Effective state-business relations, industrial policy and economic growth

Edited by Dirk Willem te Velde

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A 10-point conclusion on state-business relations and economic performance

1. Institutions matter. Economic growth depends directly on economic fundamentals such as skills and capital formation as well as the efficiency with which factors of production are put together, but the nature of SBRs is a crucial factor behind efficient skills development, capital formation and ultimately higher productivity and incomes.

2. Agencies and their interactions matter. The role of agencies and their effective interactions constitute a useful complement to the price mechanism in allocating resources and promoting efficient wealth creation. Effective SBRs can address market and coordination failures and government failures through cooperation, and can reduce policy uncertainty. When the state and business interact effectively, they can promote more efficient allocation of scarce resources, conduct a more appropriate industrial policy, remove the biggest obstacles to growth and create wealth more efficiently.

3. SBRs are not always directly observable, yet there are ways to measure the key factors behind effective SBRs through the organisation of business and government actors, the fora that bring the two sides together and the presence of competition principles ensuring absence of collusive behaviour.

4. There is considerable debate about the precise pathways and effects of SBRs, whether current SBRs are actually conducive to or hamper economic performance, and about how the nature of SBRs conditions the conduct of more active policies encouraging economic growth.

5. Selective industrial policies may work even in countries with limited government effectiveness. The risk of failure is high, however, especially when strategic decisions are taken without sufficient involvement of the business community (and hence SBRs).

6. Establishing successful SBRs requires an appropriate policy framework that allows the state to support industrial development and technological upgrading but also minimises opportunities for rent seeking, which is more likely when it is consistent with a country's comparative advantage.

7. Formalised SBRs can promote economic performance, e.g. through improved allocative efficiency of government spending and better growth and industrial policies (e.g. Mauritius). Yet, SBRs need to be disciplined by a set of competition principles, or they risk becoming collusive rather than collaborative. Not all formal SBRs work well (e.g. South Africa), and informal SBRs can play a key role (e.g. Egypt).

8. Examples show that a harmful collusive relationship can be turned into a more collaborative relationship, for example, when leaders and elites can work to form positive growth or developmental coalitions as in India.

9. Policy conclusions involve building capacity to conduct meaningful SBRs, ensuring buy-in from all actors to the effective functioning of SBRs and putting the spotlight on informal SBRs where they are not functioning well. Informal SBRs could promote growth, but a setting must be created that avoids corruption and maximises inclusiveness through an organised private sector, strong monitoring agencies and free media.

10. Further research could 1) build an enhanced theoretical underpinning of effective SBRs by modelling the economic behaviour of key actors engaged in SBRs; 2) create a worldwide index of effective SBRs; and 3) build up a set of empirical studies on successful economic functions of SBRs.

Contents

Abbreviations

AC	Active Cooperation
CIT	Communication and Information Technology
DFID	UK Department for International Development
DIE	German Development Institute
GDP	Gross Domestic Product
GMM	Generalised Method of Moments
ICI	Investment Climate Index (World Bank)
IDS	Institute of Development Studies
IPA	Investment Promotion Agency
IPPG	Research Programme Consortium for Improving Institutions for Pro-Poor Growth
JEC	Joint Economic Council (Mauritius)
LSDVC	Least Squares Dummy Variable Corrected
Nedlac	National Economic Development and Labour Council (South Africa)
NGO	Non-Governmental Organisation
ODI	Overseas Development Institute
PPP	Public-Private Partnership
PPP	Purchasing Power Parity
SBRs	State-Business Relations
SME	Small and Medium-Sized Enterprise
TFP	Total Factor Productivity
UK	United Kingdom
VECM	Vector Error Correction Model

Introduction and overview

Dirk Willem te Velde, Overseas Development Institute

This collection of essays by internationally distinguished scholars discusses the nature of state-business relations (SBRs) and the links between SBRs and economic performance. It is generally accepted that economic growth directly depends on economic fundamentals such as skills and capital formation as well as the efficiency through which factors of production are put together. But beyond this, the briefings in this publication all bring out that the nature of state-business relations is a crucial factor behind efficient skills development, capital formation and ultimately higher productivity and incomes. But there is considerable debate about how the effects work, whether current state-business relations are conducive to or hamper economic performance, and about how the nature of state-business relations conditions the conduct of more active policies encouraging economic growth.

This study is the result of the work of researchers linked through the Research Programme Consortium for Improving Institutions for Pro-Poor Growth (IPPG) which conducted research from 2005-2010. The study of state-business relations (SBRs) was at the heart of the Consortium. Relationships between states and business are usefully understood as giving rise to and reflecting both economic and political institutions. Economic, because SBRs embody formal and informal rules and regulations that are designed to perform economic functions, such as solving information-related market and coordination failures, and hence will affect the allocative and dynamic efficiency of the economy. Political, because SBRs reflect the way in which power among different agents, elites and coalitions of interest is shared. This manifests itself in both formal and informal institutional arrangements between the private sector (e.g. business associations, including organised farmer groups) and the public sector (e.g. different ministries or departments of state, politicians and bureaucrats). IPPG devoted one of three clusters of work to the study of SBRs covering sub-Saharan Africa and India.

Over the past few years, several further studies have examined how the government can support growth, either conceptually or in practice. Although their main focus may not be on institutional aspects, they complement the IPPG analysis extremely well. This includes other work at the Overseas Development Institute (ODI), the Institute of Development Studies (IDS), the German Development Institute (DIE) and the World Bank not funded by IPPG.

This publication consists of three main parts. Part A introduces theoretical aspects of the study of SBRs. Part B examines two technical and methodological aspects that have been at the forefront of the study of SBRs: how to measure SBRs and how to deal with endogeneity concerns in the relationship between SBRs and economic performance. This part is designed specifically for quantitative specialists. Part C discusses the findings, evidence and policy suggestions of IPPG research on SBRs and major work related to SBRs. A set of conclusions follows.

Chapter 1 by Te Velde argues that the role of agencies and their effective interactions constitute a useful complement to the price mechanism in allocating resources and promoting efficient wealth creation. The rationale for SBRs rests on the following building blocks. There are market failures (the market alone cannot achieve an optimal allocation of resources) and there are government failures (state actors may not be able to address market failures on their own). Effective SBRs can address such market and coordination failures and government failures through cooperation, and can reduce policy uncertainty. Te Velde suggests that, when the state and business interact effectively, they can promote more efficient allocation of scarce resources, conduct a more appropriate industrial policy, remove the biggest obstacles to growth and create wealth more efficiently.

Chapter 2 by Lin draws on recent work on a new structural approach to economic development and outlines a path towards an optimal framework for SBRs. He suggests that establishing successful SBRs requires an appropriate policy framework which allows the state to support industrial development and technological upgrading but which also minimises opportunities for rent seeking. He argues that countries that succeed in adopting and implementing such frameworks are those where government's industrial development goal is consistent with its comparative advantage, which reflects the accumulation of human and

physical capital and the change in its factor endowment structure.

Chapters 3 to 6 discuss methodological and technical aspects in the study of SBRs. Chapters 3 and 4 discuss the measurement of SBRs in Africa and India respectively. Chapter 3, by Te Velde, goes to the heart of the discussion among political scientists and economists studying SBRs, asking whether it is possible to measure SBRs meaningfully. SBRs are not always directly observable, yet we still want to assess their importance for economic performance. Te Velde provides a number of examples of measuring SBRs based on objectively measurable characteristics of good SBRs suggested by political science. He constructs SBR measures for 20 African countries over three decades, measuring the organisation of business and government actors, the fora that bring the two sides together and a set of competition principles ensuring absence of collusive behaviour. Calì, in Chapter 4, measures SBRs using observable variables at the state level for India over time. The resulting state-level measures show commonalities and differences with conventional investment climate measures.

In Chapter 5, Te Velde discusses endogeneity issues. When relationships are behavioural, observing a correlation between two variables without additional information is normally not enough to infer causality. For example, a firm can join a business association, which in turn can promote better firm performance, or, for some reason (or characteristic), good firms self-select themselves to join a business association. Both of these lead to a positive correlation between membership and firm performance. It is important for policy to understand which direction the correlation goes in. Te Velde suggests three ways used in the Africa research to address endogeneity issues: data, economic theory and specific methods such as instrumental variables estimation or the Generalised Method of Moments (GMM). Chapter 6 by Calì, dealing with the research on Indian states, suggests two new and innovative instruments that can be employed in instrumental variables estimation, drawing from India's political history: one based on land reform legislation enacted by Indian states at different points in time and the other based on the nature of the political regime in a given state. As such variables help to explain the nature of SBRs, they can deal with endogeneity issues.

Chapters 7 to 11 discuss findings and provide policy suggestions. In Chapter 7, Altenburg presents findings of a seven-country study on the role of industrial policy. He suggests that selective industrial policies may work even in countries with limited government effectiveness. The risk of failure is high, however, especially when strategic decisions are taken without sufficient involvement of the business community. Strategies to move on to higher-value activities within existing value chains look quite plausible, but they have rarely been successful to date. In most cases, the countries have lacked competitive advantages in the targeted upstream or downstream industries. Shifting to more demanding activities is a difficult task that requires a deep understanding of industry conditions. Altenburg argues for policies which are closely coordinated with the private sector, which encourage experimentation and which support innovative risk takers. Regular feedback loops with market actors to fine-tune sector strategies are important.

In Chapter 8, Te Velde discusses the findings of four African case countries on SBRs conducted by African IPPG researchers. The studies discuss the economic functions through which SBRs affect economic performance, such as affecting the allocative efficiency of government spending and industrial policy. Te Velde suggests that the studies have a number of policy implications, including the need to build capacity to conduct meaningful SBRs, ensuring buy-in from all actors to the effective functioning of SBRs and putting the spotlight on informal SBRs where they are not functioning well.

In Chapter 9, Ellis summarises ODI research which suggests that the relationship between government and large businesses is often more important in determining market outcomes than competition and market forces. This mutually beneficial relationship between government and business underpins the formation of a powerful economic elite, with vested interests in opposing pro-competition and pro-growth reforms, which has serious consequences for economic development more broadly. In this situation, it is the relationship between a business and the government that often seems to determine a company's commercial success in a country, rather than market forces, and this is likely to have significant economic costs. This is a useful reminder that SBRs need to be disciplined by a set of competition principles, or risk becoming collusive rather than collaborative.

