



State–Business Relations and Economic Growth in sub-Saharan Africa



Research Programme
Consortium for Improving
Institutions for
Pro-Poor Growth



*A review of case studies in
Ghana, Mauritius, South Africa and Zambia*

Dirk Willem te Velde
with Adrian Leftwich
July 2010

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Executive summary

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 co-operate or engage in harmful collusion. A major challenge which the cluster of research on state business relations (as part of IPPG) has addressed is to understand the relationship between state-business relations and economic performance. This paper synthesises four African case studies which cover four broad areas: 1) The drivers of state-business relations (SBRs); 2) measures of SBRs; 3) economic functions of SBRs; and 4) effects of SBRs. Whilst the case studies employ different methodologies and methods, this categorisation is a useful lens to analyse the findings of the case studies.

This synthesis includes a number of conclusions. One headline message is that formalised SBRs do matter. For example, the Joint Economic Council 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 over by government budgets. 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 provide a real consensus seeking forum, due to defections by key labour organisations from the Council and differences of approach and priorities amongst key state organisations (Treasury and Ministry of Labour), despite some early success in industrial policy.

Formal consultative fora do perform useful functions helping 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 NGOs.

Beyond formal SBRs, there are informal SBRs. The case study in Ghana 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, business membership leads to better firm performance by reducing policy uncertainty and lobbying, but individual lobbying remains important.

The studies have a number of take-away messages. For academics, the case studies provided new ways (methods and methodologies) of examining growth by including SBRs (empirical examinations rooted in theory). For government policy makers, whilst it is known that informal networks matter, 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); SMEs feel under-represented in meetings with government. And for donor agencies, it is important to consider SBRs in donor advice on economic development and in governance indices.

1 Introduction²

When the state and business interact effectively they can promote a more efficient allocation of scarce resources, a more appropriate industrial policy and a more effective and prioritised removal of key obstacles to growth, than when the two sides fail to co-operate or engage in harmful collusion. A long established view was that state-business relations in poor countries are collusive and rent-extracting (see e.g. Doner and Schneider, 2000, on the role of business associations in growth). Also, economists have for a long time held the view that a reduced role of the state and market liberalisation by itself would lead the price mechanism to allocate resources efficiently. There were market failures in theory, but in practice these were not thought to be sufficiently wide ranging to justify a strong state role (e.g. the World Bank *World Development Report* (2005) on the investment climate does not mention industrial policy).

However, both economic and political thinking has developed considerably over the past two decades. The political science and governance literatures have begun to identify what can be considered as characteristics of effective SBRs. For example, Evans (1995) suggests a number of characteristics relate to effective SBRs such as reciprocity, transparency, credibility and trust. Such views stand in sharp contrast to the earlier negative view on state-business relations. Doner and Schneider (2000) discuss a number of market complementing functions of business associations: macro-economic stabilisation, horizontal and vertical coordination, lowering costs of information, standard setting, and quality upgrading. On the economics side, Rodrik (2007) emphasised the importance of institutions in promoting growth. And more recently Lin and Monga (2010) have reinvigorated the debate on the role of the state in promoting growth, arguing that growth-enhancing policies work especially well when they follow the comparative advantage of the country. This paper argues that it is important to think about how such policies can be arrived at.

A major challenge which the cluster of research on state business relations (as part of IPPG) has addressed is to understand a new relationship between state-business relations and economic performance. Leftwich, Sen and Te Velde (2008) and Sen and Te

² This review is based on four IPPG discussion papers: Ackah et al (2010) for Ghana; Rojidi et al (2009 and 2010) for Mauritius; Bwalya et al. (2009) for Zambia; and Natrass and Seekings (2010) for South Africa. They can be downloaded from www.ippg.org.uk

³ Appendix A discusses the political functions of SBRs.

⁴ State-business relations in IPPG are seen as both political and economic institutions because they are means through which political power is shared and they perform economic functions.

Velde (2010) contain the achievements of the first phase of the research. It was argued that further country specific work would further help understand the economics and politics of SBRs. Others have also begun to study the nature of state-business relations. For example Abdel-Latif and Schmitz (2009) stress the informal nature of state-business relations. Hesselbein (2010) discusses the role of formal organisations behind state-business relations in Rwanda.

This paper synthesises four African case studies which cover four broad areas: 1) The drivers of SBRs; 2) measures of SBRs; 3) economic functions of SBRs; and 4) effects of SBRs. The case studies employ very different methodologies and methods and did not address these broad areas to the same extent. However, it is a useful lens to analyse the innovations introduced by the case studies.

The structure of the synthesis is as follows. Section 2 will discuss the rationale, scope and objectives of the IPPG cluster research on state-business relations. Sections 3-7 cover the key aspects of SBRs studied in the case studies. Section 3 conceptualises the methods and methodologies used in the four African case studies. Section 4 discusses the drivers of SBRs, drawing on the political analysis in the case studies. Section 5 discusses how case studies have addressed the measuring of SBRs, which is a crucial input into understanding the effects of SBRs. Section 6 reviews the pathways and economic functions through which SBRs can affect economic performance. Section 7 discusses the evidence on the effects (outputs) of SBRs. Section 8 reviews the econometric evidence used in the case studies in the context of the econometrics in the cluster research. Section 9 concludes.

