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STATE-BUSINESS RELATIONS, INVESTMENT CLIMATE REFORM AND ECONOMIC PERFORMANCE IN SUB-SAHARAN AFRICA^B

Researchers have long examined the factors that contribute to economic growth. The new challenge that this briefing addresses is to examine how state-business relations (SBR) affect economic performance in sub-Saharan Africa. Critics would contend that this is an impossible task because such relations are intangible and immeasurable and it would be difficult to assess the effects. While we do acknowledge that some informal aspects of SBRs will be difficult to measure, new research (listed in box 1) suggests that it is possible to identify and measure key factors behind effective SBRs conducive to growth in Africa, but more needs to be done.

The context for SBR research in Africa is rich, diverse and dynamic. Some countries have long had official relations separating state and business, while in other countries the relations are difficult and based on mistrust. There are several countries where a significant part of business are owned by the state. In some countries there is an institutionalised form of state-business relations, see e.g. box 2 on Mauritius and South Africa, while in other countries, such as Malawi, the state and business were brought together through a facilitated forum. There is a well developed entrepreneurial business sector in some countries, whilst in others this is largely absent. Nearly all African countries have seen an improvement in the factors associated with good SBRs. Growth has

Box 1: Papers on State-Business Relations reviewed in this paper:

- 'Measuring State-Business Relations in sub-Saharan Africa' (Dirk Willem te Velde) (<http://www.ippg.org.uk/PDF/State-business%204.pdf>)
 - 'Whither business regulation? Institutions and private sector development' (Dirk Willem te Velde) (<http://www.ippg.org.uk/PDF/Whither%20business%205.pdf>)
 - 'State Business Relations and economic performance in sub-Saharan Africa' (Kunal Sen and Dirk Willem te Velde, draft IPPG paper)
 - 'State Business Relations and firm performance in Zambia' (Mahvash Qureshi and Dirk Willem te Velde) (IPPG paper, see <http://www.ippg.org.uk/PDF/Firm%20Performance%20Zambia%205.pdf>)
 - State-Business Relations, Investment Climate Reform and Firm productivity in Sub-Saharan Africa' (Dirk Willem te Velde and Mahvash Qureshi) (Forthcoming IPPG paper)
- Source: www.ippg.org

also improved markedly since the mid 1990s, so it would be informative to see whether and how SBRs have facilitated economic performance, in addition to other, standard drivers of growth.

There are several unresolved issues in research on SBR. There is no single definition of SBRs

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Box 2 Two African examples of formalised state-business relations

The JEC (Joint Economic Council) in Mauritius and NEDLAC (National Economic Development and Labour Council, since 1994) in South Africa are two examples of the most developed and institutionalised SBRs in sub-Saharan Africa. The primary institution for state-business relations in Mauritius is the Joint Economic Council (JEC, 1970). The JEC meets with the prime minister on a regular basis and participates in budget proposals. The JEC of Mauritius is funded entirely by its members, which include: Mauritius Chamber of Commerce and Industry, Mauritius Chamber of Agriculture, Mauritius Employers' Federation, Mauritius Sugar Producers' Association, Mauritius Export Processing Zone Association, Mauritius Bankers' Association, Mauritius Insurers' Association, Association des Hôteliers et Restaurateurs de l'île Maurice, Association of Mauritian Manufacturers. The Joint Economic Council is managed by a Council of 18 members, with a Chairman who rotates every two years and a full-time Director. As of 1999, the JEC's top goals are to ensure a stable macro economic environment, foster greater fiscal discipline, restore financial health, and integrate all sectors of the economy in order to reduce distortions and improve efficiency of investment.

The NEDLAC has four constituencies that meet to discuss and form consensus on social and economic policy:

- 1) The Government: Departments of Labour, Finance, Public Works and Trade and Industry.
- 2) Organised Business: Under the umbrella of Business South Africa (BSA) and the National African Federated Chamber of Commerce (Nafcoc).
- 3) Organised Labour: Under the umbrella of the Congress of South African Trade Unions (Cosatu), the National Council of Trade Unions (Nactu) and the Federation of Unions in South Africa (Fedusa).
- 4) The Community: South African Youth Council, National Women's Coalition, South African National Civics Organisation, Disabled People of South Africa, and the National Cooperatives Association of South Africa.