Sen in Chapter 10 discusses how a harmful collusive relationship turned into a more collaborative relationship in India in the mid-1980s and early 1990s, and how this affected different states differently. IPPG research has shown that variations in regional institutional quality captured by the quality or effectiveness of SBRs can explain variations in economic growth in Indian states. For the Indian state of Andhra Pradesh, IPPG researchers identify the coming to power of a chief minister of the state government in 1995 as the 'critical juncture' that explains the rapid improvement in SBRs in the state and its subsequent successful record in economic growth. The Andhra Pradesh case study highlights how leaders and elites can work to form positive growth or developmental coalitions.

In the final substantive contribution, Chapter 11, Abdel-Latif and Schmitz discuss work conducted through IDS on the impact of SBRs in Egypt. They suggest that SBRs, featuring active cooperation, helped investors to overcome barriers to economic growth and policymakers to overcome deficiencies in their own government agencies, and helped both sides to work together in establishing new sector-specific rules and improving the general regulatory framework. The authors argue that informal SBRs are not necessarily all bad and can be strong growth enhancers – but a setting must be created that avoids corruption and maximises inclusiveness through an organised private sector, strong monitoring agencies and free media; and that the focus of industrial policy needs to be more on how to implement the policies than on what policies to adopt: SBRs featuring active cooperation can be very effective.

Te Velde concludes with a set of key principles on SBRs.

1 Effective state-business relations, industrial policy and wealth creation

Dirk Willem te Velde, Overseas Development Institute

When the state and business interact effectively, they can promote more efficient allocation of scarce resources, conduct a more appropriate industrial policy, remove the biggest obstacles to growth and create wealth more efficiently. When the two sides fail to cooperate, or engage in harmful collusion, economic activity centres on wealth creation for the few rather than the many. This note explains why effective interactions between state and business matter for wealth creation. Other briefings consider how such interactions can be measured. A key theoretical issue is how to conceptualise and formalise the way in which different types of state-business relations (SBRs) constrain the conduct of industrial policy to create wealth.

There used to be a long-established view that SBRs in development are collusive and rent extracting (e.g. Doner and Schneider, 2000, on changes in the perceived role of business associations in growth). Further, mainstream economists had long held the position that a reduced role for the state and market liberalisation by itself would lead the price mechanism to allocate resources efficiently, leaving no room for an active complementary industrial policy. Such mainstream economists acknowledged the presence of market failures in theory, but in practice these were not thought to be sufficiently wide ranging to justify a strong intervening role for the state (e.g. the World Bank's World Development Report (2005) on the investment climate does not mention industrial policy). The global financial crisis and the need to address climate change, but also other developments, have affected the belief that the market, or government, can do everything on its own. A more nuanced view of the respective roles of state and business, and their interaction, is now being considered.

The political science and governance literatures have begun to identify what can be considered as characteristics of effective SBRs. For example, political scientists suggest that good SBRs are based on benign collaboration between business and the state (Harriss, 2006), with positive mechanisms that enable transparency, ensure the likelihood of reciprocity, increase state credibility among the capitalists and establish high levels of trust between public and private agents. They provide a transparent way of sharing information, lead to more appropriate allocation of resources, remove unnecessary obstacles to doing business (i.e. a good investment climate) and provide checks and balances on government intervention.

Doner and Schneider (2000) discuss a number of market-complementing functions of business associations as key agents in the conduct of organised SBRs: macroeconomic stabilisation, horizontal and vertical coordination, lowering costs of information, standard setting and quality upgrading. Lin and Monga (2010) have reinvigorated the debate on the role of the state in promoting market-oriented growth, arguing that growth-enhancing policies work best when they follow the comparative advantage of the country.

The role of agencies and their effective interactions constitute a useful complement to the price mechanism in allocating resources and promoting efficient wealth creation. The rationale for SBRs rests on the following building blocks. There are market failures (the market alone cannot achieve an optimal allocation of resources) and there are government failures (state actors may not be able to address market failures on their own). Effective SBRs can address such market and coordination failures and government failures, and can reduce policy uncertainty (we discuss this below).

Effective SBRs address market and coordination failures, which constrain growth of small and large firms

Effective SBRs can help solve information-related market and coordination failures in areas such as skills development (Lall, 2001), infrastructure provision, technological development (ibid) and capital markets (Stiglitz, 1996). Business associations and government departments may help to coordinate dispersed information among stakeholders. The coordinating actions of these agents allow a country to create wealth at a faster rate. A good example is where business associations lobby the government, e.g. to provide more appropriate and good quality education and infrastructure, which is unlikely to be supplied through a fragmented private sector which relies on a price mechanism based on incomplete markets. Our econometric work based on

a large survey of firms in a number of sub-Saharan African countries (Qureshi and Te Velde, 2007) suggests that both small and medium-sized enterprises (SMEs) and large firms derive growth benefits from being a member of a business association, consistent with their stated preferences that business associations lobby on their behalf (in addition to direct lobbying) and provide relevant information. Whereas SMEs and large firms make a similar contribution to growth, the growth constraints are different (Kurokowa et al., 2008), and business associations can help SMEs lobby for the removal of SME growth constraints.

Effective SBRs address failures in government policy designed to overcome market failures

Public support may fail to correct market failures, for several reasons. Governments are unlikely to have perfect information and perfect foresight; government intervention can suffer from moral hazard problems (Hausman and Rodrik, 2002), in that the private sector may not act once the government has provided an incentive; private non-market means can solve market failures; joint action may raise collective efficiency, by internalising externalities, and this could be more appropriate than state intervention; national level coordination failures based on scale economies are probably the most far reaching in scope and hence the most risky; and government intervention carries the risk of misallocation and rent-seeking behaviour.

Effective SBRs (e.g. a democratic way of conducting SBRs underpinned by the principles enshrined in an effective competition policy) provide a check and balance function on government policies and their tax and expenditure plans (Bwalya et al., 2009 suggest how the private sector in Zambia can be successful in its budget proposals). Effective SBRs may help to ensure that the provision of infrastructure is of good quality and appropriate to the needs of the market (and avoid circumstances where technology institutes are supply driven and delinked from the private sector, see Lall 2001 in the case of Tanzania). The design of effective government policies and regulations depends, among other things, on inputs from and consultation with the private sector. Regular sharing of information between the state and businesses ensures that private sector objectives are met with public actions and that local-level issues are fed into higher-level policy processes. The private sector can identify constraints, opportunities and possible policy options for creating incentives, lowering investment risks and reducing the cost of doing business. This can facilitate appropriate and active market-friendly interventions. More efficient institutions, rules and regulations might be achieved through policy advocacy, which could reduce the costs and risks faced by firms and enhance productivity.

SBRs can help to address coordination failures, as government action on its own is risky. Any intervention needs to be updated when new information becomes available, and it is therefore essential to consult the market through effective SBRs. Stiglitz argues that flexibility of policy interventions is important in securing a positive outcome.

Effective SBRs can reduce policy uncertainty; promote innovation and create wealth

Effective SBRs and membership of business associations may help to reduce policy uncertainty. Firms operate in an uncertain environment and frequently face risks and resource shortages. They undertake decisions concerning technology, inputs and production facilities based on anticipated market conditions and profitability. Uncertainty can have significant negative effects on investment and hence wealth creation, when investment involves large sunk and irreversible costs and there is the option to delay the decision to make the investment until further information becomes available (Dixit and Pindyck, 1994). Policy uncertainty is an important source of uncertainty. Businesses that have a better relation with the government may be able to anticipate policy decisions. When this relation becomes too close, collusive behaviour may result in capture of policy to the benefit of few, not all, firms. A key problem is to understand when SBRs are of the collusive type and when they are developmental. Econometric evidence from Mauritius (Rojid et al., 2009) suggests that improvements in SBRs over the past three decades have led to more appropriate growth-enhancing policies and more fixed capital formation crucial for wealth creation. Evidence from around 1,000 firms in a number of sub-Saharan African countries finds that firms that are a member of a business association pay a lower percentage of revenue as informal payments to government officials, face lower lost costs of insufficient water supply and make more use of information and communication technology facilities. This suggests that organised SBRs play an important role in the creation of good institutions and governance, and the establishment of a better investment climate (Qureshi and Te Velde, 2007).

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2
Optimal framework for state-business relations

Justin Yifu Lin, The World Bank

The relative roles of governments and markets have always been an area of fundamental importance in economic theory and policy. For too long, economists were trapped in the false dichotomy that opposed the market and its 'invisible hand' and its planning and implementation capabilities. From Adam Smith's laissez-faire to Keynesian interventionism, from the old structuralist school to neoclassical economics, the pendulum has swung from one extreme to another, generating many intellectual controversies and many policy failures across the developing world.

With the emergence of new growth theory, new trade theory and new institutional economics, significant advances have been achieved towards a systematic comparison of market and governments (or centrally operated mechanisms – Acemoglu et al., 2008). A broad consensus has emerged in recent years that both states and markets play a key role in the transformation of all economies – especially developing ones. It is now widely accepted that even the most advanced economies need constant and strategic state action to support and regulate private businesses and help generate and disseminate on a large scale the technological progress that sustains economic growth (Aghion, 2009; Romer, 1990). However, despite intellectual progress in building modelling tools for assessing economic performance in various systems, economic theory is still struggling to offer a convincing and practical policy framework to maximise the potential of public and private agents. This note draws on recent work on a new structural approach to economic development and outlines a path towards an optimal framework for state-business relations (SBRs) (Lin, 2009, 2010; Lin and Monga, 2010).

The main theoretical justification for government intervention in economic development is twofold: the need to account for externalities beyond the realm of any individual firm and the need for coordination.

Industrial diversification and upgrading is a process of innovation, in which pioneering firms generate public (non-rival, non-excludable) knowledge for other firms in the economy. That is, consumption of the new knowledge by one firm does not reduce its availability for others, and no-one can effectively be excluded from using it. Adequate public compensation is desirable for the information externality that the pioneer firms generate. Meanwhile, in most cases improvements in infrastructure, both hard (such as transportation) and soft (such as financial and legal institutions), cannot be internalised in an individual firm's investment decision, yet they yield large externalities to other firms' transaction costs. The idea that some business activities exhibit externalities that increase with the size of the industry and that arise through localised industry-level knowledge spillovers, input-output linkages and transportation costs has been well documented (Harrison and Rodriguez-Clare, 2010). This can give rise to geographic concentration and labour pooling among firms in the same industry (Krugman, 1991; Marshall, 1920).