2 The research cluster on State-Business Relations: rationale, scope and objectives

The four African case studies were undertaken after a number of initial exploratory studies of state-business relations in the first phase of the research (micro-economic, macro-economic, historical institutionalist). These initial studies provided a clear rationale for the four case studies.

Political science: characteristics of effective state-business relations

An analysis of the political science suggested that good SBRs are based on benign collaboration between business and the state (Maxfield and Schneider, 1997; Harriss, 2006; Hyden et al., 2004; Grindle, 2004; Leftwich, 2008) 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. They provide a transparent way of sharing information, lead to a more appropriate allocation of resources, remove unnecessary obstacles to doing business, and provide checks and balances on government intervention.

The discussion on effective SBRs is linked to the literature on good governance, characterised by four aspects: 1) the rule of law; 2) predictability; 3) transparency; and 4) accountability. This governance structure assumes that the government needs to be fully accountable and needs to provide a sound institutional environment in which a rational private sector maximises profits. Khan points to the importance of feasible reforms.

Economics: effective state-business relations have a sound economic basis

Effective state-business relations or public-private sector dialogue are important determinants of economic performance. The rationale for SBRs rests on the following building blocks. There are market failures (the market alone cannot achieve an optimal

allocation) and there are government failures (the state may not be able to address market failures on their own), and effective SBRs address market and government failures.

State-business relations affect growth through a number of routes. The main three functions of SBRs are: 1) addressing market and co-ordination failures; 2) addressing government failures; and 3) reducing policy uncertainty. We discuss these routes in turn.

Addressing market and co-ordination failures

SBRs can help to solve information related market and co-ordination failures in areas such as skill development (Lall, 2001), infrastructure provision, technological development (Lall and Teubal, 2000), and capital markets (Stiglitz and Uy, 1996). Business associations and government departments may help to co-ordinate dispersed information amongst stakeholders.

Addressing government 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 coordination failures based on scale economies are probably the most far-reaching forms of failure in scope, and hence the most risky. Government intervention carries the risk of misallocation and rent-seeking behaviour.

SBRs provide a check and balance function on government policies, tax and expenditure plans. Good SBRs may help to ensure that the provision of infrastructure is appropriate and of good quality. The design of effective government policies and regulations depends, among other things, on input 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. 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 using effective SBRs. Stiglitz argues that flexibility of policy interventions is important in securing a positive outcome.

Reducing policy uncertainty

Policy uncertainty is an important source of uncertainty and effective state-business relations and membership of business associations may help to reduce policy uncertainty. Firms operate in an uncertain environment and frequently face risk 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, 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). Businesses that have a better relationship with the government may be able to anticipate policy decisions. When this relationship becomes too close, collusive behaviour may result in capture of policy to the benefit of few, not all, firms.

Objectives of cluster

The objectives of the SBR cluster have been threefold. They were, first, to understand the nature of formal and informal interactions between the state and business, and how the institutions governing these have evolved over time; second, to understand the effects of different types of SBRs on measures of economic performance; and, third, to understand conditioning factors affecting this relationship.

SBRs affect the process of economic growth in various ways and it is crucial to gain a deeper understanding of the links. This involves understanding the nature of SBRs as well as a full understanding of the (causal) links between SBRs and growth. We examined SBRs from both political and economic perspectives; both types of studies have brought new insights but have also spurred some fundamental questions which in essence imply that both perspectives should be seen as interrelated.

We followed three working hypotheses for the country case studies. First, is it possible to identify growth enhancing characteristics and functions of SBRs (at country level and perhaps beyond)? Second, is it possible to identify what drives effective SBRs? Third, is it possible to inform policy makers about effective SBRs? We will return to these hypotheses in the conclusions.

Scope of cluster

The exploratory studies had examined SBRs from different angles: micro-economic, historical institutionalist and across country over time (Leftwich, Sen and Te Velde, 2008). It was suggested that country case studies could shed further light on function and effects of SBRs, by bringing both economic and political analysis together.

Each of the three country case studies aimed to address the following five points:

- 1) Provide an analytical and historical account of the political provenance of SBRs in the country concerned, including discussion of the nature of the state and especially the political relations (eg overlap or separation) of leaderships, elites and coalitions in

the formation of SBRs, and discussion of issues of transparency, credibility, trust and reciprocity between state and business sides.

- 2) Describe formal and informal institutional and organisational forms in both public and private sectors and the relations between them, and provide tables of main institutions and their functions and operations over time.
- 3) Discuss economic functions of SBRs in the specific country context (prioritising and tackling/lobbying for economic reforms, improving govt expenditure/ allocative efficiency, solving co-ordination failures/dynamic efficiency) and provide plausible hypotheses of how SBRs affect economic performance.
- 4) Discuss specific instances of effective SBRs, or ineffective SBRs (where appropriate backed up with data analysis) on economic performance at macro and micro levels. This might include econometric analysis, or another data-based interpretation of cause and effect. The importance is to show instances where the effects of state-business relations can be isolated as far as possible. It needs to discuss, measure and test hypotheses as formulated in 3) above.
- 5) Provide conclusions which include a) an assessment of the extent to which social and especially political institutions and processes affect the character and b) effects of economic institutions, as well as an assessment how SBRs affect economic performance.

The case studies were expected to focus on these aspects, although of course highlighting specific aspects which could differ by case study.