All agreements and findings under NEDLAC are made public and tabled in Parliament. The NEDLAC Annual Summit brings together delegates representing over 300 constituencies.

which makes the topic more difficult to navigate. But questions of substance relate to how state-business relations are formed, what different forms they take, whether the essence of SBRs can be measured, whether SBRs can have measurable effects at micro and macro level, and whether different forms or functions of SBRs have different effects on performance. This briefing summaries ongoing research on the factors associated with effective SBRs, how SBRs can be measured, what the effects of SBRs are and concludes with some implications.

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What factors are associated with effective state business relations?

Effective SBRs can provide address both market and co-ordination failures. Good SBRs are based on a benign collaboration between business and the state 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.

In order to measure SBRs and assess its importance for economic performance, we need to determine the key factors behind SBRs. In order to obtain credibility and reciprocity we suggest both the public and private sectors need to be organised or institutionalised. Positive mechanisms for transparency require rules and institutions that bring the state and business together.

The following four factors are suggested to 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.

Visible aspects of state-business relations can be measured. 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 visible aspects are important in their own right, and that the informal aspects may influence the links between measurable aspects of SBRs and performance but not in such a systematic way that there is no link between formal SBRs and growth. Hence, our hypothesis is on understanding the effects of the measurable aspects of SBRs.

Measuring state-business relations

Measuring SBRs at the country (or state) level involves the measurement of the four factors identified above. The measurement of the role of

the private sector in state-business relations is based on the presence and length of existence of an umbrella organisation linking businesses and associations together. The measurement of the private sector in state-business relations is based on the presence and length of existence of an investment promotion agency (IPA) to promote business (it is often process leading up to this rather than the act that might be important). Effective SBRs requires the cooperation of the public and private sector, and we examine a number of factors. This mechanism can come in a number of different forms: it can be open to all and autonomous of government intervention as is the case with a formal existing body, or it can be an informal 'suggestive' body with no entrenched power. The measurement of how the state interacts with business is based on the format, frequency, and existence of state-business relations. Finally, the presence and length of existence and effectiveness of laws protecting business practices and competition measures the mechanisms to avoid collusive behaviour.

Measuring at the macro level. Each of the four factors above can be measured for a number of African countries over time. In our background research, we focused on 20 African countries for which we have data on each of the four indicators. This leads to four, time-varying indicators per country. In order to obtain a composite measure, we take the average of the above indicators (attaching the same weight to each indicator). A background paper shows the raw data for country-specific averages. Chart 1 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 have grown faster. Of course, appropriate

