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PUBLIC-PRIVATE SECTOR RELATIONSHIPS IN DEVELOPING COUNTRIES

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This paper refutes the conventional wisdom, bolstered in the wake of the Asian financial crisis that governments should not become too friendly with the private sector but, instead, should remain neutral and at arms-length distance. The empirical findings presented here indicate that countries in which governments have forged close and cooperative working relationships with the private sector have had much greater economic success. Furthermore, countries with more business-friendly public-private sector relationships tend to exhibit greater positive responsiveness to pro-growth policy reforms. In many developing countries today, where public-private sector relationships are characterized more by mistrust than cooperation, more not less collaboration is needed to spur economic growth. The art of governance, however, is avoiding state capture and not letting this partnership degenerate into favoritism and cronyism.

Keywords: Public-Private Sector Relationships, Governance
JEL classification: O1

1. INTRODUCTION

Choosing the right policies to promote economic growth and development is, of course, essential. Countries that have relied on free, open and competitive markets and maintained macroeconomic stability have generally performed better than those that have not adopted these policies (Fischer (1993) and Sachs and Warner (1995)). The high-performing economies of East Asia are often cited as a dramatic example of this success (Leipziger and Thomas (1993)). However, there are developing countries today that have also moved in this same, more liberalized, policy direction, albeit more recently, but have not yet experienced sustained rapid economic growth. Why do the same pro-growth policies that succeed in one country fail or have little impact in another? Is it just that not enough time has elapsed or that the policy dosage is still too small?

In seeking to answer these questions, this paper tests the hypothesis that the quality of public-private sector relationships or, more specifically, the degree of trust and

cooperation between government and private sector agents, is an important factor that needs to be taken into account in explaining differences in economic performance across countries with similar policy regimes.[1] Just getting policies right, as important as that is, may not be enough to promote growth and development in countries where strong and effective public-private sector relationships are lacking.

To measure public-private sector relationships, an index, called the Business-Friendly (B-F) Index, is constructed. The B-F Index is tested in a multiple regression model to estimate its importance in explaining economic performance. Panel data are used, covering a wide cross section of developing countries for the last two decades (1980-97).

2. DEFINING PUBLIC-PRIVATE SECTOR RELATIONSHIPS

Most studies of public-private sector relationships tend to concentrate on the functional nature of these relationships or, more specifically, on the obstacles, mainly defined in terms of the policies and actions taken by government, to doing business in a country (Brunetti, Kisunko and Weder (1998)). However, the focus here is not these "rules of the game" as such, but rather on the manner in which they are implemented. The term "relationship" describes how civil servants, charged with the responsibility of implementing policies, and private sector agents, who must respond to those incentives, interact in terms of the mutual trust and support that are provided. At one end of this spectrum, are those relationships where governments are generally helpful, friendly and supportive, and, at the other end, are those mostly dysfunctional, predatory or adversarial relationships in which governments may regard the private sector only as a source of economic rents. One implication of this definition is that governments with similar functional responsibilities (e.g., market-oriented economies) could have quite different (friendly or unfriendly) public-private sector relationships. Therefore, one cannot, automatically assume that market-friendly implies business-friendly.

Furthermore, business-friendly should not be confused with cronyism, which refers to favoritism or the preferential treatment accorded a select number of businesses or individuals. To the contrary, the B-F Index is intended to measure how the public sector relates to the private sector as a whole, not just to a privileged part of it.

[1] Mahbub ul Haq (1997) was one of the first to recognize the importance of this relationship. After comparing South Asia's economic performance with East Asia's, and finding that the usually cited factors (human and physical capital and outward orientation), cannot adequately explain the differences, Haq concludes that the missing explanation lies in the close, cooperative relationship between the public and private sectors in East Asia in contrast to the paternalistic relationship in South Asia.

3. THE BUSINESS-FRIENDLY INDEX

The B-F Index is composed of four subcomponents. Each subcomponent and the construction of the B-F Index are described below.