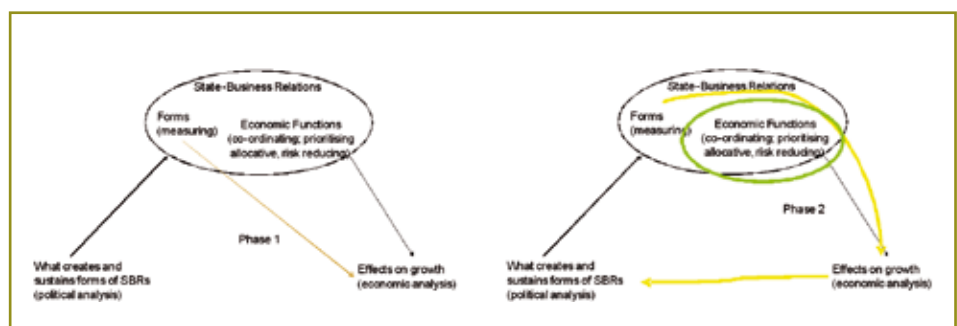
3 Methodologies and methods used in case studies

Methodologies

The methodology of phase 1 research followed two separate tracks. One track was the political analysis which tried to explain the way SBRs are formed and sustained. Each set of SBRs depends on country-specific power relationships. The second track examined the effects of a specific set of SBRs on economic performance. The latter analysis needs to have some measure of SBRs, which could be informed by the historical institutionalist perspective. The measurement of SBRs thus lies at the heart of the intersection between political science literature explaining SBRs and the economic literature explaining the effects of SBRs. If there is no agreement on the importance of measuring, it will not be able to prove any hypothesis that certain SBRs have growth enhancing effects.

Phase 2 research (the four African case studies) would build on this and move beyond the country wide measure of SBRs by describing specific economic functions of SBRs (co-ordinating; prioritising; allocative; risk reducing) which could lead to better economic performance at a country level.

Figure 1: African research on SBRs (phase 1 and phase 2)



Phase 2 research focused on the following four areas, but with a different emphasis on each aspect: the drivers of SBRs, measuring SBRs, economic functions of SBRs, and economic effects.

Methods

The methods employed by the case studies differed in part because the focus of each piece of research was different. They have included political/historical analysis of SBRs (mainly at country level, e.g. in South Africa, or Ghana), measuring SBRs at country level (Mauritius) or firm level (Mauritius, Ghana), using existing data sets (Ghana) or new surveys (Mauritius), econometrics studies of the effects of SBRs at country level (Mauritius) or firm level (Ghana), and functional approaches (budget process in Mauritius and Zambia).

Table 1 provides a summary of country case study approaches. Table 2 places the key findings of the case studies in this methodological grid.

Table 1 - Country case study methods and approaches

	Drivers	Describe/ measure	Economic functions	Effects on growth performance
Ghana	Historical institutionalist inductive theories	Existing data sets		Micro econometrics
Mauritius	Analytical and historical account	Survey	Effect SBR on budget policy proposals	Micro econometrics / firm performance / macro economics
South Africa	Tracing history of state- business organisation, explore nature of SBR			
Zambia			Effect SBR on allocation of pro poor public spending	

Source: IPPC SBR workshop Nairobi July 2008

Table 2 Country case study descriptive results

	Drivers	Describe/ measure	Economic functions	Effects 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 SBR remain
Mauritius	Long history of co-habitation (though disputed)	Proposals taken over by budgets (new measure)	SBRs affect govt 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	Effect SBR on allocation of pro poor public spending	Effect SBR on allocation of pro poor public spending	

Source: country case studies

4 Drivers of State-Business Relations

The first part of the research focused on what drives and sustains state-business relations. This would set the scene for examining the effects of SBRs.

Mauritius

Rojid et al (2009 and 2010) suggest that effective SBRs have prevailed in Mauritius for a long time, and can be traced back to the 18th and 19th centuries. Successful SBRs over the years can be explained by the willingness of both state and business to cohabitate for mutual benefit, even though the relationships between the parties have not always been very cordial. The two parties have believed in dialogue and sharing of ideas for effective SBRs. The essence was the presence of the considerable cooperation between the state and the market sector through two-way flow of relevant information and trust.

With the increase in Mauritius' trade, the Mauritian business community felt the need for a formal representational and arbitration framework to foster the interests of the trading community and to settle disputes and conflicts arising in trade-related activities. The private sector grouped themselves as early as 1850, more than a century before Mauritius got its independence from the British, and they established the Mauritius Chamber of Commerce and Industry (MCCI).

While economic development is left in the hands of the private sector, the state plays a major role in ensuring the welfare of the state and development-led investment facilitation. In fact, over the years, this relationship has been further strengthened, so much so that consultation between the public and the private sector, on issues that affect development, is an on-going process. While the public sector continues to maintain a high-level dialogue with the private sector on relaxing barriers to doing business, the private sector on its side plays an important role in improving the livelihood of citizens through its activities in relation to its corporate social responsibility.

South Africa

Nattrass and Seekings (2010) suggest that SBRs have been transformed in the post-apartheid period by corporate unbundling and the rise of Black Economic Empowerment but the growth path has remained fundamentally untransformed in that labour-market and industrial policies continue to support a high-wage, high-productivity economy. There appear to be strong continuities between the post-apartheid 'variety of capitalism' and its apartheid predecessor. By retaining, albeit in a deracialised form, the labour-market and welfare policies of the apartheid government, the post-apartheid state continues to foster social divisions between insiders (the employed) and a marginalised unemployed population.

