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.

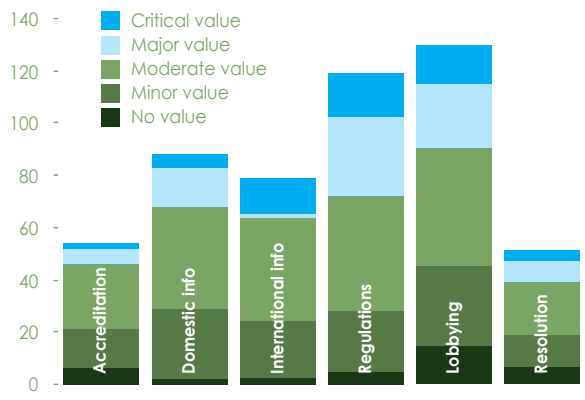
Doner and Schneider suggested that 'This institutional strength depends in turn on high member density, valuable selective benefits (often delegated by governments), and effective internal mediation of member interests. In addition external factors, especially competitive markets and government pressure,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

Doner, R.F and Schneider, M.R. (2000) 'Business Associations and Economic Development: Why Some Associations Contribute More than Others.' Business and Politics 2(3): 261-288.

Olson, M. (1982) The Rise and Decline of Nations. New Haven, CT: Yale University Press.

Rojid, S., Seetanah, B., Shalini, R. and Te Velde, D.W. (2009) 'State-Business Relations and Economic Growth in Mauritius.' Journal of International Business and Economics http://findarticles.com/p/articles/mi_6775/is_2_9/ai_n39315038/.

Sen, K. and Te Velde, D.W. (2009) 'State-Business Relations and Economic Growth in Sub-Saharan Africa.' Journal of Development Studies 45(8): 1-17.

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