As a country climbs up the industrial and technological ladder, many other changes take place: the technology its firms use becomes more sophisticated and capital requirements increase, as does production scale, Markets grow and transactions increasingly take place at arm's length. A flexible and smooth upgrading process therefore requires simultaneous improvements in educational, financial and legal institutions and hard infrastructure, so that firms in the newly upgraded industries can produce sufficient amounts to reach economies of scale. Clearly, individual firms cannot internalise all these changes cost-effectively, and spontaneous coordination among many firms to meet these new challenges is often impossible. A change in infrastructure requires collective action or at least coordination between the provider of infrastructure services and industrial firms. It falls to government either to introduce such changes itself or to coordinate them proactively. Thus, on top of an effective market mechanism to allocate resources at each stage of economic development, government needs to play an active facilitating role in the industrial diversification and upgrading process and in the improvement of infrastructure.

The general concern with state involvement in economic development is its propensity to create suboptimal business arrangements and practices, inefficiencies and costly

distortions that open the way to rent seeking. In this context, establishing successful SBRs requires an appropriate policy framework which allows the state to support industrial development and technological upgrading but also minimises opportunities for rent seeking.

Countries that succeed in adopting and implementing such frameworks are those where government's industrial development goal is consistent with its comparative advantage, which reflects the accumulation of human and physical capital and the change in its factor endowment structure. When firms choose to enter industries and adopt technologies that are consistent with the comparative advantage determined by the country's factor endowments, they are viable in an open, competitive market and the economy is most competitive. As competitive industries and firms grow, they claim larger market shares and create the greatest possible economic surplus in the form of profits and salaries. Reinvested surpluses earn the highest return possible as well, because the industrial structure is optimal for that endowment structure. Over time, this strategy allows the economy to accumulate physical and human capital, upgrading the factor endowment structure as well as the industrial structure, and making domestic firms more competitive over time in more capital- and skills-intensive products. As new firms in the process are viable, the role of the state in industrial diversification and upgrading is limited to providing information about the new industries, coordinating related investments across different firms, compensating pioneer firms for information externalities and nurturing new industries through incubation and encouragement of foreign direct investment (Lin, 2009; Lin and Chang, 2009). Large subsidies and protection for new firms are not required. Opportunities for rent seeking and other distortions are therefore limited.

Such an approach to SBRs rejects conventional import substitution strategies that rely on the use of fiscal policy or other distortions, in low-income and labour- or resource-abundant economies, to develop high-cost, advanced, capital-intensive industries that are not consistent with the country's comparative advantage, with firms in these priority industries not viable in an open, competitive market.

Following the economy's comparative advantage will also allow developing countries to tap into the potential advantage of backwardness. At each stage in their development, firms can acquire the technologies (and enter into industries) that exist in more advanced countries and that are appropriate for their endowment structure, rather than having to reinvent the wheel (Gerschenkron, 1962; Krugman, 1979). This use of off-the-shelf technology and entering into existing industries has allowed some of the East Asian newly industrialised economies to sustain annual gross domestic product (GDP) growth rates of 8% and even 10% for two or even more decades, and is being emulated successfully by many other countries around the world.

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3 Measuring state-business relations in Africa

Dirk Willem te Velde, Overseas Development Institute

There is heated discussion among political scientists and economists studying state-business relations (SBRs) on whether it is possible to measure such relationships meaningfully. SBRs are not always directly observable, yet we still want to assess their importance for economic performance. There have been very few direct attempts to measure SBRs, and none on the basis of objective observable characteristics, although many have focused on related concepts:

- Hyden et al. (2004) focus on six governance categories, including economic society; this (deliberately) includes subjective questions covering perceptions of SBRs.
- Kaufman et al.'s indicators have been used extensively by the World Bank, but these are about perceptions of governance variables such as government effectiveness and rule of law.
- Investment climate measures in the World Bank's Doing Business Reports are objective, but measure e.g. administrative procedures not SBRs and these are unlikely to be fundamental drivers of economic performance (in fact there is little theory surrounding regulation and development) and can be rather seen as outcomes of SBRs.

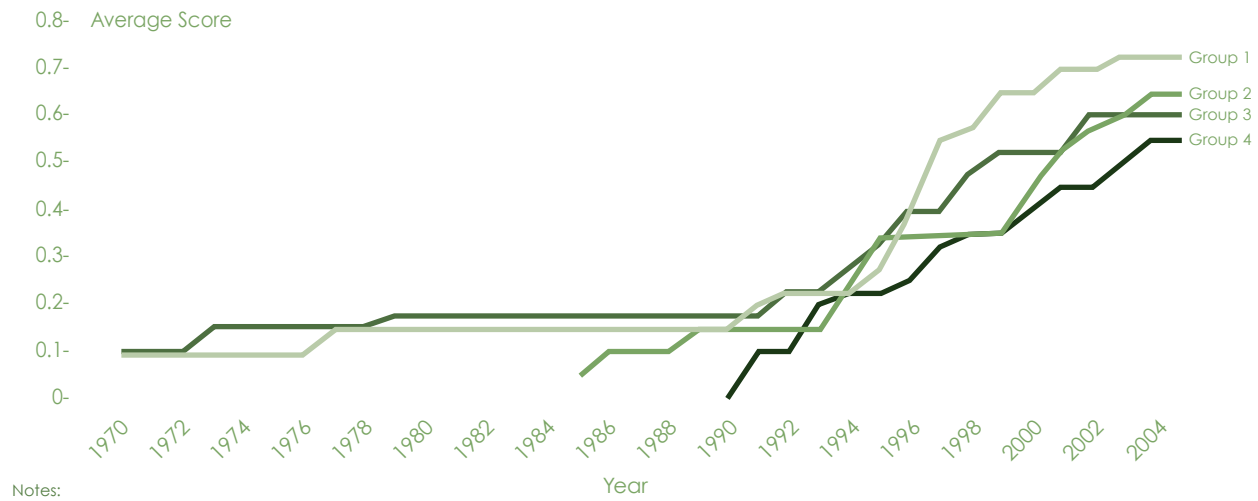
Of course, condensing relationships into a set of measures could lead to the loss of relevant detail. Done well, though, it could describe the essence of SBRs (e.g. key economic functions). Hence, there was a need to create new measures to reflect objectively the characteristics of good SBRs. We already knew what researchers thought: an analysis of the political science suggested that good SBRs were based on benign collaboration between business and the state (Harriss, 2006; Hyden et al., 2004; Leftwich, 2008; Maxfield and Schneider), with positive mechanisms that enable transparency, ensure the likelihood of reciprocity, increase credibility of the state among the capitalists and establish high levels of trust between public and private agents.

We cannot measure many directly such good characteristics of SBRs, but we can identify the key factors behind them. For example, to obtain credibility and reciprocity, both public and private sectors need to be organised or institutionalised. Positive mechanisms for transparency require that some rules or institutions bring the state and business together. And a set of competition principles is needed to restrain collusive behaviour. In sum, we suggest four factors make for effective SBRs, which can clearly be expanded and improved on in specific research contexts:

1. The way the private sector is organised vis-à-vis the public sector;
2. The way the public sector is organised vis-à-vis the private sector;
3. The practice and institutionalisation of SBRs;
4. The avoidance of harmful collusive behaviour.

These are visible aspects of SBRs that can be measured more or less objectively. Some would argue that less visible, informal aspects are equally, if not more, important. Trust, for instance, is not always dependent on contracts or visible enforcement mechanisms. This we acknowledge. However, we argue that, although the informal aspects may influence the links between measurable aspects of SBRs and performance, they do not do this in such a systematic way that there is no link between formal SBRs and growth. As such, we have focused mostly on understanding the effects of the measurable and formal aspects of SBRs:

1. Measurement of the role of the private sector in SBRs is based on the presence and length of existence of an umbrella organisation linking businesses and associations. There are many other aspects and forms of business associations – the key is to come up with measurable aspects that can be compared across dimensions and over time.
2. Measurement of the public sector in SBRs is based on the presence and length of existence of an investment promotion agency (IPA) to promote business. There is a



Notes:
Group 1 = Botswana, Mali, Mauritius, Mozambique, Uganda, Mozambique;
Group 2 = Ghana, Kenya, Eritrea (part), Senegal, Tanzania;
Group 3 = Benin, Ethiopia, Nigeria, Rwanda, South Africa;
Group 4 = Côte d'Ivoire, Madagascar, Malawi, Zambia, Zimbabwe.
Groups based on purchasing power parity (PPP) gross domestic product (GDP) per capita growth rates over 1980-2004.

source: TeVelde, 2006

literature on the effectiveness of IPAs.

3. Effective SBRs require the cooperation of the public and private sector, measured by examining a number of factors and forms, for example open to all and autonomous of government intervention, as with a formal existing body, or an informal 'suggestive' body with no entrenched power. One possible measure is based on the format, frequency and existence of SBRs.
4. The presence, length of existence and effectiveness of laws protecting business practices and competition are measures of avoidance of collusive behaviour.

Te Velde (2006) measured each of the four factors over time, focusing on 20 African countries for which data were available. This led to four indicators for each country and at varying times, averaged using a composite measure (attaching the same weight to each, although this could be varied). The chart plots the averages for four groups of countries, ranging from the fastest-growing groups over 1970-2005 (Group 1) to the slowest-growing group (Group 4). As expected, country groups with higher SBR scores grew faster. We also used the individual measures rather than a composite to address concerns about weighting.

Improving Institutions for Pro-Poor Growth (IPPG) further undertook a series of country case studies on measuring SBRs. For example, the Mauritius study used three measures of SBRs at the macro level. The first measure uses an average indicator proposed by Te Velde (2006) (based in part on the presence and length of existence of umbrella organisations linking businesses and associations). This idea is that the longer the membership of firms in the umbrella organisation, the more the maturity and the higher the level of collaboration.

A second measure is the number of firms that are members of the umbrella business organisation (the Joint Economic Council – JEC) as a ratio of the total number of firms. It is proposed that, with an increasing ratio, the positions that the umbrella organisation takes during discussions with the state will be strengthened. There are two constraints: 1) this is an input indicator and 2) mature SBRs are based not on confrontation but rather on dialogue and understanding by each party of the other party's position.