3.1. The Subcomponents

3.1.1. Government Supportiveness

One way by which to gauge government supportiveness is to examine the pattern of public expenditure. For example, public investment in infrastructure, such as transport, power, water and telecommunications, directly supports and enhances the productivity of private sector investments (Blejer and Khan (1984), Greene and Villanueva (1991), Wai and Wong (1982), and Hadjimichael *et al*. (1995)). Because per capita power consumption is correlated with the other indices of infrastructure adequacy and has the advantage of having data available for a large number of developing countries over the last several decades, it was used as a proxy for this subcomponent.[2]

3.1.2. Government Disposition Towards the Private Sector

To help capture the manner and mindset, either friendly or otherwise, by which governments relate to private enterprises, a second subcomponent was defined. Because business-friendly governments generally do not tax business enterprises excessively, especially when alternative and more efficient ways to raise tax revenue exist, the highest marginal rate of corporate taxation was used as a proxy for this subcomponent. To define this subcomponent positively, the highest marginal rate of corporate taxation was subtracted from one.[3]

[2] During the last two decades, developing countries depended heavily on the public sector to supply electric power. Recently a few countries have allowed independent power producers to supply power to the national grid and, in some cases, directly to private distribution companies under the oversight of public regulatory agencies. Thus, the public sector has either been directly involved in the supply of power or, more recently, in a few cases, it has worked with and/or provided the enabling environment for the private sector. For this reason, per capita power consumption is probably a good indicator of the general supportiveness of the public sector, if not, in all cases, an indicator of public outlays. The data on per capita power consumption are drawn from the World Bank's World Development Indicators (CD-ROM 2000).

[3] For the 1990s, the data on corporate tax rates were drawn from the World Bank's World Development Reports; for the 1980s, the data were obtained from the primary source, Price Waterhouse Coopers.

3.1.3. Ensuring Business Security

Another measure of public-private sector friendliness is the extent to which governments ensure the security of doing business. If the judicial system does not provide low cost and impartial means for adjudicating disputes or if there is risk of expropriation or repudiation of contracts by government, public-private sector relationships are likely to be characterized by suspicion and mistrust. Survey data, compiled by International Country Risk Guide (ICRG), was used to measure this subcomponent.[4]

3.1.4. Government Openness and Helpfulness

Cooperative and friendly public-private sector relationships are also likely to entail the sharing of information as well as a civil service that is willing and able to assist the entire business community in complying with the nation's laws and regulations. Even in countries where market-friendly policies exist, they can be easily undermined if important information is not readily available or businesses have to overcome costly government bureaucratic hurdles. Two variables from the ICRG data series (quality of the bureaucracy and corruption in government) were used to measure this subcomponent.[5] It is principally through this subcomponent, that the prevalence of cronyism or favoritism can be gauged.

3.2. Constructing the B-F Index

To construct the composite B-F Index, first the values for the subcomponents were normalized by establishing minimum and maximum values for each subcomponent.[6] The value for each subcomponent was then calculated using the following formula:[7]

$$X_{1j} = \frac{X_{1j}\,(actual) - X_{1j}\,(min)}{X_{1j}\,(max) - X_{1j}\,(min)}, \tag{1}$$

[4] Values for three ICRG variables (rule of law, expropriation risk and repudiation of contracts) were combined to derive values for this subcomponent. The rule of law variable is on a 6-point scale, which was converted to a 10-point scale, consistent with the other two variables. Knack and Keefer (2000), in defining their variable "property and contractual rights," use a slightly broader measure.

[5] These two variables, originally on a 6-point scale, were converted to a 10-point scale.

[6] For the two subcomponents based on survey data (security of doing business and government openness), the minimum and maximum values correspond to the survey scale, which ranges from 0 to 10 after adjustment. For the two other observable subcomponents, the range is defined by their actual distributions.

[7] The same method is used by the UNDP (1997) in calculating the human development index (HDI).

where: $X_{1j} = j^{th}$ subcomponent of the B-F Index (X_1),
$X_{1j}(actual)$ = actual value of X_{1j},
$X_{1j}(min)$ = minimum value of X_{1j},
$X_{1j}(max)$ = maximum value of X_{1j}.

