

The Global Financial Crisis and Institutions: The Evolving Role of State Business Relations

The global financial crisis will have a major effect on developing country economies. Last month's news that Chinese trade shrank for the first time since 2001, and that India's industrial output fell for the first time since 1994, will have dispelled any remaining hopes that developing countries would be insulated from the global financial crisis. Forecasts for 2009 suggest that developing countries will grow by at least 2 percentage points less than originally thought. This IPPG Briefing Note considers whether this global economic shock will have implications for the way state-business relations (SBRs) operate: in short what institutional implications the crisis will have.

IPPG research on state-business relations has focused on two crucial aspects. First, how are effective SBRs formed and maintained? Second, what are the effects of different types of state-business relations? The current global financial crisis is likely to lead to new insights into the determinants of SBRs, but it might also reveal other insights about whether and how certain types of SBRs are more flexible and better placed to respond to the crisis.

There are at least two hypotheses about the relationship between the crisis and SBRs. Slower growth might slow down institutionalisation because – as proponents of this view argue – good institutions are only formed when incomes are high. Alternatively, a shock of this proportion opens up new opportunities which constitute a critical juncture, shifting the nature and focus of SBRs, which are otherwise slow-moving. The current global financial crisis may provide an ideal testing ground.

The concept of the 'critical juncture' is used to identify moments when institutional innovation or change may be initiated or, at least, which create the opportunity for it to occur. Clearly, contingent events do occur which call into question existing institutional arrangements or allow the chance for them to be changed.

Some critical junctures may be internal, such as the onset of democratisation after a long spell of authoritarian rule. Revolutions – directly aimed at complete institutional change – are also obvious examples, as are coups d'état. Some

junctures may be external in origin and impact. They could be political, for example the collapse of the Soviet Union and the 'end' of communism in Eastern Europe which had far reaching effects on international and national institutional patterns in both politics and economics. But, equally, they could be economic. The eruption of the global financial crisis is another juncture, as it is likely to fundamentally change the rules and regulatory apparatus governing the financial sector, as well as the way state and business relate for some time to come. Other economic junctures include a sustained collapse in price of a major export commodity as economic and political elites decide to develop new institutional relations and initiate new policies and programmes. Do rapid changes in copper prices change the nature of state-business relations in Zambian mining? Or is it back to business as usual after variations in prices?

So what is happening in practice? State-business relations are clearly in flux in some countries. Most visibly in the UK, the public sector has taken over banks, forcing them to lend to SMEs. In India, the government has been reluctant to act on the recommendations of the Committee on Financial Sector Reforms chaired by the ex-Chief Economist of the IMF, Raghuram Rajan, which includes the privatisation of small public sector banks. There is now a shared belief that (financial) markets can also fail. Hence there will be an increased emphasis on how relationships between state-business and regulators will work. There are also new initiatives in developing countries. For instance, the current crisis has led to a sub-commission of NEDLAC (the formal SBR in South Africa). Ghana also set up a commission to monitor the impact of the crisis.

In other countries, organisations which embody the formal institutionalised arrangements for SBRs, such as the JEC in Mauritius, have put out policy statements to support new measures to address the fall-out of the crisis. This also raises the question as to what type of SBRs can best respond to the global financial crisis, and the answer may well point towards those that are most institutionalised.

However, it is also important to note that the crisis may challenge and even undermine the implicit bargains that form the foundation for specific SBRs. Thus, in South Africa for example, 'Black Economic Empowerment' (BEE) requirements have wrought fundamental changes in the composition of the capitalist class and in the way that the state structures its support for business. Business has had to comply with BEE codes (notably racial quotas in employment and ownership) to benefit from government procurement contracts and various supportive policies. The agenda has been facilitated by the long economic boom which gave existing firms the space they needed to accommodate the increased costs of doing business. Similarly, beneficiaries could rely on rising share prices to cover any debts incurred in obtaining equity. With falling share prices and falling demand, the economic conditions do not bode well for this particular transformative SBR.

In short, the global financial crisis may well turn out to be a critical juncture with implications for the evolution of institutions governing state-business relations. There are already some signs that new formal structures are beginning to contemplate responses to the crisis which

include radical solutions. However, it is not clear whether these structures are also supported by changes in underlying informal institutions. The jury is out, but the SBR cluster of IPPG is hoping to shed new light on this, to understand whether the current global financial crisis will indeed turn out to be the critical juncture for change that can lead to better state business relations. It may be too soon for the evidence to be available, but the question needs to be explored.

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