A third indicator is output based, unlike the previous two. It captures the economic functions of SBRs by measuring in percentage terms the effectiveness of the umbrella organisation in its demands. This has been addressed, in full or partially, during the Chancellor's budget presentation. It does this for a long time series, with such variables subsequently used in quantitative research (Rojid et al., 2010).

The Zambian study measures one specific economic function of SBRs: whether businesses have been effective in getting their proposals on tax policy into the budget by comparing the number of proposals submitted with budget outcomes.

Other studies show that SBRs can also be measured at the micro level (see the Briefing on dealing with endogeneity at the micro level in Africa). The ability to describe SBRs using a set of indicators is particularly useful for subsequent quantitative analysis (e.g. Sen and Te Velde, 2009). Moreover, measuring SBRs leads to important discussions between political scientists and economists about the essence of SBRs.

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4
Measuring state-business relations in Indian states

Massimiliano Calì, Overseas Development Institute

Institutional quality is arguably one of the main drivers of differences in income across countries (e.g. Rodrik et al., 2004). The economic literature has devoted increasing attention to quantifying their impacts and disentangling their mechanisms. These exercises need to rely on adequate quantification of institutional variables, which are starting to emerge.[1]

The measurement of state-business relations (SBRs) has so far received relatively little attention, but their importance in the economic development process is clear in those countries where the state has intervened in the economy so as 'to provide incentives to private capital and to discipline it' (Harriss, 2006).[2] We apply the measurement to the major Indian states over 1985-2006: this represents the first effort to characterise SBRs at the sub-national level. India is an appropriate context for building sub-national indices, as it is a federal country composed of several states with a fairly high degree of political autonomy and legislative power. The relevance of SBRs in this context is underlined by the view that the radical shift in the attitude and practice of the political leadership in relation to the private sector in the 1980s was at the root of India's sustained economic growth in the past decade (Kohli, 2006a; 2006b).

As with other economic (and non-economic) institutions, measurement of the effectiveness of SBRs is complicated by the inherently unobservable nature of institutional quality. Several indices tackle this problem by relying on perceptions, e.g. by firms, experts or non-profit organisations. This creates a measurement error problem typical of subjective survey response data. In turn, the likely causal correlation of this measurement error with dependent variables may generate biased estimated coefficients when testing for the effects of institutions (Bertrand and Mullainathan, 2001). This is why we instead use actual observable variables to build the indicators.

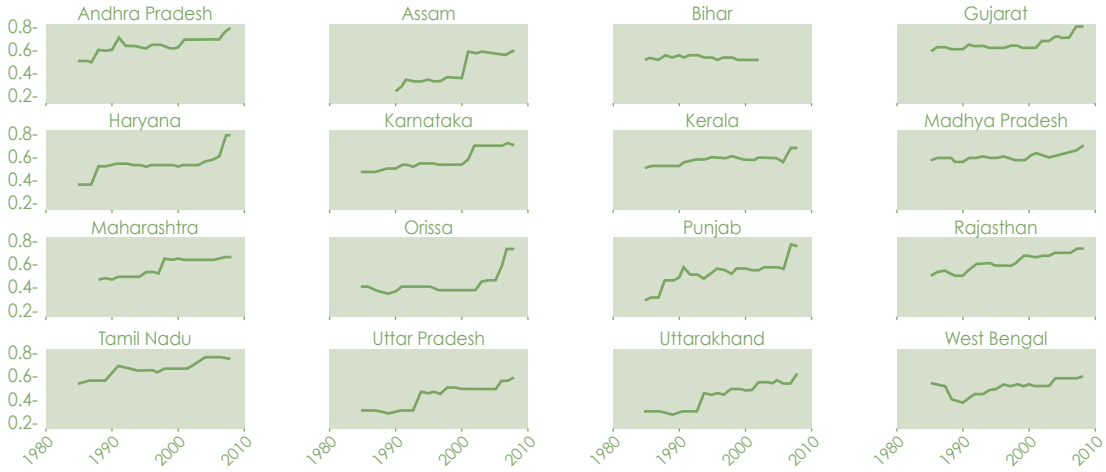
Using actual variables in a sub-national context poses a problem of data availability, which conspicuously constrains the extent to which one can construct proxies capturing the essence of SBRs. This is particularly the case here, as we aim to cover a fairly long time span. Therefore, in our choice of variables, we need to strike a fine balance between representativeness and availability. For this, we gathered data for variables that were as close as possible to our ideal notion of effective SBRs, through interviews with business associations in each state and government officials from the industry department of almost every state. We also collected data from secondary sources whenever they were available. Despite substantial efforts, we were not always able to obtain data on the desired variables. For example, we would have liked to measure the ability of the private sector (the 'B' in SBRs) to advance its interests through indicators such as number of members (e.g. a more effective organisation raises the expected returns of becoming a member) and the share in total staff salaries of non-administrative staff (who mainly perform lobbying and/or strategic activities, which ideally favour SBRs). But time-varying data on such measures proved impossible to collect. Despite this, and with the usual notes of caution when interpreting any quantitative indicator, we are confident that the measures constructed provide a fairly reliable indication of the quality and effectiveness of SBRs across Indian states in the past 30 years.

We created a composite SBR index, made up of four dimensions reflecting the main aspects of effective SBRs, as argued by Te Velde (2006), which was the first study to develop quantitative measures of SBRs quality (in Sub-Saharan Africa):

1. The way the private sector is organised vis-à-vis the public sector;
2. The way the public sector is organised vis-à-vis the private sector;
3. The practice and institutionalisation of SBRs;
4. The avoidance of harmful collusive behaviour.

We amended the measurement of each dimension to adapt it to the specific characteristics of the sub-national context in India. For example, Indian states historically have had stronger institutions than African countries, so accurate identification of inter-state differences is preconditioned on the formulation and use of new and innovative ways of

SBR indices across Indian states



source: Author's elaborations on various sources.

scoring SBR effectiveness using more qualitative and/or specific data.

Each of the dimensions was measured through an appropriate sub-index, using data on relevant variables. The various SBR sub-indices were then combined to arrive at an overall index. The construction of composite and specific indices of SBRs took into account facilities provided by state business associations for their members, such as publications and websites, the office premises of such associations, steps undertaken by the government to facilitate an interface with business and measures to prevent collusion/exclusionary action involving business houses and government in different states.[3]

An examination of the evolution of the SBR indices suggests that SBRs have improved over time for all states except Bihar. This is consistent with various accounts of recent Indian policies towards businesses (e.g. Kohli, 2006a; 2006b). This generalised secular upward trend is characterised by variations across time and states. Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu show a stable and high ranking over time, Assam and Uttar Pradesh a stable and low ranking. The major gainers over time are Haryana, Orissa and Punjab, but these also exhibit the highest variation or, equivalently, the lowest stability. The major losers are Madhya Pradesh and West Bengal. These variations suggest that there is potential for Indian states to learn from each other, given similarities in political and institutional setups and linkages to the same central government.

The SBR measure is strongly positively correlated with economic growth, which hints at the importance of SBRs for economic growth in the Indian context. However, there is a need for deeper study to estimate the impact of SBRs on economic performance after controlling for other determinants of growth and for the likely endogeneity of SBRs.[4] Although the SBR index aims to capture a unique economic institution, it is useful to compare it with other indices measuring the quality of the business environment. A comparison between state-level SBR rankings and the World Bank's ranking based on the Investment Climate Index (ICI – Iarossi, 2009) for 14 states in the year 2005 suggest there are marked differences between the SBR index and the investment climate index across Indian states, suggesting that, although effective SBRs may be important for the investment climate, they are measuring a fairly different economic institution. Such differences are less important in the case of the Doing Business indicators which, unlike the ICI, are not based on perception surveys. This confirms the need for caution when interpreting perception-based indicators, which we argue should ideally be complemented by indicators based on actual values of different variables.

Endnotes:

1. E.g. Kaufmann and Kraay (2008); corruption indicators from Transparency International.

2. The most prominent examples of this type of intervention in recent times are provided by the East Asian countries (e.g. Johnson, 1987).

3. For more details on the specific variables and on the aggregation procedures used in index construction, see Cali et al. (2009).

4. See Cali and Sen (2009) for such analysis.

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5
Are effective relationships between the state and business the cause or effect of improved economic performance?

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Several studies examine empirically the link between measures of state-business relations (SBRs) and economic performance. A typical methodology takes a measure of economic performance at firm or country level as the dependent variable and relates this to a number of key determinants selected on the basis of economic theory and/or empirical fit ('the model'), including in this case a measure of SBRs. In natural science or engineering, a relationship is often explicitly causal – if a driver steps on the brake, the car stops. In economics, relationships can be identities (a number of certain inputs contribute to income) or more often are behavioural. When relationships are behavioural, observing a correlation between two variables without additional information is normally not enough to infer causality. For example, a firm can join a business association, which in turn can promote better firm performance, or, for some reason (or characteristic), good firms self-select themselves to join a business association. Both of these lead to a positive correlation between membership and firm performance. It is important for policy to understand which direction the correlation goes. Methodologically, there are at least three ways to address endogeneity issues: data, economic theory and specific methods such as instrumental variables estimation or the Generalised Method of Moments (GMM). Research Programme Consortium on Institutions and Pro-Poor Growth (IPPG) research in Africa has employed all three methods, although instrumental variables are more thoroughly applied in the case of India (see the next briefing on endogeneity in India).

The data approach considers the data directly and examines whether variation in the explanatory variable preceded variation in the dependent variable. For example, in sub-Saharan Africa we tended to observe an improvement of the SBR measure one or a few years before the upturn in economic growth (of course the relationship is more complex). The fact that institutional strengthening occurred before growth is also being used in econometric estimation procedures using instrumental variables (past values help to explain current values). It could also be the basis of Granger causality tests.

The theoretical approach to endogeneity considers the validity of the economic model and its underlying assumptions. Indeed, the literature suggests that it is more likely that firms become members because they expect higher benefits (and not because they have good performance to start with). Olson (1982) and Doner and Schneider (2000) suggest that the right incentive structure (i.e. benefits for selected firms) is a key driver for membership of a business institution.

