rate of variation;
- the average cost of a created job may vary for different regions and what is the permissible rate of variation;
- whether the different cost entails or should entail jobs of different quality. Also, it has not been decided whether and during which period the expenditure on the creation of jobs should be covered from the tax revenue received from supported businesses.

Proposals of the SAO

To ensure that the government knows how effective has business support been, whether the taxpayers' money has been used purposefully and how much money should be envisaged for this purpose in the future and how:

- the Minister of Economic Affairs and Communications should precisely define the following principles which the implementing units are required to respect when granting business support:

- the maximum risk acceptable to the government arising from the duplication of support to the same project (at the moment it is possible to receive several aid awards and thus lift the risk to the government to a level which is considerably higher than that allowed in the case of a single aid award),
- the period during which the government expects the supported business to created a new job and also the minimum period of maintaining that job,
- the payback period of support or its irrelevance;

- the Minister of Economic Affairs and Communications and the Minister of Social Affairs should lay down the following performance indicators to be respected by the implementing units:

- the average cost of a created job acceptable to the government,
- the expected number and quality of new jobs (complexity, average salary, etc),
- the acceptable share of unsuccessful projects, including whether and to which extent is failure tolerated more in the case of certain types of support or regions.

Responses from the Ministers

In his comments on the harmonisation of the principles of granting support the Minister of Economic Affairs and Communications agreed to the need of improving the information system of implementing units in order to allow avoiding the provision of support for the same expenses from different sources. Furthermore, he undertakes to consider the possibility and purposefulness of cross-usage of the new customer management systems in implementing units during the phase of designing such systems. The Minister believes that it is not reasonable to require a business to create a job within a certain time limit and maintain it for a certain period, since this would force it to make irrational decisions, which would not be based on the economic situation, but on the intent to maximise the support. The Minister noted that the payback period of support is very different for the various types of support and the methodology for calculating this period is questionable.

As regards performance indicators, the Minister of Economic Affairs and Communications was of the opinion that the cost of a created job acceptable to the government cannot be calculated only on the basis of the support, maintaining that the calculation of the average value is pointless, since the support has other objectives as well. According to the Minister, one of the objectives of the EEF start-up aid is to increase the survival rate of supported businesses to 70 % in three years. The survival rate is not appropriate for infrastructure support, since the beneficiaries are businesses, which are already active. The SAO draws attention to the fact that this objective was set only in conjunction with the commencement of the implementation of structural funds and it has no connection with the projects financed in 2002. The Minister of Social Affairs did not express his views on performance indicators.

There is no adequate information on the effectiveness of support

The SAO can only state the fact that no system for collecting and analysing relevant information has

been created for monitoring the effectiveness of business support. The information concerning the number of created jobs currently collected by the implementing is not reliable, because:

- there is no information on the jobs actually created – only the number of jobs expected/promised by the beneficiaries is known;
- the expected jobs are counted multiple times as created jobs in cases where several implementing units grant support for the same project;
- the ration between the jobs added and those abolished during the same period is not known, meaning that there is no information on whether and how much the employment opportunities actually increased as a result of the support.

Proposals of the SAO

- Both the Minister of Economic Affairs and Communications and the Minister of Social Affairs should provide for the obligation to evaluate the effectiveness of business support in order to find out the connection between support and the changes on the labour market.
- In this context, the Minister of Economic Affairs and Communications should specify the period during which the EEF and KredEx are required to collect and analyse information pertaining to the effectiveness of support and the Minister of Social Affairs should specify, in the Employment Service Act, the period during which information on the results must be collected from businesses benefiting from the LMB start-up aid.
- Both Ministers should require the implementing units to provide information on the jobs actually added, not on the jobs declared in aid applications.
- The implementing units should create a system for monitoring the effectiveness of support, which provides an objective overview of the businesses' activities and allows monitoring the effectiveness of support for individual counties and sectors by way of reference to the performance indicators established by the government.
- It is important, in this regard, that the implementing units:
    - wouldn't count jobs, which would have been created without government intervention, as those created with the help of support and take account only of the potential standalone effect of the support; and
    - that they would establish a single database on businesses who have received support, thus avoiding the excessive concentration of support in certain sectors, the sole financing by the government as a result of repeated supporting of the same project, the supporting of repeatedly failed operators, the multiple counting of the actual number of jobs, etc.

Responses from the Ministers

In his response, the Minister of Economic Affairs and Communications refers to the obligation to collect information on the results set out in the Structural Funds Act and undertakes to consider regulating the matter by means of the Government Support to Business Act. However, the Minister notes that plans have been made to conduct an impact assessment three years after the end of each project, whereby the beneficiary is required to produce reports to the EEF within three years after the end of the project. The Minister of Social Affairs did not express his views.

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