The authors suggest that the political-economic origins of this outcome lie in the path-dependent character of the South African transition. Change was managed cautiously by the ANC, with care taken to avoid alienating the established business sector and organised labour. However this involved policy incoherence, where labour-market policy was implemented by a pro-union Ministry of Labour, and where more market oriented economic policies were implemented elsewhere. Despite the creation of NEDLAC and what appeared to be some impetus towards the construction of a broader national political accord, this institutional innovation failed to live up to its potential promise as a forum for the construction of an inclusive growth coalition.

The history of NEDLAC points to the reluctance of organised labour to make compromises, to conflict between different ministries, and to the growing disenchantment with NEDLAC on the part of big business. Both organised labour and big business preferred to engage with the state directly, rather than in a tripartite context.

This account shows the importance of politics and institutions in shaping SBRs and the necessity for strong government commitment and support in building growth coalitions with business and labour. Growth or development coalitions do not arise organically between labour and business – they are facilitated (or not as the case may be) by the state. So, the question then becomes: why did the post-apartheid government sideline NEDLAC and instead engage with business and labour in separate, less transparent bilateral deals? It was ultimately the weakness of the state which caused the sidelining of NEDLAC.

Ghana

The relationship between the state and the business community in Ghana has varied since independence. Though each government has had distinct relations with business and the private sector, civilian governments have generally promoted and enjoyed good rapport with the business community while military governments especially in the 1980s have tended to have confrontations with the private sector, because of their different political and ideological positions.

Table 3 – Summary of the evolution of SBRs in Ghana

Period	Political parties and institutionalised forms (examples) of SBRs	Examples of effects and functions of SBR set-ups
Pre-independence	Cocoa associations	Good relationship between colonial state and business community
Nkrumah	Socialist approach, state overwhelming, SBR by invitation; CPP 1952-1966	Existence of “CPP favoured businesses” (eg land for commercial farming) set against private enterprises
Busia	1966, NLC, PP 1969 constitution	Market oriented, but PP officials on boards of companies, some business maintained close association with ruling government
Acheampong	1972-1979, military, NRC, SMC , AFRC	Corruption and rent-seeking; political instability
Limann	1979, PNP	Little change
Rawlings	1982 - 1992, PNDC 1990-1992, PSAG (formal SBR institution), WB influenced 1992-2000, PSR under NDC	Non-functional BAs, state anti-private sector. No consultation with private sector. Main recommendations of PSAG implemented by government PSR no impact, but PEF good promoter of business
Kufuor (2001 -2008)	NPP, “Golden age of business” GIAC, since 20002	Participation of private sector in budgetary process through NPP; better knowledge on private sector (PSI) Formal institutions have little capacity to adapt to new roles and responsibilities

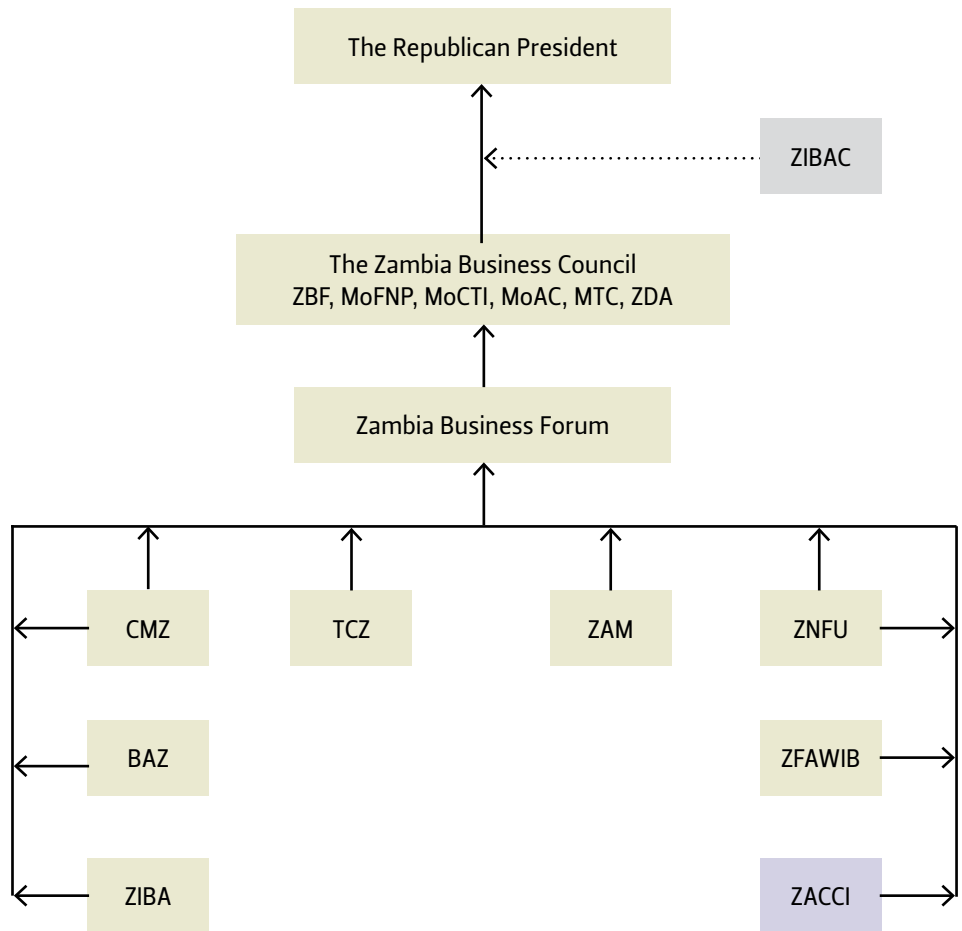
Source: based on information contained in Ackah *et al* (2010). For explanation of terms used see original paper.