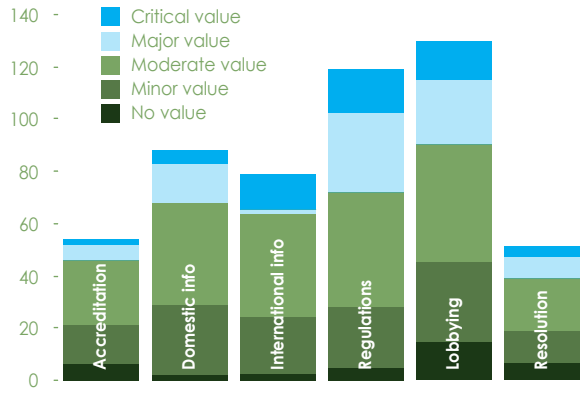
Doner and Schneider suggested that 'This institutional strength depends in turn on high member density, valuable selective benefits (often delegated by governments), and effective internal mediation of member interests. In addition external factors, especially competitive markets and government pressure, encourage associations to use their institutional strength for productive ends.'

Olson and Doner and Schneider suggested that the source of extensive collective action (and high density) is the provision of selective incentives. When associations have crucial benefits that they can offer only to members, membership is valuable and exit becomes costly. The type of selective benefits varies from association to association, from marketing, to export quotas, to export licenses and import controls, to export market information, to upgrading support, to a privileged role as the exclusive intermediary with state actors, especially negotiators for trade agreements. Such benefits can lead to improved firm performance, including higher productivity.

Moreover, evidence from World Bank Enterprise Surveys suggests that firms perceive services of business associations to be of high value. Business associations provide different types of services, and some are regarded as highly beneficial. In the World Bank Enterprise Surveys, lobbying government and information on government regulations are on average the two most important services provided by business associations to the firms covered in the sample. The least important services are resolution of disputes (with officials, workers or other firms) and accrediting standards or quality of products.

The econometric evidence shows that the effectiveness

Value of services by business associations to firms in Zambia



source: World Bank Enterprise Surveys: Ethiopia, South Africa and Zambia, Qureshi and Te Velde (2007)

Effects of different services of business associations on productivity

Variable	Estimated coefficient in productivity equation	Perceived usefulness on scale of 0 (no value) – 4 critical value, mean value
Information on government regulation	0.10*	1.85
Lobbying government	0.08*	1.41
Information on domestic markets	0.07	1.42
Information on international markets	0.07	1.34
Accreditation standards	0.08	1.00
Resolution of disputes	0.02	0.97

Note: This is the coefficient on the business association variable in an equation explaining productivity (total factor productivity – TFP) controlling for other factors, based on data available from Ethiopia, South Africa and Zambia.

source: Qureshi and Te Velde (2007)

of business associations works primarily through solving information-related market and coordination failures and lobbying government. The findings confirm that the perceived value of services provided by the business association (final column in the table) is in line with the estimated effects. The more important a service is perceived, the more important its estimated effect. Thus, business associations affect firm performance by reducing policy uncertainty and by lobbying government over regulations (see the first note, on SBRs, industrial policy and wealth creation).

In short, the assumptions behind the conjectures advanced by Doner and Schneider (2000) remain valid. The fact that firms perceive business associations to perform useful functions goes counter to the notion of self-selectivity and hence its possible endogeneity problem.

The instrumental variable approach to endogeneity has been used at the macro level in Sen and Te Velde (2009). Instruments contain useful variations which are correlated with explanatory variables (here measures of SBRs) but not with the dependent variable (here economic performance) in any other way. Sen and Te Velde used GMM estimates, which use lagged variables as instruments (at the macro level it could be that institutional development, including better organised and effective SBRs, are the results of higher incomes). In addition, Rojid et al. (2009) estimated a system of equations which allows for endogeneity issues explicitly using the Vector Error Correction Model (VECM) estimations. The use of structural instruments could potentially improve the results further, but the papers were unable to use suitable structural instruments. Hence, there is a reasonable amount of information suggesting that it is likely that good SBRs lead to better economic performance. This now ought to be considered in further work.

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6
Addressing endogeneity in state-business relations across Indian states

Massimiliano Calì, Overseas Development Institute

This note discusses how the India research has addressed endogeneity concerns. The construction of an index of the quality of state-business relations (SBRs), described in the fourth briefing, allows us to test for the effects of effective SBRs on per capita incomes growth across Indian states for the 1985-2006 period. We estimate the SBR effect by using the following generic form:

$$Y_{it} = \alpha + \beta_0 Y_{it-1} + \sum_k \beta_k X_{ikt} + \rho SBR_{it} + v_t + u_i + e_{it} \qquad (1)$$

Where *i* designates the state, *t* designates time, *Y* is the logarithm of real gross domestic product (GDP) (state) per capita, SBR_{it} is the measure of SBRs and X_{ikt} is a vector of standard control variables. The error terms v_t and u_i capture the time-invariant and state-invariant components of the error term, and e_{it} is the white noise component of the error term. The presence of the lagged GDP term, Y_{it-1}, captures both path dependence in growth experiences and the conditional convergence hypothesis predicted by the neoclassical theory of economic growth.

This specification confronts us with two important endogeneity problems. First, the presence of the lagged dependent variable in equation (1) leads to inconsistent estimates because of the endogeneity of the latter term. A natural solution for the first-order dynamic panel data models is to use Generalised Method of Moments (GMM). However, this method is efficient only asymptotically, and is suitable for samples with large N and small T. In our case, we have a small N (15 states) with a relatively large T (22 years). Therefore, the GMM estimation may not be appropriate. Instead, we use the Least Squares Dummy Variable Corrected (LSDVC) estimator to tackle the endogeneity of the lagged dependent variable. This method, originally proposed by Kiviet (1995) and Bun and Kiviet (2003), has been developed precisely as a suitable dynamic panel data technique in the case of small samples, where GMM cannot be applied efficiently.

However, the LSDVC estimation is valid only in the presence of exogenous regressors. To the extent that the SBR measure may be endogenous to economic activity, the SBR coefficients would be biased and the LSDVC method would be invalid. There may be two types of endogeneity here: one driven by an omitted variable and one by reverse causality. The former could occur, for instance, if a successful private sector drove both sustained economic growth and pro-business reforms (captured by an increasing SBR measure). Part of the eventual correlation between SBRs and growth would be driven by the omitted private sector variable. Similarly, an increased rate of economic growth may provide more space for the government to enact business-friendly reforms in an attempt to facilitate the future growth process. On the other hand, the same situation may act as an incentive to obtain concessions from businesses in favour of workers, as the former are already gaining from increased growth. We do not speculate here on which situation may be more likely in the Indian context. However, we do acknowledge that this may be an issue. This potential endogeneity calls for an instrumentation strategy for our main SBR variable.

In order to control for the potential endogeneity of the SBR variable, we proceed in two stages. We first regress the SBR variables on a set of instruments supposed to be exogenous in specification (1) affecting per capita GDP growth via the SBR measure only. This is run through the following specification:

$$SBR_{it} = b_0 + B\mathrm{K}_{it} + \gamma_t + \eta_i + \varepsilon_{it} \qquad (2)$$

where K is the matrix of instruments. Taking the fitted value $\hat{SB}_{it}$ from (2), we can plug it into specification (3) and estimate it via the LSDVC method:

$$Y_{it} = \alpha + \beta_0^{LSDVC} Y_{it-1} + \sum_k \beta_k^{LSDVC} X_{ikt} + \rho^{LSDVC} \hat{SBR}_{it} + v'_t + u'_i + e'_{it} \qquad (3)$$

We propose two types of instruments to estimate equation (2) drawing from India's political history, one based on land reform legislation enacted by Indian states at different points in time and the other based on the nature of the political regime in a given state.

Land reform was implemented under the 1949 Indian Constitution, according to which states are granted the power to enact (and implement) land reforms. Each state parliament implemented the reform through autonomous acts, with

significant differences in the intensity with which states have enacted the various types of land reform legislation over time. Such differences are captured by Besley and Burgess (2000), who constructed a panel data-type land reform variable by cumulating land reform acts between 1957 and 1992 in the major Indian states. By using land reform legislation and not the actual implementation of land reforms as a proxy of the anti-business attitude of state governments in India, we avoid the possibility that land reform implementation may be correlated with growth and therefore, cannot be a valid instrument.[1]

Land reform legislation in India was intensely political. We postulate that the political process underlying SBRs was the mirror image to that underlying land reform legislation. States that implemented land reform aggressively were likely to be concerned mainly with the rural sector and the rural poor, while being relatively insensitive to the needs of the industrialists. The reverse argument should apply as well. Therefore, we would expect the intensity of the land reform legislation to be inversely related to the quality of SBRs. The data we analyse confirm that this is very much the case. Moreover, using the cumulative land reform variable, Besley and Burgess showed that land reform had a significant impact on reducing poverty but did not affect the overall rate of growth of Indian states over time. This is the necessary exclusion restriction condition for using land reform legislation as a valid instrument for SBRs.

The second type of instrument is based on the results of the political elections at the state level. We exploit the fact that SBRs are the outcome of a political process, with different groupings in state legislatures (the Vidhan Sabha) having different propensity to engage with businesses. We use data from records of the number of seats won by different national parties at each of the state elections under four broad groupings in line with the classification of Besley and Burgess. We update their data to the most recent elections and express seats as a share of total seats in the legislature.[2] We lag these variables one year to decrease the potential concern about their endogeneity.

The results from the first stage estimation (2) confirm our priors. Land reform legislation (lagged two years) appears to be negatively and significantly associated with the SBR variable. The electoral results variables are also broadly in line with expectations, although they are not significant – which suggests that SBRs are not driven mainly by electoral results. The F-test strongly rejects the hypothesis that the instruments are jointly not significantly different from zero, reinforcing the belief that these variables are good predictors of SBRs. The fitted SBR value from this first stage estimation should be purged of the endogeneity of the actual SBR value and can be used for the second stage estimation. The results from the latter suggest that SBRs have a significant and positive impact on the growth of income per capita in the panel of the major Indian states we consider.

Endnotes:

1. Deininger et al. (2009) show that land reform implementation in India has had a positive effect on household incomes and accumulation of physical and human capital, although their effect on economic growth is unclear.

2. The parties contained in the relevant groups are given in parentheses after the name of the grouping. These are (i) Congress Party (Indian National Congress + Indian Congress Socialist + Indian National Congress Urs + Indian National Congress Organization), (ii) a hard left grouping (Communist Party of India + Communist Party of India Marxist), (iii) a soft left grouping (Socialist Party + Praja Socialist Party) and (iv) Hindu parties (Bhartiya Janata Party + Bhartiya Jana Sangh).

