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## With a little help from our friends: The effect of USAID assistance on SME growth in a transition economy

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### ABSTRACT

**Bah, El-hadj, Brada, Josef C., and Yigit, Taner**—With a little help from our friends: The effect of USAID assistance on SME growth in a transition economy

Using survey data on Macedonian firms that participated in USAID programs providing technical and financial assistance for small and medium-sized enterprises (SMEs) and on firms that did not, we estimate the effectiveness of such assistance in increasing the growth of employment in the assisted firms. We control for selection bias in program participation and use both kernel and caliper propensity score matching to estimate the excess growth of employment in assisted firms. We find that assistance programs raised employment growth by 16–20 percentage points in the first year after assistance and by 26–30 points by the third year. *Journal of Comparative Economics xxx (xx) (2011) xxx–xxx*. The University of Auckland, Private Bag 92019, Auckland 1142, New Zealand; Arizona State University, PO Box 879801, Tempe, AZ 85287-9801, USA; Macedonian Academy of Sciences and Arts, Bul. Krste Misirkov, 2, 1000 Skopje, Republic of Macedonia; FEASS, Bilkent University, Ankara 06800, Turkey.

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### 1. Introduction

One of the more troubling aspects of the economic transition in Eastern Europe has been that the growth of aggregate output since the early to mid-1990s has been accompanied by stagnant or declining employment, particularly in South East Europe. This has resulted in gains in wages, clearly a desirable result, but in some countries it has also resulted in high levels of unemployment or underemployment, creating a phenomenon that some observers have called “jobless growth”.<sup>1</sup> The lack of job growth, particularly in the SEE countries has contributed to a variety of social and political problems, and dealing with them has been a serious policy concern, both in the countries of the region and among foreign assistance donors. One of, if not the, worst performing transition countries in terms of unemployment has been the Republic of Macedonia, whose registered unemployment rate over the past 20 year period peaked above 40% and remains in the low- to mid-30 percent rate to this

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<sup>1</sup> For a discussion of this phenomenon and related labor market issues see, Svejnar (2002a,b). Brown and Earle (2008) examine this phenomenon from the standpoint of firm-level data.

day.<sup>2</sup> Lehmann (2010) describes Macedonia as “one of the worst performing economies in Europe, both in terms of unemployment and employment rates” in large part due to the fact that it “shows very little capacity of job creation” (p. 6).

Given Macedonia’s poor labor market performance, foreign aid donors have focused much of their assistance to the country on job creation programs. Moreover, given the lack of small and medium-sized enterprises (SMEs) at the start of transition and the widely-held perception that SMEs have the potential to create jobs rapidly and in large numbers, much of that assistance has been directed at SMEs. In this paper we examine the effectiveness of a set of programs developed by the United States Agency for International Development (USAID) to provide mainly technical assistance, but also financial assistance, to Macedonian firms in order to improve their performance and particularly to increase the number of jobs that they provide. The technical assistance programs provided business and technical knowledge and skills to Macedonian entrepreneurs through training, seminars, demonstrations and consulting. We employ survey data collected from Macedonian firms that had participated in USAID program as well as from firms that had not, and we estimate the effects of USAID assistance on job creation in recipient firms using matching techniques that compare their performance to a sample of firms that did not receive assistance. We find that USAID assistance had a positive and significant effect, in both the statistical and in the economic senses, on full-time and total employment in Macedonian firms that participated in USAID programs.

In the next section of the paper we selectively review the literature on the effectiveness of technical and financial assistance to firms in market economies as well as the more limited literature on the effectiveness of assistance to firms in transition economies. Section 3 describes the data used in this study as well as the surveys used to obtain the data. Section 4 explains the matching techniques we use to estimate the effectiveness of USAID programs in Macedonia, and Section 5 presents the results of our estimates of job creation due to the assistance that firms received, compares them with other relevant studies and draws out the policy implications. Section 6 concludes and suggests avenues for further research.

## 2. Barriers to firm growth

Research on the barriers to the growth of SMEs in transition economies was initially directed toward identifying the most important changes in the business and regulatory environment of transition economies so as to promote SME formation, survival and growth. Johnson et al. (2000) studied firms in five transition economies and concluded that the main barrier to SME growth lay much more in unclear property rights than in lack of access to bank credit. Pissarides et al. (2003), on the other hand, concluded, based on their analysis of Bulgarian and Russian managers’ perceptions, that lack of finance was a much greater barrier than were unclear property rights. While such studies may have been useful in guiding policy makers in these countries in shaping their reform agendas, they do have a number of shortcomings as guides to formulating programs to assist SMEs in the region now. In part this is due to the fact that the data from which these conclusions are drawn are now rather dated, with the former study based on 1994–1996 data and the latter on surveys administered in 1995. Clearly, there has been tremendous, although varying by country, progress in both the development of the financial sector and in the strengthening of property rights and the rule of law in many transition countries, and thus the barriers that were important in the early stages of the transition are not necessarily the ones that need to be addressed now. Moreover, these studies did not attempt any evaluation of the effectiveness of assistance to SMEs in overcoming the obstacles to growth, and thus they are of limited use in framing current and future assistance programs. Finally, Commander and Svejnar (in press) show that the effect of these and other perceived barriers to growth is hard to demonstrate when the barriers are introduced jointly or when country fixed effects are accounted for.

More relevant for the evaluation and design of assistance programs for SMEs in transition economies are two studies, Brown et al. (2005) and Brown and Earle (2009), that examine the effectiveness of financial assistance programs for Romanian SMEs. The first of these is a study that, like ours, is based in part on a survey of firms, but it includes only firms that participated in assistance programs, imposing a significant econometric burden to account for the “counterfactual” of the performance of firms that did not participate in such programs. Besides being more recent than the previously mentioned studies because their surveys were undertaken in 2000, Brown et al. (2005) were able to cover a longer time period from the time of the firm’s founding to the time of the survey. In a follow-up paper, Brown and Earle (2009) added Romanian firms that did not participate in the assistance programs to their sample, and thus they were able to use matching methods to better estimate the effects of assistance. Both papers conclude that financial assistance did have a positive and significant impact on firm growth, but technical assistance, although valued by recipients, had no significant effect on job creation in the recipient firms.<sup>3</sup>

While the evidence from transition economies of the effectiveness of assistance to SME’s is thus limited to this paper and the two studies just discussed, there is large body of research on the effectiveness of both financial and technical assistance to SMEs in market economies, and we briefly and selectively review this literature to put our findings and methodology into a broader perspective. We begin by noting that many countries and regional governments fund and operate assistance

<sup>2</sup> The high registered unemployment rate is partly due to the linking of health benefits to an individual’s status as either working or registered unemployed. Labor force survey data report unemployment rates that are on average about 10 percentage points lower, still a high level by international standards.

<sup>3</sup> The authors report some positive effects of technical assistance in some of their regression results, but not in the majority of their specifications and not in those estimates that appear most reliable from an econometric standpoint.

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