**Substitution**

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| ***Substitution occurs when a company or other beneficiary specifically changes its activities or processes to benefit from public sector support. The most obvious examples are labour market subsidies when companies may change their recruitment practices solely to take advantage of the money on offer.*** |

**Why is it important?**

Substitution is generally seen as a negative factor in that any economic gains accruing to the beneficiary are offset by reductions in employment or output elsewhere. Whilst this is likely to be the case for mainstream economic development, there are often strong equity reasons why programmes that result in substitution are introduced. For example, it may be felt by politicians and policy makers that some groups (for example young people, those living in specific areas or members of particular ethnic minorities) are at a disadvantage when applying for jobs. Offering employers some form of financial incentive may be a way of overcoming these disadvantages. The objectives are therefore to secure community and social benefits rather than necessarily achieve net economic gains.

However, although substitution might, at times, be a factor in mainstream economic development interventions the evidence is that its impact is likely to be relatively insignificant, as well as being difficult to evidence.

**What is Substitution?**

The Treasury Green Book[[1]](#footnote-1) defines substitution as the situation in which a firm substitutes one activity for a similar activity (such as the recruitment of a different job applicant) in order to take advantage of government support. The Department for Business Innovation and Skills (BIS) is more specific. In the context of the Regional Development Agencies Evaluation Framework it defines substitution:-

“*as a negative effect that arises when a firm substitutes a jobless person to replace an existing worker to take advantage of the public sector assistance*[[2]](#footnote-2)”.

Substitution is therefore generally seen as being something that has an impact upon labour market interventions: an area of activity that SE is not directly involved in.

It is claimed that displacement and substitution are closely related in so far as both result in the economic benefits to the beneficiary being offset to some extent by the reduction in output or employment elsewhere. Substitution has also been described as “in-firm” displacement[[3]](#footnote-3) which would be true if there were evidence that a company had stopped doing one activity and substituted another in order to take advantage of public sector support. It does, however, seem difficult to accept this as a valid definition for the labour market adjustments outlined above where the impact of changes in recruitment practices are mainly experienced externally.

**How Significant is Substitution?**

The evidence is that *“overall substitution is not seen as a significant issue”[[4]](#footnote-4)*. The same source, drawing on the evidence from 286 evaluations (of which 54 were from Scottish Enterprise, although not all necessarily commissioned by SE) reported that:-

* For the Business Development and Competitiveness Theme (covering the types of activity that SE is involved in such as support for internationalisation and sector/cluster support) substitition values ranged from 0% to 87.5%. However, the upper end of the range would seem to be so atypical that it should have perhaps have been excluded. More relevant were the findings that the mean value was 3.4% whilst the median was 0%; and
* Similar findings were seen when the values for the Regeneration through Physical Infrastructure (again the type of activity that SE is involved in) were considered: a mean value of 2.2% and a median of 0%.

Given this it seems that substitution is a minor factor in any additionality adjustments. One reason for this may be the fact that it is difficult to identify it with any degree of precision. For example, asking beneficiaries if they have changed their activities to take advantage of public sector support is likely to elicit a negative response.

**How should substitution be dealt with?**

In most of SE’s interventions substitution is rarely likely to be an issue. Accordingly the general advice is that it should be ignored when making the additionality adjustments. For example, the 2013 evaluation of account management[[5]](#footnote-5) assumed that it was zero based on the evidence from a number of face-to-face company consultations. If however, there is firm evidence that a company’s activities are being changed solely to take advantage of publc sector support then some adjustment should be made. If such evidence is not available then substitution should be ignored.

**Need more help?**

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1. <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220541/green_book_complete.pdf> [↑](#footnote-ref-1)
2. <http://www.bis.gov.uk/assets/biscore/economics-and-statistics/docs/09-1302-bis-occasional-paper-01>

   p. 23. [↑](#footnote-ref-2)
3. <http://www.evaluationsonline.org.uk/evaluations/Search.do?ui=basic&action=show&id=530>

   p. 74. [↑](#footnote-ref-3)
4. Ibid, p.23, para. 6.4. [↑](#footnote-ref-4)
5. <http://www.evaluationsonline.org.uk/evaluations/Search.do?ui=basic&action=show&id=530> [↑](#footnote-ref-5)