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7 Managed latecomer strategies vs. political capture:

Can developing countries handle selective business promotion?

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Industrial policy is a hotly debated issue. The controversy is about selective interventions that favour some sectors over others, and thus interfere with the price mechanism as the main signalling device of market economies. On the one hand, it is generally recognised that there is a theoretical case for industrial policy, mainly because of the existence of coordination failures, dynamic scale economies and knowledge spillovers.[1] This is especially relevant for countries at early stages of market development. It is hard to imagine how a latecomer country with an open economy could embark on a new activity that requires economies of scale and a range of specialist inputs, when it has to compete against foreign companies that enjoy all the advantages of long-established specialised production networks (Collier and Venables, 2007). To succeed despite such disadvantages, concerted efforts would be needed to tackle a range of issues simultaneously. These include technical and managerial skills development, improvement of electricity supply and transport infrastructure, development of capital markets and encouragement of supporting industries and service providers. Last but not least, mindsets and societal institutions inherited from preindustrial phases need to be adapted to the needs of an open economy. Industrial policy requires intensive state-business interaction in order to maximise the exchange of information and mobilise synergies between public and private economic action (Bräutigam, 2000; Evans, 1995).

On the other hand, critics insist that governments are usually not very good at identifying coordination failures or anticipating future knowledge spillovers, and their decisions may well waste scarce resources if they bet on the wrong sectors. Moreover, the fact that politicians interfere strongly in the relative profitability of economic activities – via differentiated taxes, tariffs and subsidies – creates rent-seeking incentives for investors as well as for bureaucrats. Industrial policies should therefore be subject to checks and balances, including controls through auditor generals, parliaments and a free press, systematic impact evaluation and the application of results-based management in implementing agencies. However, developing countries tend to rank very low with regard to almost any indicator of government effectiveness. Here, state-business relations (SBRs) are often of a corporatist nature, whereby protected cartels of business 'insiders' benefit from state support, whereas the state gains support from the respective faction of the private sector. Protected cartels tend to be inefficient, as they are not fully subjected to market discipline. Their protection thus implies a (usually anti-poor) in-transfer of surpluses from consumers and taxpayers. Close trust-based collaboration between state agencies and business is thus a double-edged sword when favouritism is a key mechanism to stay in power and checks and balances are not well established.

Hence, developing countries face a dilemma: they are confronted with the strongest market failures and need to intervene most actively in the governance of productivity development; at the same time, the probability of achieving the pursued welfare effects is less than anywhere else. A few countries have managed to escape this dilemma, gradually increasing their competitiveness and improving the quality of their economic institutions in parallel. These include Brazil, Chile, Malaysia, South Korea and Taiwan, and more recently mainland China. These cases are well documented (e.g. Amsden, 2001) and testify to the feasibility and importance of industrial policies. However, critics argue that more than 100 developing countries that have pursued industrial policies have remained stuck in a vicious circle of low productivity and weak economic and political institutions (Pack and Saggi, 2006).

Against this background, the German Development Institute carried out a research project in seven low- and lower-middle-income countries: Egypt, Ethiopia, Mozambique, Namibia, the Syrian Arab Republic, Tunisia and Vietnam.[2] The main purpose was to understand the specific conditions for industrial policy in poor countries, to assess to what extent industrial policies can obtain the desired results even when overall government effectiveness is low and to identify which institutional arrangements and policies work best in their conditions.

In all countries included in the research project we observed an increasing recognition of private business as the main driver of productivity enhancement and economic

growth. Most of the countries had experienced long phases of central planning and had felt the limitations of this type of economic management strongly. Today, all seven countries embrace the principles of the market economy, have privatised a number of state enterprises and have established mechanisms for public-private dialogue.

At the same time, most governments are reluctant to privatise state-owned enterprises in certain strategic industries and to deregulate factor markets. There are different reasons for this. First, there are concerns about social costs of liberal market reforms. Second, political considerations play an important role – although they are usually not addressed openly. All countries are still undergoing major system transitions; their political institutions are still vulnerable and the political balance among different political or ethnic power groups is often fragile. Governments therefore try to maintain important assets that enable them to buy in political support from specific constituencies; moreover, they avoid certain reforms, e.g. labour market or land market liberalisation, which might provoke political resistance.

All countries of the sample apply selective policies in favour of specific industries and groups of firms. These include special export promotion programmes, value chain programmes, industrial parks and a range of small and medium-sized enterprise (SME) policies, among others. Some of these selective programmes have been quite successful – e.g. creating a seafood industry in Vietnam, promoting cut flower exports from Ethiopia, creating supplier linkages around an aluminium smelter in Mozambique and improving manufacturing practices in the Tunisian export industry. Policies have been effective when they have built on comparative advantages and established collaborative relationships with private enterprises. Many other selective policies have failed, because governments offered inappropriate support that did not address the most binding constraints or that turned out to be insufficient. Typical examples are industrial parks or business incubators that fail to attract investors.

The degree to which governments intervene at the company level varies considerably, however. Ethiopia and Tunisia engage strongly in hand-holding of firms, arguing that (besides some traders) they do not yet have a business sector that might trigger technological development and productivity growth, and therefore need to create a critical mass of efficient manufacturing enterprises. In Tunisia, this has been rather successful, whereas in Ethiopia the process is still too recent to assess its results. Most other countries engage much less with individual firms – with varying success: in Vietnam, entrepreneurship sprung immediately up when the restrictions of the centrally planned economic policies were lifted, whereas local enterprises in Namibia and Mozambique showed very little progress. The appropriate level of enterprise-level support thus obviously depends on country conditions.

In many cases, industrial policies are designed in a top-down manner rather than through systematic deliberations with the business community. As a consequence, policy priorities are often set in a non-creative technocratic manner. Most priorities are derived from the desire to develop forward or backward linkages in order to develop integrated value chains. To strengthen forward linkages, Namibia for example subsidises value addition of diamonds and other raw materials, Mozambique taxes raw cashew exporters to promote investments in national processing and Ethiopia taxes exports of unfinished leather while supporting an incipient leather products industry. As an example of backward linkages, Vietnam supports the textile industry in order to improve national supplies for its large garment industry.

At first glance, such strategies to move on to higher-value activities within existing value chains look quite plausible, but they have rarely been successful to date. In most cases, the countries have lacked competitive advantages (e.g. economies of scale) in the targeted upstream or downstream industries. Shifting to more demanding activities is a difficult task that requires a deep understanding of industry conditions. It calls for policies which are closely coordinated with the private sector, which encourage experimentation and which support innovative risk takers. Regular feedback loops with market actors to fine-tune sector strategies are important.

In sum, selective industrial policies may work even in countries with limited government effectiveness. The risk of failure is high, however, especially when strategic decisions are taken without sufficient involvement of the business community.

Endnotes:

1. That is, investments are not undertaken because they depend on investments in related areas which do not materialise unless governments coordinate a big push of simultaneous investments; and entrepreneurs under-invest in activities that might create manifold spillovers in the future but do not pay off immediately for the individual investor.

2. Results are summarised in Altenburg (forthcoming); the first published case studies can be downloaded at www.die-gdi.de.

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8

State-business relations and economic performance in sub-Saharan Africa

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When the state and business interact effectively, they can promote a more efficient allocation of scarce resources, appropriate industrial policy and a more effective and prioritised removal of key obstacles to growth, than when the two sides fail to cooperate or engage in harmful collusion. A major challenge that the Research Programme Consortium on Institutions and Pro-Poor Growth (IPPG) cluster of research on state-business relations (SBRs) has addressed involves understanding the relationship between SBRs and economic performance. This note discusses the findings of four African case studies in this regard: Ghana, Mauritius, South Africa and Zambia.[1] These use different methods and methodologies but all cover four broad areas, to varying degrees: 1) the drivers of SBRs; 2) measures of SBRs; 3) economic functions of SBRs; and 4) effects of SBRs. Table 1 below provides a summary of the case study approaches implemented.

The studies include a number of important findings, reflected in Table 2. One headline message is that formalised SBRs do matter. For example, the Joint Economic Council (JEC) is an influential private sector actor in SBRs in Mauritius, and measured SBRs led to higher growth in a regression over the period 1970-2005. Budget proposals, which include suggestions for better industrial policies, are frequently taken up by government budgets (Table 3). This constitutes an important economic function of effective SBRs.

However, effective formalised SBRs cannot simply be put in place, and not all formal institutions matter to the same extent. The South Africa case study found that the National Economic Development and Labour Council (Nedlac) did not represent a real consensus-seeking forum, owing to defections by key labour organisations and differences of approach and priorities among key state organisations (Treasury and Ministry of Labour), despite some early success in industrial policy.

Formal consultative forums can perform useful functions that help business at macro level. The Zambia case study provides an analysis of new, transparent mechanisms to channel budget proposals and suggests that business organisations and actors have influenced budget outcomes (especially when using civil servants to shepherd proposals), more than other stakeholders such as non-governmental organisations (NGOs).

Beyond formal SBRs, there are also informal SBRs. The Ghana case study shows that more developed social networks (politicians, civil servants) of firms (in a sample of 256) lead to better firm performance. Such informal SBRs may provide a stepping stone towards formalisation. Business association membership is frequently associated with better firm performance. In several African case studies, membership leads to better firm performance by reducing policy uncertainty and lobbying, although individual lobbying remains important.

The studies have a number of takeaway messages. For academics, the case studies have provided new ways (methods and methodologies) of examining growth by including SBRs (empirical examinations rooted in theory). For government policymakers, informal networks matter but

Table 1: Country case study methods and approaches to the study of SBRs

	Drivers of SBRs	Measures of SBRs	Economic functions of SBRs	Effects of SBRs on growth performance
Ghana	Historical institutionalist inductive theories	Existing datasets		Micro econometrics
Mauritius	Analytical and historical account	Survey of firms	Effect of SBRs on budget policy proposals	Micro econometrics/ firm performance/ macro economics
South Africa	Tracing history of state-business organisation, exploring nature of SBRs	Descriptions		
Zambia		Measuring budget proposals	Effect of SBRs on allocation of pro-poor public spending	

source: IPPG SBRs workshop, Nairobi, July 2008.