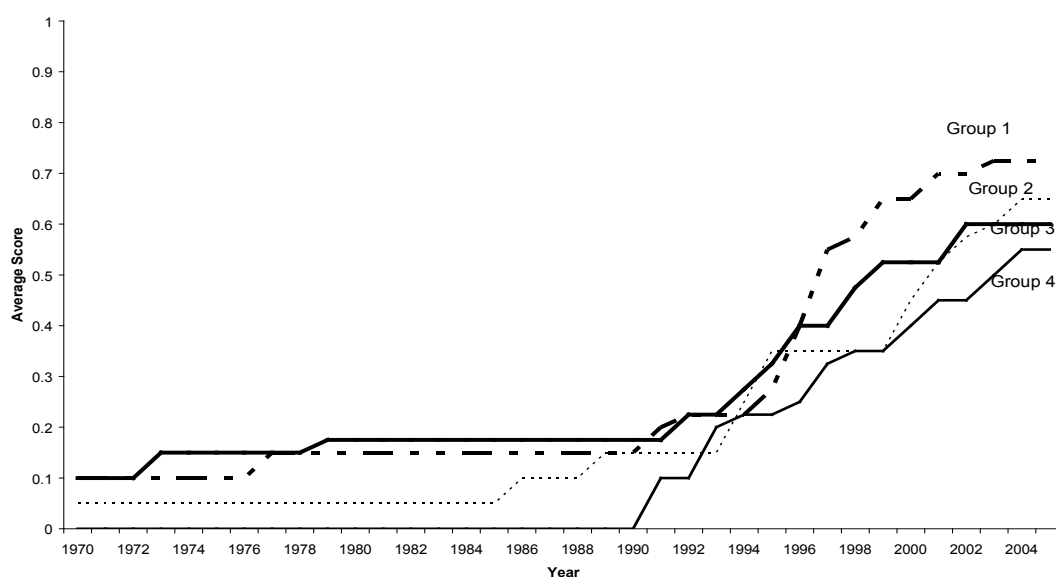


Chart 1: Higher SBR scores for groups of faster growing countries

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

Source: 'Measuring State-Business Relations in sub-Saharan Africa'.

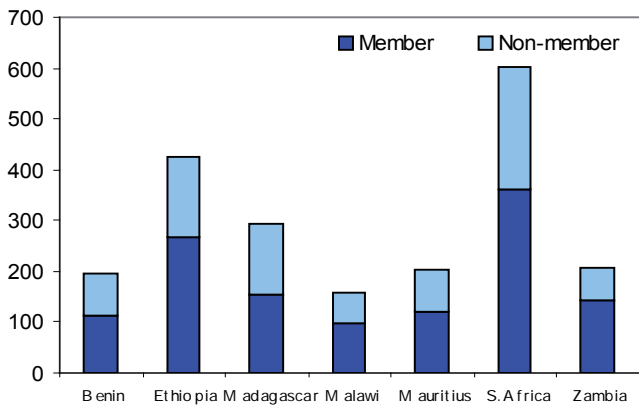


Chart 2: Private sector organisations membership across African countries

Source: World Bank Enterprise Surveys and 'State-Business Relations, Investment Climate Reform and Firm productivity in Sub-Saharan Africa'.

regressions with appropriate explanatory variables are required to establish the robustness of this initial finding.

Measuring at the micro level. There are also indicators of state-business relations at the micro level. One indicator associated with good SBRs is an organised private sector, which is measurable at micro level as firm membership of business associations. Chart 2 shows firms that are members of business associations across 7 African countries.

Business associations provide different services. The World Bank investment climate questionnaire asks firms which services are perceived to be most important. 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 (Chart 3). The least important services are resolution of disputes (with officials, workers, or other firms) and accrediting standards or quality of products. Research also shows that business membership varies by sector and firm size; but all sectors and sized are covered to some extent.

How do good state-business relations affect development?

Effective state-business relations or public-private sector dialogue are important determinants of economic growth at the macro-level. State-business relations affect growth through a number of routes, which apply at both the macro and micro level. First they can help to solve information related market and co-ordination failures in areas such as skill development or infrastructure provision. For instance, business associations or government departments may co-ordinate dispersed information amongst stakeholders.

Secondly, SBRs provide a check and balance function on government policies and tax and expenditure plans. Thus 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 action 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 and rules and regulations might be achieved through policy advocacy which could reduce the costs and risks faced by firms and enhance productivity.

