Summary of Akava Works report 4/2025

Business subsidies and renewal of the business subsidy system

There is a wide consensus that business subsidies need to be cut but no clear strategy for reducing them. Based on research data, this report reflects on the situations in which business subsidies are justified and on different forms of business subsidies. In addition, the report examines current business subsidies in light of statistics. Based on the results of the report, concrete measures are proposed for the renewal of the business subsidy system so that the subsidies would better benefit both companies and society as well as support growth, renewal and, from a wider perspective, the well-being of society.

Business subsidies can be divided into four categories as follows: 1) non-remunerative grants, 2) remunerative financial support (incl. loans, warranties, guarantees and equity funding), 3) tax subsidies and 4) regulation and other similar support procedures.

1) The key economic justification for non-remunerative grants involves the positive externalities that business activities provide for the society. The best-known example are the positive benefits of research and development (R&D), but the subsidies associated with guaranteeing the security of supply or competitiveness may also have positive externalities. As far as non-remunerative grants are concerned, it is recommended that the estimated positive externalities of a project be emphasised when considering the granting criteria.

2) Government guarantees and loans are justified support instruments for correcting market failures caused by asymmetrical and imperfect information. Debt loans are, however, surprisingly rarely used for the purpose of supporting businesses. Loan financing is especially proposed for small expansive companies whose ability to invest is limited by the bottlenecks associated with their access to financing. Loan subsidies, not non-remunerative grants, are also recommended to be used as the primary measure to support companies facing temporary difficulties (e.g., crisis situations). Business subsidies in the form of equities should be approached very critically because they compel the State, municipality or another public administration organisation to become a market operator in a manner that is not among their basic duties.

3) Tax subsidies for companies, like grants, can be justified by positive externalities. The advantages of well-planned tax subsidies, when compared to other forms of subsidies, include the fact that they cause less distortion of competition and have a smaller administrative burden. The most significant problems associated with tax subsidies are their poor accuracy and predictability. Since externalities are very heterogeneous, it is difficult to allocate the tax subsidies precisely for the intended purpose. Furthermore, the current tax system is very fragmented. To streamline the tax system, it is suggested that all tax subsidies that have been found in studies to be harmful or that are estimated to have a minor or unclear impact should be eliminated.

4) Companies can also be supported and encouraged through, for instance, regulation. The report finds that increasing companies' R&D activities is, at present, not a question of incentives but, rather, limited mostly by the lack of new ideas and professionals. Universities play a key role in both of these aspects. It is proposed that a long-term strategy should be drafted to secure the core funding of universities so that high quality education and basic research provided by the universities could be guaranteed. This is required by the R&D activities of companies operating on the international market.

Public debate on business subsidies is characterised by a somewhat short-sighted search for savings, but, unfortunately, identifying easy savings has proven to be difficult. As a solution, a more comprehensive strategic and long-term development of the innovation policy, industrial policy, tax policy, the State's owner policy as well as other policy sectors related to businesses is recommended with the aim of increasing market competition, rectifying market distortion and promoting the growth conditions for profitable companies. In this way, the savings achieved from cutting the subsidies that preserve the economic structures as well as the tax revenue gained through the elimination of companies' tax subsidies would be a beneficial by-product of these more extensive development operations rather than an end in itself.

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