Table 2: Country case study descriptive results

	Drivers of SBRs	Measures of SBRs	Economic functions of SBRs	Effects of SBRs on growth performance
Ghana	Politics matters for determining forms of SBRs	Number of known politicians and bureaucrats, but formalised SBRs evolving rapidly		Informal networks with civil service and politicians matter, but questions on importance of formalised SBRs remain
Mauritius	Long history of co-habitation (though disputed)	Proposals taken over by budgets (new measure)	SBRs affect government budgets (via JEC)	SBRs associated with growth
South Africa	Informal networks (politicians and big business) prevail	Historical accounts of SBRs	Not significant	No debate within Nedlac
Zambia		Budget proposals submitted by various groups	Effect of SBRs on allocation of pro-poor public spending	

source: Country case studies.

Table 3: Budget proposals of JEC (2006/07) and implementation status in Mauritius

	Fully implemented	Partly implemented	Not implemented
1. The transformation of Mauritius into one seamless and integrated business platform		X	
2. The adoption of transparent, simple and minimum procedures to start and operate businesses	X		
3. The establishment of a competitive air access policy		X	
4. The introduction of competitive pricing policies for international bandwidth	X		
5. The establishment of an open policy to import high skills			X
6. Operationalising of the Public-Private Partnership (PPP) legislation and the mainstreaming of SMEs in the new economic model			X (initiated in 2008/09 budget)
7. Transforming the labour environment into a more flexible one	X		
8. Establishing the right balance between legislative control and 'space' for investment			X

source: Rojid et al. (2010).

formalised ways of engaging with business can also be useful for economic development. For business leaders, engaging in a well-informed democratic conversation with government helps (and pays for itself): small and medium-sized enterprises (SMEs) often feel underrepresented in meetings with government. And for donor agencies, it is important to consider SBRs in advice on economic development and in governance indices.

The studies have a number of more specific policy implications:

- Build capacity to conduct SBRs. For example, business and other actors were more successful in the budget process in Zambia when government officials had sufficient capacity.
- Ensure buy-in from all actors to the effective functioning of SBRs. This requires above all a strong state that is committed to SBRs and convinced of the economic case. This can be quite hard, especially when different parts of government have different policy views (South Africa). Further support could be helpful here so that official bodies are not sidelined.
- Put the spotlight on informal SBRs where they are not functioning well (e.g. Zambian mining). This action would not be akin to intervening, which would run the risk of changing a complex political process. It would merely identify possible problems that could be solved by the players itself, which could be supported further.

Endnotes:

1. This review is based on four IPPG discussion papers: Ackah et al. (2010) for Ghana; Bwalya et al. (2009) for Zambia; Nattrass and Seekings (2010) for South Africa; and Rojid et al. (2010) for Mauritius. They can be downloaded from www.ippg.org.uk.

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9

How state-business relations trumps market forces in determining commercial success

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Recent Overseas Development Institute (ODI) research shows that the relationship between government and large businesses is often more important in determining market outcomes than competition and market forces (Ellis and Singh, 2010).

Markets need to be disciplined through competition (and in some instances appropriate regulation) to work efficiently. The research confirmed this, by comparing outcomes in four very different markets – sugar, cement, beer and mobile telephony – across five countries – Bangladesh, Ghana, Kenya, Vietnam and Zambia. The analysis showed significant differences in the performance of each market across countries, caused by differences in both policy and private sector behaviour.

Markets characterised by more competition, with more players, more dynamic entry and exit and more intense rivalry for customers, tended to deliver better market outcomes, including lower prices, better access to services for consumers and improved international competitiveness. An increase in competition through new market entry often delivered significant and rapid benefits.

The cement industry provides a good example of the benefits of competition. In countries with many players, such as Bangladesh, which has 34 players, prices are much lower and there is more potential for exports and growth. In Zambia, which had only two cement producers in 2008, prices were as much as three times higher than in Bangladesh. But since the entry of a new cement plant in Zambia in 2009, prices have dropped by almost 10%, whereas prices in other countries have risen. Cement is an important input for construction and infrastructure development, which are often paid for out of the government budget and which underpin growth and industrialisation. Thus, its price and availability are important.

The impacts of competition are clear in other markets as well. For example in Kenya, mobile phone tariffs fell by as much as 50% following the introduction of two new entrants into the mobile phone market in 2008, which should make the use of mobile phones more affordable for many poor people.

Yet, despite the clear benefits of competition, the study identified various cases in which government has allowed monopolies or uncompetitive market conditions to persist. In some of the countries studied, competition authorities have investigated the competition problems identified but have been prevented from tackling them effectively.

What is often observed, especially in sectors dominated by large firms, is a very close relationship between business and government, such that government actors share in some way in the profits of those businesses. This may happen through state ownership, through ownership by individual politicians, through corrupt business deals, through corporate social responsibility initiatives e.g. building clinics or schools, through 'favours' such as selective price discounts or simply through high levels of taxation. This gives government a shared interest in the monopoly profits of these businesses, and means that government may continue to protect those businesses from competition, e.g. through barriers to imports or market entry.

Thus competition itself can become a bargaining chip in a power game between government and business, as these examples show:

- One company in sub-Saharan Africa claimed that they were asked by government to provide their product at discounted rates to a new foreign company in another industry that the government was trying to establish in the country. They claimed that, when they refused, their punishment was the government licensing of a new entrant to compete with them, thus undermining what had been a longstanding monopoly position.
- Sugar mills in some sub-Saharan African countries face frequent price intervention by government, which is determined to keep prices down for electoral reasons. This has sometimes caused them financial difficulties, resulting in underinvestment, which has reduced the efficiency of the mills and pushed up costs significantly. But in return, they have enjoyed significant protection from imports until now. Prices in such countries have become uncompetitively high though, which is bad

for poor consumers and which makes the sector very vulnerable to liberalisation, as neighbouring countries produce sugar much more cheaply.

This mutually beneficial relationship between government and business underpins the formation of a powerful economic elite, with vested interests in opposing pro-competition and pro-growth reforms, which has serious consequences for economic development more broadly. In this situation, it is the relationship between a business and the government that often seems to determine a company's commercial success in a country, rather than market forces, and this is likely to have significant economic costs.

The best way to tackle vested interests that oppose reform is to establish and facilitate coordination among other interest groups that stand to gain from reform. This includes consumers, both household (who can be mobilised through consumer groups) and industrial, who may gain considerably from lower priced inputs. It also includes potential new entrants to the market, who can make their voices heard through business associations.

If these groups can be mobilised to lobby effectively for reform, this can help offset the political pressure to maintain the status quo. Competition authorities can play an important role here, in coordinating such groups, publicising the costs of a lack of competition and providing evidence on the benefits of reform. Donors can also help support the development of constituencies for reform, by building the evidence base on the benefits of competition, working with civil society to develop a culture of competition and supporting the establishment of effective competition authorities.

Achieving a sound framework for competition is difficult, and beset by vested interests, but it is crucial to ensuring that markets work efficiently to deliver growth and development. The extent of competition is also crucial in determining the impact of globalisation on development, whereby large multinationals with considerable market power are entering small underdeveloped economies, which desperately need the products, investment capital and know-how that they bring but want to avoid the repatriation of excess profits and the unfair suppression of domestic business. Thus, sound competition policy is an important accompaniment to globalisation and liberalisation processes, to ensure that developing countries achieve the expected benefits.

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10
From collusion to collaboration:

State-business relations and economic performance in India

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From independence and till the early 1990s, the Indian economy was characterised by a command and control regime, whereby the state essentially shaped the investment decisions of the private sector and the public sector occupied the 'commanding heights' of the economy. Most commentators are of the view that such a dirigiste regime led to a collusive and rent-seeking relationship between the state and the private sector, and that this had significant negative impacts on economic performance.

There were signs even in the early 1980s that the attitude of the Indian state towards the private sector was changing. In 1991, the Indian economy underwent major economic reforms, and the command and control regime was dismantled. Along with this, there was a clear shift in the Indian state away from a hostile relationship with the business sector, towards a closer and more collaborative relationship with private capital. However, given India's federal structure and the significant political autonomy and independence in legislative powers enjoyed by state governments, the evolution of state-business relations (SBRs) has not been the same across Indian states, with more collaborative relationships forming in some states and not in others.

Has this change in the nature of SBRs in Indian states, from a collusive to a more collaborative relationship, had any impact on economic growth? Strikingly, although economic growth in India has been strong since the mid-1980s, not all regions in India have benefited equally from the improvement in overall economic performance. States like Andhra Pradesh, Gujarat, Karnataka, Kerala and Tamil Nadu have grown at a rate of per capita income that has exceeded 4.5% per annum during the period. On the other hand, states such as Assam, Bihar and Madhya Pradesh have grown at around 2% or less in the same period. These variations in economic growth across states in India have been strongly correlated with poverty declines in India, with high and persistent rates of poverty in states such as Assam and Bihar as compared with Andhra Pradesh and Gujarat. Improving Institutions for Pro-Poor Growth (IPPG) research has shown that variations in regional institutional quality captured by the quality or effectiveness of SBRs can explain variations in economic growth in Indian states.

Cali et al. (2009) measure the nature of SBRs in India across states and over the period 1975-2004. They find that this measure shows an unambiguous improvement in the functioning of SBRs across most Indian states, especially from the 1980s. However, the rate of improvement has differed widely across states, and has occurred at different points in time in different states. This suggests that state-specific political processes have shaped the nature of SBRs in any given state, and that these factors have differed across states and over time.

Using the SBR measure, Cali and Sen (2009) examine the impact of functioning of SBRs on economic growth in Indian states. Taking into account other determinants of economic growth, they find that effective SBRs have contributed significantly to economic growth across states in India. They also find that that the key dimensions of SBRs that stimulate economic growth seem to be those related to the actual operations of the interactions between states and businesses. On the other hand, the creation of formal organisations (both public and private) per se does not seem conducive to economic growth. An important policy implication of their finding is that business associations should support and broker more collaborative relations between sub-national states and the private sector. Overall, their research illustrates the importance of active cooperation between agencies of the state and the private sector towards the goals of policies that both parties expect will foster investment and increases in productivity.

To better understand the micro-foundations of the relationship between SBRs and economic growth, IPPG researchers have also examined the effect of SBRs on productivity growth at the industry and firm levels. Kathuria et al. (2009; 2010) find similar positive effects of well-functioning SBRs on industrial productivity growth and manufacturing firm performance in India. The research suggests that one important route by which better SBRs can affect economic growth is increasing total productivity growth, especially in the industrial sector. Interestingly, the authors find that the growth in industrial productivity is

mostly confined to the formal sector of the manufacturing sector: the benefits of effective and formalised SBRs do not seem to reach the informal sector, where most of the poor reside. This suggests that, although effective SBRs matters for economic growth, they do not matter for poverty reduction to the same degree.