Finally, 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

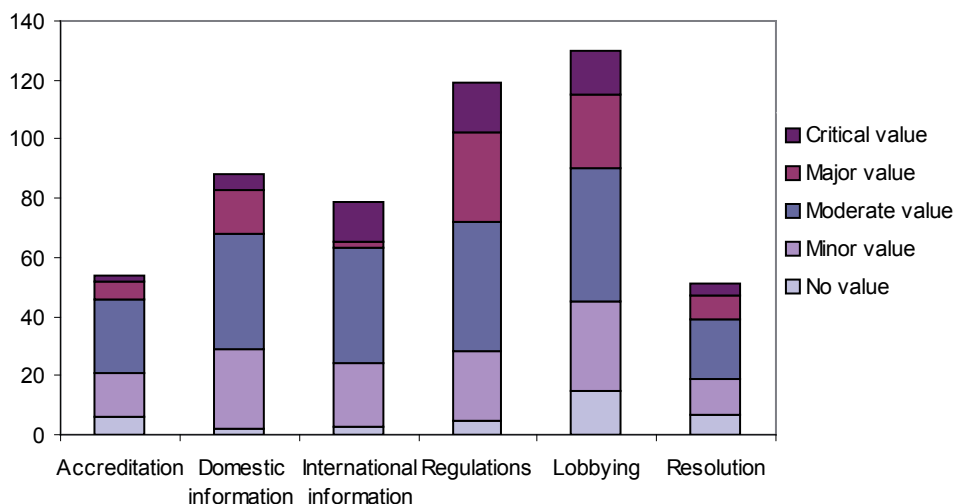


Chart 3: Value of services by business associations to firms in Zambia

Source: World Bank Enterprise Surveys: Ethiopia, South Africa and Zambia and 'State-Business Relations, Investment Climate Reform and Firm productivity in Sub-Saharan Africa'.

available. Businesses that have a better relation with government may be able to anticipate policy decisions and make investment plans more efficiently.

New evidence on the effects of state-business relations in Africa

Macro level While the importance of SBRs has been acknowledged in the context of SSA, it has not been discussed extensively in the literature on economic growth and its effect has never been quantified. New research has begun to quantify the effects of effective state-business relations. The macro paper (Sen, Te Velde) uses the index developed on the basis of measuring SBR (as detailed above) and estimates standard growth regressions in dynamic panel form for 20 African countries over the period 1970-2004, controlling for more conventionally used measures of institutional quality in the empirical literature. The results, based on GMM and fixed effects estimators, show that effective state-business relationships contribute significantly to economic growth in Sub-Saharan Africa – countries which have shown improvements in state-business relationships have witnessed higher economic growth, controlling for other determinants of economic growth. The index of SBRs has advanced significantly and began to improve before the pick up in growth (though different conditions applied in different countries).

Micro level The micro-level studies (Qureshi, Te Velde) follow a two-stage approach. In the first stage it estimates a production function on the basis of firms in a country, explaining production value added as a function of capital and labour. The estimation procedure uses the Levinsohn-Petrin technique to account for endogeneity of the error term and factor inputs labour and capital. In this respect, the data set is rich as we can exploit the fact that there are often three years worth of firm performance data as well as variables such as material input costs that can be used instruments. In the second stage, we estimate a total factor productivity equation,

where productivity is taken from the residuals in the first stage.

The micro level regressions for Zambia used the enterprise survey data of the World Bank Group for around 200 firms with data on performance and productivity and on the institutional context facing or perceived by firms. It finds that membership of a business association enhances Zambian firm performance in the form of productivity improvements in the range of 37 to 41 percent. This finding is robust to including other variables. Further, joining a business association is particularly useful for small and medium sized firms. Finally, the results supported the view that foreign owned firms lobby the government more effectively than their Zambian counterparts.

Subsequent work used the enterprise survey data of the World Bank Group for seven African countries, independently as well as in a panel of African firms (allowing for country and sector specific effects). The results show that being a member of a business association improves firm performance in the form of total factor productivity improvements on average between 25 to 35 percent. This finding is robust to including other variables that are commonly used to describe the investment climate, and robust to using estimates of productivity that account for endogeneity problems. The questionnaire suggests that firms perceive there to be value from being part of a business association suggesting that the causation runs from joining to firm performance.

Detailed findings in Table 1 show that the effectiveness of business association works primarily through solving of information related market and coordination failures and lobbying government. The findings confirm that the perceived value of services provided by the business association is in line with the estimated effects. The more important a services is perceived the more important is its estimated effect. Thus, business associations affect firm performance by reducing policy uncertainty and by lobbying government over regulations.

Membership of business associations can also work though its effect on business climate

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

Table 1: Effects of different services of business associations on productivity

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

Source: 'State-Business Relations, Investment Climate Reform and Firm productivity in Sub-Saharan Africa'.

indicators. For instance, we found that business association membership decreases the size of informal payments by individual firms and improves other investment climate indicators. Finally, membership also increases labour productivity so that positive productivity effects are at least in part captured by labour; most of these benefits are going to the skilled workers providing positive dynamic incentives throughout the economy.

Linking micro and macro. The micro level evidence for the 7 African countries reveals that there are significant differences in the effects of membership across countries, ranging from highly significant and positive in Mauritius and Ethiopia to insignificant in Benin and Madagascar, with effects positive and significant in Malawi and Zambia.