However, much of the evidence also suggests that irrespective of formal institutions, informal ties were a key aspect of the evolution of SBRs in Ghana. Under Nkruma there were “CPP favoured businesses” (eg land for commercial farming) set against private enterprises; under Busia the SBRs were more market oriented, but PP officials were on boards of companies, and some businesses maintained close association with the ruling government; corruption and rent-seeking, and political instability was apparent under Acheampong; there were non-functional business associations under Rawlings; and under Kufuor, formal institutions had little capacity to adapt to new roles and responsibilities. It seems that informal ties between business and state have been crucial throughout. Nonetheless, the formalisation of SBRs has also taken place.

Zambia

During the last decade, and in particular during the tenure of office of the late President Mwanawasa, the government and the private sector agreed to initiate a more formalised consultative process where key government institutions and the private sector would have dialogue on key policy issues. The objective of the private consultation was to generate ideas and dialogue with government on institutional, regulatory and policy reforms that need to be undertaken to promote private sector development. There is now a large number of organisations involved in the conduct of SBRs (see figure 2)

Figure 2: The Structure of the Zambia Business Council



Source: Bwalya et al (2009). For explanation of terms used see original paper.

The analysis of the nature of SBRs indicates that although the President spearheaded the establishment of the Zambia Business Council to consolidate engagements with the private sector through the Zambia Business Forum, this institutional arrangement is not formalised and is not backed by any legal framework and has not been sufficiently institutionalised to guarantee continuity and effectiveness. The study suggests a Zambia Business Council formally reporting to the President through the Office of the Economic Advisor or directly to Parliament. There is also need to institutionalise this arrangement and organisational structures of the Zambia Business Council to ensure that it is more formally established with clear mandates and reporting channels. On the other hand, the Zambia Business Forum requires deeper reforms to enable it function more effectively as a cohesive and stable private sector organisation. This may in part require affiliated associations to coordinate their lobbying activities through the Zambia Business Forum. This will strengthen its lobbying efforts and ensure that the Forum speaks with one voice on issues of national policy.

Conclusion

SBRs evolve differently over time in different countries, depending largely on the degree and forms of organised power and political orientations which key state and private sector organisations bring to the relationship. Mauritius provided an example where the state and business have worked together for mutual benefit since the 18th century with key private sector organisations being formalised in 1850; the good relationship is continuing until today. By contrast, whilst there has been a multitude of organisations conducting SBRs in Zambia, it is still lacking a formal Zambia Business Council. In Ghana there are increasingly more formalised organisations, but informal ties and networks still prevail. Finally, in South Africa there has been a long tradition of (informal) collaboration between big business and the state. The NEDLAC, a formal body to bring together business, labour and the state, failed to live up to its promises; state ministers began to sideline NEDLAC so that it lost its convening and co-ordinating powers.

5 Measurement of SBRs

In order to measure SBRs and assess their importance for economic performance, one needs to determine the key factors behind SBRs. The 'economics of SBRs guide' discusses the measurement issues. It suggested that the literature on measurement of state-business relations (institutional side) was seen as weakly developed (and some maintain measuring a relationship cannot be done) and suggested that new measures need to be created to reflect the characteristics of good SBRs (Te Velde, 2006).

In order to obtain credibility and reciprocity we suggest that both the 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. Four factors make for effective state-business relations:

1. the way in which the private sector is organised vis-à-vis the public sector
2. the way in which 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.

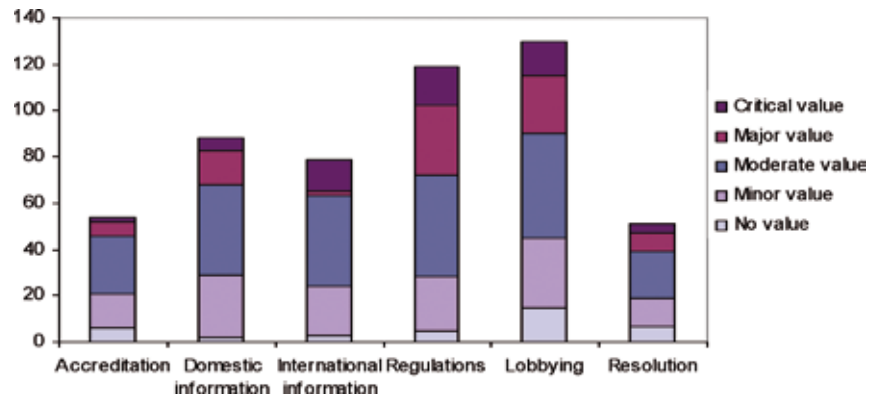
There are visible aspects of state-business relations which can be measured (see Sen and Te Velde, 2009). Some would argue that less visible informal aspects are equally if not more important. Trust, for instance, is not always dependent on contracts or visible enforcement mechanisms. This we acknowledge. However, we argue that the above visible aspects are important, and that while 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. Hence, the case studies such as Mauritius, Zambia and Ghana focused on understanding the effects of the measurable and formal aspects of SBRs. The guide provided more information on macro and micro measurement issues

One indicator associated with good SBRs is an organised private sector, which is measurable at micro level as membership. We can be more specific. Business associations provide different services and the World Bank questionnaire asks firms which services are found to be the most important: accreditation; provision of domestic information; provision of information on international markets; provision of information of government regulations; lobbying government; provision of support for conflict resolution.