IPPG researchers have also attempted to understand of the provenance, evolution and forms of informal institutional interactions between states and businesses and to identify the factors that affect relations between states and businesses and shape the institutions (both formal and informal) that govern them. One important finding of the research has been that institutions that shape SBRs are path-dependent, and are resistant to change. This has been found in the case of West Bengal, a coastal state in eastern India and unique among Indian states, not only by virtue of being ruled by an uninterrupted Leftist regime for the past 32 years but also because it witnessed a turnaround in its outlook towards private capital by the state government from an outright hostile position in the 1980s to a more positive one in the early 1990s. Chakravarti and Bose (2009) show that this change in policy by the state government towards the private sector did not have desired outcomes in bringing about an increase in the rate of growth of the formal manufacturing sector, with most manufacturing activity remaining in the exploitative and low productivity informal sector. They attribute this to 'sticky' political institutions, such as existing attitudes towards the private sector among lower-level functionaries of the ruling party, which has been resistant to change.

In contrast, for the Indian state of Andhra Pradesh, Alivelu et al. (2009) identify the coming to power of Chandrababu Naidu as Chief Minister of the state government in 1995 as the 'critical juncture' that explains the rapid improvement in SBRs in the state and its subsequent successful record in economic growth. The Andhra Pradesh case study highlights how leaders and elites can work to form positive growth or developmental coalitions. On the other hand, the West Bengal case study suggests that such growth coalitions cannot be had to order, but are the product of ongoing political negotiation and reconstruction as the relative power of each side undergoes (often slow) transformation in the context of local, national and international circumstances – political, social and economic (Leftwich, 2009).

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11

State-business relations and investment in Egypt[1]

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The relative roles of governments and markets have always been an area of fundamental importance in economic theory and policy. For too long, economists were trapped in the false dichotomy that opposed the market and its "invisible hand" to the state and its planning and implementation capabilities. From Adam Smith's laissez-faire to Keynesian interventionism, from the old structuralist school to neoclassical economics, the pendulum has swung from one extreme to another, generating many policy failures across the developing world, disappointment, and intellectual controversies.

Can state-business relations (SBRs) influence private investment at the sectoral level? Are all informal SBRs bad and corruptive, or can they also have potential for positive enhancement of growth in a developing country? These and other related questions have been addressed by research on the case of Egypt. In what follows, we briefly present the private investment trend and evolution of SBRs that triggered the research, followed by a brief overview of the research methodology, analysis, main conclusions and policy implications.

Industrial investment as a percentage of total investment in Egypt has been declining since the late 1960s, from 30% to only 10% in 2005. The private sector has shown decreasing interest in industrial investment: its share of total private investment decreased from 26% in 1992-1997 to 11% in 2000-2003. Serious private divestiture was also observed in 2002 and 2003. The year 2004 saw a sudden change of trend: industrial investment increased, first making up for lost investments in the previous couple of years, then achieving positive rates of growth.

What is most interesting is that this positive change in the private investment pattern coincided with a major cabinet change in 2004, involving the appointment of members of the business community to ministerial positions for the first time in Egypt since 1952. The change brought about a change in perceptions and attitudes, creating a 'friendly and useful' atmosphere for SBRs that created the potential for cooperation between the state and the private sector. This is opposed to the 'hostile' relations of the 1960s – when the public sector dominated the scene – and the 'friendly yet useless' setting that governed relations from the resurge of the private sector with the open door policy in 1973 until 2003. In the friendly yet useless phase, the state and the business community accepted each other's existence and often interacted, but no real cooperation ever took place.

Even though the cabinet changes were followed by the swift introduction of a number of regulatory changes improving the business climate, this still could not fully explain the new investment trend, especially the substantial inter-sectoral and intemporal differences in investment. It also could not explain why investment was increasing even though investors continued to suffer from other serious constraints in the business climate.[2] Also, why witness an increase in 2004 specifically, when policy changes to enhance investment have been initiated since the mid-1970s with little response by investment?

The situation called for deeper exploration of the reasons behind the recent increases in private investment, particularly inter-sectoral differences, and the potential role played by SBRs, if any. Using quantitative and qualitative techniques, the research explored the cases of four sectors: two traditional sectors (food and furniture) and two modern ones (communication and information technology – CIT). The analysis revealed the existence of active SBRs, particularly informal SBRs, at the sectoral level, with very high intensity in sectors witnessing unusual increases in investment. The empirical research collected detailed evidence on informal SBRs' contribution to overcoming impediments to growth and investment in these sectors.

For example, informal SBRs contributed significantly to the removal of initial barriers to entry in the CIT sectors, and thus the establishment of a new industry virtually from scratch. It also contributed to the resolution of the long pending problems of introducing a unified food law and harmonisation of standards, in the case of food industries. Informal SBRs also backed up the introduction of permanent formal institutions, such as product export councils in food and furniture and semi-formal arrangements such as ad hoc working groups in the case of communication. Both

arrangements created forums for active technical cooperation between the state and the private sector to the benefit of the sector and its business community. One major observation is that more inclusive benefits from SBRs, formal and informal, exist the better organised the sectoral business community. In such cases, the naturally exclusive SBRs between specific players in each of the two groups benefit a whole sector and promote its growth.

The research on Egypt clearly shows that SBRs played a critical role in raising levels of investment and fostering economic growth in specific sectors, not as a direct cause but rather through improving policy formulation and overcoming supply constraints and impediments to policy implementation that impede the wheel of growth, thus unleashing the full potential of the sector. This positive role of SBRs, however, is possible only when interactions between the state and business reach the stage of mutual understanding of, and mutual interest in, the sector. We call this the stage of active cooperation (AC). Comparative observations showed that common social roots and professional backgrounds facilitate the emergence of an effective public-private growth alliance, but the only necessary conditions remain common interest and common understanding of the problems to be solved.

Quantitative examination of whether SBRs, featuring AC, had an enduring investment-enhancing effect was inconclusive. There is no doubt, however, that this was an effective transitional arrangement. It helped investors to overcome barriers to economic growth, it helped policymakers to overcome deficiencies in their own government agencies and it helped both sides to work together in establishing new sector-specific rules and improving the general regulatory framework. The main general policy implication of this research is that such transitional arrangements deserve more attention, both to gain a better understanding of the political economy of investment and growth and to make research more relevant for policy. More specific implications are: 1) informal SBRs are not necessarily all bad and can be strong growth enhancers – but a setting must be created that avoids corruption and maximises inclusiveness through an organised private sector, strong monitoring agencies and free media; 2) there is a need for change of public and private mentalities towards seeing working together as the only way forward; and 3) the focus of industrial policy needs to be more on how to implement the policies than on what policies to adopt. On the how side, SBRs featuring AC can be very effective.

Endnotes:

1. This paper draws on Abdel-Latif and Schmitz (2009) and work in progress.

2. For example, inconsistent legislation and weak contract enforcement, not to mention poor understanding and implementation of new legislation, such as in the case of the new competition law.

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Conclusion

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This set of essays by internationally recognised experts contains the following 10 conclusions on the topic of SBRs and economic performance.

1. Institutions matter. Economic growth depends directly on economic fundamentals such as skills and capital formation, as well as the efficiency with which factors of production are put together, but the nature of SBRs is a crucial factor behind efficient skills development, capital formation and ultimately higher productivity and incomes.
2. Agencies and their interactions matter. The role of agencies and their effective interactions constitute a useful complement to the price mechanism in allocating resources and promoting efficient wealth creation. Effective SBRs can address market and coordination failures and government failures through cooperation, and can reduce policy uncertainty. When the state and business interact effectively, they can promote more efficient allocation of scarce resources, conduct a more appropriate industrial policy, remove the biggest obstacles to growth and create wealth more efficiently.
3. SBRs are not always directly observable, yet there are ways to measure the key factors behind effective SBRs through the organisation of business and government actors, the fora that bring the two sides together and the presence of competition principles ensuring absence of collusive behaviour.
4. There is considerable debate about the precise pathways and effects of SBRs, whether current SBRs are actually conducive to or hamper economic performance, and about how the nature of SBRs conditions the conduct of more active policies encouraging economic growth.
5. Selective industrial policies may work even in countries with limited government effectiveness. The risk of failure is high, however, especially when strategic decisions are taken without sufficient involvement of the business community (and hence SBRs).
6. Establishing successful SBRs requires an appropriate policy framework that allows the state to support industrial development and technological upgrading but also minimises opportunities for rent seeking, which is more likely when it is consistent with a country's comparative advantage.
7. Formalised SBRs can promote economic performance, e.g. through improved allocative efficiency of government spending and better growth and industrial policies (e.g. Mauritius). Yet, SBRs need to be disciplined by a set of competition principles, or they risk becoming collusive rather than collaborative. Not all formal SBRs work well (e.g. South Africa), and informal SBRs can play a key role (e.g. Egypt).
8. Examples show that a harmful collusive relationship can be turned into a more collaborative relationship, for example, when leaders and elites can work to form positive growth or developmental coalitions as in India.
9. Policy conclusions involve building capacity to conduct meaningful SBRs, ensuring buy-in from all actors to the effective functioning of SBRs and putting the spotlight on informal SBRs where they are not functioning well. Informal SBRs could promote growth, but a setting must be created that avoids corruption and maximises inclusiveness through an organised private sector, strong monitoring agencies and free media.
10. Further research could 1) build an enhanced theoretical underpinning of effective SBRs by modelling the economic behaviour of key actors engaged in SBRs; 2) create a worldwide index of effective SBRs; and 3) build up a set of empirical studies on successful economic functions of SBRs.

This collection of essays by distinguished scholars discusses the nature of state-business relations (SBRs) and the links between SBRs and economic performance. It is generally accepted that economic growth depends on economic fundamentals such as skills and capital formation as well as the efficiency by which factors of production are put together. But beyond this general point, the briefings in this publication argue that the nature of state-business relations is a crucial factor behind the efficiency of skills development, capital formation and ultimately productivity and economic performance. There is considerable debate about how the effects operate, whether current SBRs are conducive to or hamper economic performance, how to measure SBRs and about how the nature of state-business relations can set a framework for the conduct of more active policies to promote economic growth.

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