Importantly, when we compare the estimated coefficients for membership with the overall SBR scores computed for these seven countries as detailed above, we estimate the correlation coefficient to be 0.55, see Chart 4. This suggests that there is a strong link between the advancement of visible aspects of SBRs at the macro level (SBR country measure) and the effects on firm performance at the micro level. In general, the effects of SBRs are more pronounced in countries that have strong institutional set-ups to support and conduct effective SBRs.

Conclusions and implications

This new and ongoing research on understanding the key characteristics and effects of SBRs is challenging and is yielding preliminary, but interesting, insights and implications:

- SBRs can be measured at micro and macro level.
- We can already sketch out some ways through which SBRs affect economic performance theoretically and empirically, but *much more needs to be done*.

Conceptually, it is important to test the boundaries of what can be measured in terms

of state-business relations. In part this is about what can be measured per se, and in part about data collection on what can be measured. It is important to test the effects of the measurable aspects of SBRs; we suggested that as a very general conclusion measurable aspects of SBR have a positive impact on economic performance in sub Saharan Africa at both micro and macro level. This provides support for the hypothesis that more open, visible, and therefore more and democratic, state-business relations are good for economic performance in Africa.

However, it is too soon to assess and understand the precise effects of SBRs on development and what the exact channels are. So far, the available evidence points to a number of possible routes. The micro-evidence suggested that business associations lobby government (in addition to own firm’s lobbying) and this is both perceived to be important as well as estimated to increase firm performance. We would need to know why this is so. One such possible route is that the business association would be effective in identifying and removing investment barriers by lobbying the government. Such a mechanism would provide for a democratic way of conducting effective state-business relations; in fact, membership is associated with a reduction in informal payments by individual firms.

Of course, further research is required. In part, there is a need to know more about the precise effects on economic performance, but also on different types of growth. And the precise routes through which this is expected to work. A conceptual piece on SBRs and shared growth is lacking. But we also need to know more about what leads to the formation of SBRs, what sustains them and what factors are we excluding when we focusing on measurement issues. The focus on measuring SBRs facilitates a debate between economists, sociologists and political scientists on what matters for state-business relations to improve growth prospects in developing countries.

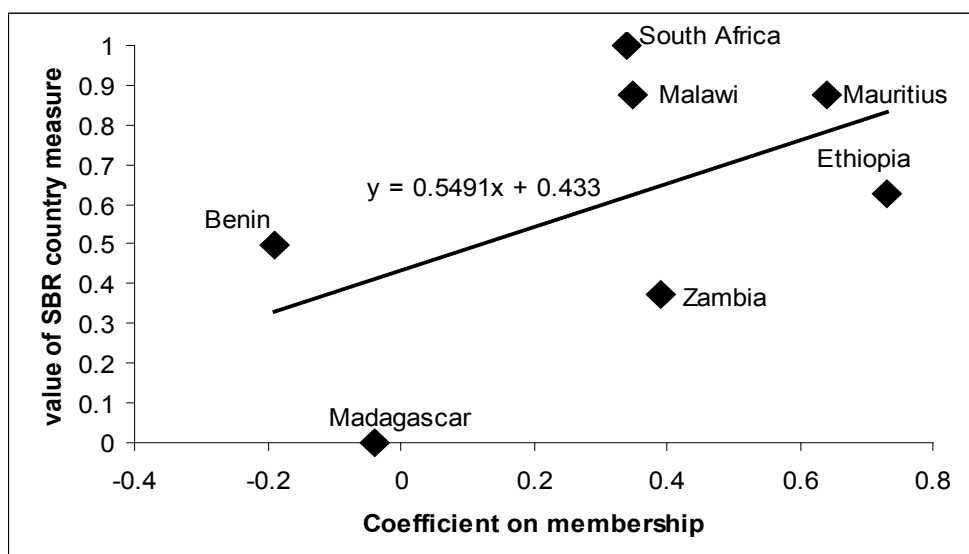


Chart 4: The effect of business association membership on productivity is greater in countries which are better prepared for state-business relations.