In the case of Zambia, 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 (figure 3). The least important services are resolution of disputes (with officials, workers, or other firms) and accrediting standards or quality of products. The research also shows that business membership varies by sector and firm size; but all sectors and sizes are covered. The fact that firms perceive a high value in the services provided suggests that business associations provide useful economic functions leading to better performance.

Figure 3: Value of services by business associations to firms in Zambia



Source: Qureshi and Te Velde (2007) based on World Bank Enterprise Surveys.

Mauritius

The Mauritius case study used three measures of SBRs at the macro level.

The first measure uses an average indicator proposed by Sen and te Velde (2007)⁵ (which is based in part on the presence and length of existence of the umbrella organisations linking businesses and associations together). This idea is that the longer the membership of firms in the umbrella organisation, the greater the maturity and the higher the level of collaboration.

A second measure is the number of firms which are members of the umbrella organisation as a ratio of 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. However two constraints can be found: first, like SBR 1, it is an input indicator and, second, a mature SBR relationship is not based on confrontation but rather on dialogue and understanding of each party's position.

⁵ Sen and te Velde's (2009) index of SBRs measures the cooperation of the public and private sector and includes the following elements i) open to all and autonomous of government intervention as is the case with a formal existing body ii) an informal 'suggestive' body with no entrenched power iii) how the state interacts with business is based on the format, frequency, and existence of state-business relations and iv) on the presence and length of existence of laws protecting business practices and competition measures the mechanisms to avoid collusive behaviour.

The third indicator, unlike the other two SBR indicators, is output based, and captures the effectiveness of the umbrella organisation in its demands. This index measures the percentage of the different demands of the umbrella organisation, that have been addressed, in full or partially, during the budget presentation of the Chancellor or equivalent.

Zambia

The Zambian case study measures one specific economic function of SBRs: whether businesses have been effective in getting their proposals on tax policy into the budget (see table 4).

Table 4 : Effectiveness of lobbying by interest group

Interest groups	Number of Submission (a)	Total no. of proposals (b)	No of successful proposals (c)	Average proposals per institution $d=b/a$	Success rate (%) $e=c/b$
Business and professional associations	11	134	12	12.2	1.5
Companies	16	40	3	2.5	7.5
Government	8	55	12	6.9	21.8
Religious Group(s)	1	10	8	10.0	80.0
Individuals	3	10	0	3.3	0
Total	42	249	36	5.9	14.5

Source: Bwalya et al (2009)

Ghana

The Ghana case study uses several elements of the institutional and policy environment (i.e. the investment climate) in Ghana as proxies for effective SBRs at the firm level. In the presence of market and state failures, socio-political networks play a very critical role in the ability of businesses to overcome red tape and other constraints. One important measure is to use the extent to which firms or their managers have close contacts within the government or bureaucracy. The World Bank RPED data (Regional Program on Enterprise Development) includes questions on social networks, providing information on each firm's social connectedness within the government or bureaucracy. The Ghana study used this information to test whether productivity rates are higher among those firms who are better socially or politically connected and have 'friends' in government. Since political networks appear to be particularly important for firms we focus on the way such networks affect the productivity of firms.

Conclusions

Sen and Te Velde (2009), and Qureshi and Te Velde (2007) measured SBRs at macro and micro level. The country case studies improved on this in two main aspects. First, they provided a better macro measure based on outcome or economic functions of SBRs (the extent to which the budget takes on proposals put forward by the private sector). The Zambia and Mauritius study used different methods for this. Secondly, they provided a different micro measure taking into account that firms use informal networks (Ghana study) as well as their formal business associations.

6 Economic functions of SBRs

The Mauritius and Zambia case studies focused on the budget allocation function of effective state-business relations.

Mauritius

The Mauritius study examined the extent to which the Joint Economic Council (JEC) is successful in working with government on budget proposals. Private sector demands are formally sent to the Government, through the apex body, the Joint Economic Council (JEC). Although the JEC meets the Ministry of Finance and other line ministries and the Prime Minister frequently, it has been assumed that all their proposals for policy changes are manifested in their document that is sent to the Ministry of Finance just before the budget, each year.

The private sector institutions are well organised and structured so that proposals from the private sector on policy changes that do not appear in their pre-budget proposal document are insignificant. The index of success of the JEC has been constructed based on the extent to which individual proposals have been taken into account by the Ministry of Finance in the immediate budget. Scores have been assigned based on the study's perception as to whether the proposal has been fully accepted, partially accepted, or not accepted at all.

For each fully implemented proposal, a score of one has been assigned. For each proposal rejected, a score of zero has been assigned. And for each proposal partially included in the budget, a score of 0.5 has been assigned. Then the score for each year is the ratio of the summation of the scores obtained divided by the total number of proposals made during that year. Table 5 presents the data for the year 2007-2008. Out of eight main budget proposals, three were fully implemented, two were partially included in the Budget and three were completely excluded. Thus for this year, the aggregate score is 4 (i.e. $3 \cdot 1 + 2 \cdot 0.5$) and thus SBR ratio for this year is 0.5 (4/8). This exercise has been conducted for a period of 38 years, (i.e. 1970 to 2008).

Table 5 Budget proposals of JEC (2006/2007) and implementation status

	Fully	Describe/ measure	Economic functions
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 2008/2009 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: Rojide et al (2010)

Zambia

The Zambia case study examined whether the current budget process provides adequate scope for productive engagement of non-state organizations in formulating the national budget. Firstly, analysis of registration data has revealed significant growth in the number of interest groups, including business and civil society organisations formed following political and economic liberalisation in 1991. This suggests an increasing interest of non-state actors to actively participate in the political and economic governance of the country. Secondly, analysis of tax and expenditure proposals submitted to government through the Ministry of Finance and National Planning have also increased, reaching 42 submissions containing 249 different proposals. The study finds that most of these proposals did influence tax policy and budget outcomes - a key economic function of effective SBRs - and those submitted through line government ministries, departments and agencies have a greater chance of being adopted in the budget than those submitted directly to the tax policy committee in the Ministry of Finance and National Planning, unless these are competently presented and justified. This means that the organizational and professional capacity to articulate policy proposals is important in influencing fiscal policy decision-making, but other political and institutional factors also come into play.

Conclusion

Using different methods and mechanisms, the Mauritius and Zambia case studies show how effective SBRs fulfil economic functions such as informing and affecting the budget through transparent and democratic means.

7 Identifying the effect of SBRs on economic performance

The identification of the effects of certain types of SBRs on economic performance is challenging because of at least three issues: translating the role of economic functions into testable hypotheses; challenges in measuring SBRs; and econometric issues such as potential endogeneity of SBRs to economic performance and the specification of economic performance (e.g. how is productivity measured).

Two econometric methods have been used to try to address these issues.

Econometrics: Macro level.

Building on the modelling approach introduced in Te Velde (2006) and Sen and Te Velde (2009), the Mauritius case study undertook the following steps: Tabulate SBR measures, assemble data on economic performance (e.g. growth or productivity), formulate a testable model and address dynamics and endogeneity issues.

The case study used a number, including a particularly innovative measure of SBRs in a rigorous dynamic time series analysis through a VAR / VECM framework which addresses the dynamic and endogeneity issues in growth modelling. The results show that SBRs have a positive and significant effect on output in Mauritius in the long run with an implied elasticity of 0.18. Private capital is the most important factor followed by openness and the quality of labour. The results also apply to the short run. Moreover the paper suggests it is important to include a dynamic specification in growth modelling. SBRs also appear to have an indirect effect on output in the short-run via 'the private capital channel'.

Econometrics: Micro level.

The Ghana case study estimated an equation explaining total factor productivity (TFP) through standard variables as well as measures of networks. In these equations, the variable Network-civil servants has a positive and significant coefficient, suggesting that having strong ties with public officials is indeed important for the productivity of firms in Ghana, probably more so for firms who tend to face the severest of investment climate constraints to their operations and growth. These results indicate that firms which are overregulated as illustrated by rampant 'unfriendly' changes in government regulations pertaining to their operations have a lower level of TFP than firms which

are not overregulated, while firms with many 'friends' in government will have a higher level of TFP. Being well connected with those who make and implement government policy increases the chances of being able to lobby to overcome some of the difficulties confronting normal business enterprises, such as unnecessary red tape, the number of procedures it takes to obtain licenses and permits and the number of days it takes to clear imported goods from the port. Given the prevalent market and government failures in many sectors, it appears making friends with government bureaucrats may represent a strategic firm response to the difficulties in doing business in Ghana.

8 Reviewing the econometric evidence

Having presented the results of phase 2 research, it is also important to review the econometric evidence on the basis of three questions.

Are the underlying economic models based on sound economic theory?

The African case studies (Ghana, Mauritius and Zambia) are all based on the notion that there are market and co-ordination failures which the economic functions of effective SBRs address in theory. Whilst this is a sound theoretical basis (and also used e.g. by Doner and Schneider, 2000, for their examination of business associations), the underlying theory might be more formalised to explain the underlying economic functions (e.g. Dixit and Pindyck, 1994; Rodrik, 1996). This could be a topic for further research.

Are the econometric methods and measurement issues sound?

The econometric studies in the SBR cluster use up to date econometric methods such as IV (instrumental variables), GMM (general methods of moments), VAR modelling (macro – such as in Mauritius) and the Levinsohn-Petrin technique (as in Zambia, Qureshi and Te Velde, 2007) at the micro level. It should be noted that the testing of the economic models relies on the measurement of the economic functions whereas in reality we measure the forms of institutions – this is a common problem in the literature on institutions and growth. In fact, the studies in this cluster have begun to measure some economic functions such as the effects of the SBRs through budgetary processes which present a significant step forward in the literature.

What do the case studies say about causality between state business relations?

The studies in the SBR cluster have addressed causality issues (that institutions and growth can affect each other both ways) in several ways. Following the structural approach, SBRs

studies are based on a sound underlying model which provides a plausible underpinning of the effects of SBRs. Statistically, a quick look at the data suggests that institutional change often occurred before improved growth performance; the econometric techniques used (VECM in Rojid et al, 2010) address endogeneity issues through the use of systems of equations and time lags. The African research did not use IV estimation apart from the GMM estimator used by Sen and Te Velde (2009). The results are often backed up by survey evidence, suggesting that firms report that business associations perform useful functions (Qureshi and Te Velde, 2007). This is in line with Doner and Schneider (2000), as mentioned in the introduction. 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.

9 Conclusions

This synthesis of the four African case studies in phase 2 of the research has reached a number of conclusions.

One headline message is that formalised SBRs do matter. For example, the Joint Economic Council is an influential private sector actor in SBRs in Mauritius; measured SBR leads to higher growth in a regression over 1970-2005. For example, budget proposals which include suggestions for better industrial policies are frequently taken over by government budgets. However, effective formalised SBRs cannot simply be put in place. The South Africa case study found that NEDLAC did not provide a real consensus seeking forum, due to defections by key labour organisations from the Council and differences of approach and priorities amongst key state organisations (Treasury and Ministry of Labour), despite some early success in industrial policy.

Formal consultative fora do perform useful functions helping business at macro level. The Zambia case study (Bwalya et al, 2009) 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 NGOs.

Beyond formal SBRs, there are informal SBRs. In Ghana (Ackah et al. 2010) show 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 (Qureshi and Te Velde, 2007), business membership leads to better firm performance by reducing policy uncertainty and lobbying, but individual lobbying remains important.

The studies have a number of take away messages. For academics, the case studies provided new ways (methods and methodologies) of examining growth by including SBRs (empirical examinations rooted in theory). For government policy makers, whilst it is known that informal networks matter, 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); SMEs feel underrepresented in meetings with business. And for donor agencies, it is important to consider SBRs in advice and in governance indices.

Finally, we return to the three working hypotheses for the research. The first hypothesis was whether it is possible to identify growth enhancing characteristics and functions of SBRs. This can be answered affirmatively as we have found several examples of economic functions, such as influencing the allocation of resources through the budget process. However, this does not mean that all SBRs are effective and further empirical research is required for specific circumstances.

Second, it is possible to identify what drives effective SBRs. The short answer is politics (i.e. the way power is shared amongst actors), but a longer answer is that historical patterns matter. For example, the institutionalised nature of state-business relations in Mauritius is rooted in decades and centuries of “cohabitation” between state and business actors. A formalised SBR worked. In South Africa, it was clear that the lack of the political will by the state and, later, business led to a sidelining of the official body for SBRs.

Finally, we hypothesised that it is possible to inform policy makers about effective SBRs. This is the most difficult hypothesis to discuss. On the one hand we have identified growth enhancing effects of SBRs, but on the other hand we have not identified very specific drivers of SBRs which can also be facilitated by external actors. For example, how can trust be enhanced?

Despite such difficulties we think the following donor/policy implications are important:

- Build capacity with actors to conduct SBRs. For example, business and other actors are 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 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), and 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, or Ghanaian industry). The purpose would be to identify possible problems which could be solved by the players themselves.

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Appendix A: Political functions of SBRs

The political processes through which effective SBRs (and their various forms) are established represent one of the mediums through which ‘political settlements’ occur. ‘Political settlements’ are not exclusively about formalised political relations and agreements in respect of the constitutional distribution of authorised political power. ‘Political settlements’ which work to establish the platforms from which formal institutional arrangements can develop usually include what might be termed ‘economic settlements’; that is, broad agreements about the rights and responsibilities of the private sector vis a vis the state, and about the extent to which the state may regulate or control the private sector, as well as agreements about the individual rights and responsibilities of citizens in relation to the state in a much broader sense.

The concept of ‘political settlement’ should however not be understood to mean a single event – though it might start with that – but an on-going process of political negotiation between states, businesses and many other organisations and citizens in the wider society. Though SBRs can take many forms, the establishment of effective SBRs – where there is trust, transparency, credibility and reciprocity – requires just such an on-going political bargaining between representative and authoritative actors and organisations in both the private and public sectors. Where these relations are established, consolidated and have the means – formal or informal – for review, reform and renewal, they also contribute to one of the key dimensions of building or stabilising effective states.

The modern state consists of a set of public institutions and organisations that together define and implement not only the legitimate use, control and distribution of power (and coercion) over a given sovereign territory and people, but also the use and distribution of resources. Establishing effective SBRs therefore means forging the broad agreements that underpin the institutions which shape the economic behaviour, rights and obligations of the private sector. Thus while the economic functions of effective SBRs can be shown to have positive growth effects, they also constitute an important political function in that they represent one key pillar in the formation and maintenance of stable and effective states.



When the state and business interact effectively – avoiding capture, collusion or predation – they can promote a more efficient allocation of scarce resources, negotiate appropriate industrial policy and bring about a more effective and prioritised removal of key obstacles to growth.

The characteristics of effective state business relations are trust, transparency, credibility and reciprocity. Recent econometric analysis of state-business relations in Africa, as reported in this publication, shows that where effective state-business relations are established – either through formal or informal institutional patterns and relationships – the growth effects are generally positive.

But forming such institutions of cooperation and credibility cannot be had to order and is not a simple matter of administration or pragmatism. Establishing, sustaining and renewing effective state-business relations are political processes. And the better organized the business community and the government are for purposes of such relations, the more effective state-business relations will be in negotiating growth enhancing policies.

Where these relations are established, consolidated and have the means – formal or informal – for review, reform and renewal, they also contribute to one of the key dimensions of building or stabilising effective states.

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