Lastly, the B-F Index was calculated by taking the simple arithmetic mean of the four subcomponents. Values range from 0 (the least friendly) to 1 (the most cooperative and supportive) and were calculated for 73 developing countries for which data were available over the 18-year period, 1980-1997. Table 1 shows the correlation matrix for the four subcomponents, all of which are positively correlated and, therefore, pulling in the same direction.

Table 1. Correlation Matrix for Subcomponents of Business-Friendly Index

Subcomponents	Government Supportiveness	Business Friendliness	Security of Doing Business	Openness and Helpfulness
Government Supportiveness	1			
Business Friendliness	.12	1		
Security of Doing Business	.47	.48	1	
Openness and Helpfulness	.41	.14	.57	1

4. EMPIRICAL RESULTS

4.1. Country Rankings

Table 2 shows the ranking of countries according to the B-F Index for the 1980s and 1990s. Table 3 summarizes this same information by geographical region. Over the two decades, governments in all of the countries in the sample, without exception, moved towards a more cooperative and friendly relationship with the private sector. The average country improved its score on the B-F scale by 0.15 points.

Not surprisingly, the original Asian "Tigers" (Singapore and Korea) and some newly industrialized countries (NICs) - Thailand and Malaysia - are at the top of the B-F scale, while many South Asian, Central American and African countries are near the bottom. However, there are some notable exceptions. Indonesia, often grouped with the NICs, has a relatively low ranking on the B-F scale and the African countries of Botswana, Namibia, the Gambia, and Guinea have relatively high scores. In fact, in the 1990s

Botswana recorded the second highest score after Singapore. However, in terms of overall regional averages, East Asia in the 1990s had the highest scores, followed by South America, the Middle East and North Africa, Sub-Saharan Africa, Central America, and South Asia.[8]

Table 2. Ranking of Countries by B-F Index

Rank	1980-89		1990-97		1997	
1	Singapore	0.64	Singapore	0.79	Singapore	0.86
2	Botswana	0.58	Botswana	0.70	Namibia	0.80
3	Papua New Guinea	0.57	Korea, Rep.	0.69	Korea, Rep.	0.74
4	Niger	0.53	Namibia	0.68	Botswana	0.69
5	Burkina Faso	0.48	Papua New Guinea	0.64	Papua New Guinea	0.67
6	Gambia	0.48	Gambia	0.63	Gambia	0.67
7	Malaysia	0.48	Saudi Arabia	0.60	Malawi	0.64
8	Madagascar	0.47	Guinea	0.59	Malaysia	0.64
9	Malawi	0.46	Thailand	0.58	Chile	0.63
10	Brazil	0.45	Malawi	0.58	Saudi Arabia	0.63
11	Sierra Leone	0.45	Malaysia	0.58	Guinea	0.60
12	Trinidad & Tobago	0.44	South Africa	0.58	Trinidad & Tobago	0.60
13	Saudi Arabia	0.44	Trinidad & Tobago	0.58	Thailand	0.59
14	Costa Rica	0.43	Chile	0.57	South Africa	0.59
15	Chile	0.43	Brazil	0.57	Jamaica	0.59
16	Korea, Rep.	0.43	Costa Rica	0.57	Uganda	0.59
17	Venezuela	0.42	Venezuela	0.57	Jordan	0.59
18	Thailand	0.41	Burkina Faso	0.56	Costa Rica	0.58
19	Cote d'Ivoire	0.41	Madagascar	0.55	Burkina Faso	0.58
20	South Africa	0.41	Argentina	0.54	Venezuela	0.57
21	Togo	0.39	Niger	0.54	Brazil	0.57
22	Mexico	0.38	Jordan	0.54	Uruguay	0.57
23	Colombia	0.38	China	0.54	Argentina	0.56
24	India	0.38	Turkey	0.53	Syrian Arab Rep.	0.56
25	Uruguay	0.38	Mexico	0.53	Madagascar	0.56
26	Ecuador	0.37	Uganda	0.53	Tunisia	0.55
27	Turkey	0.37	Togo	0.53	Morocco	0.55
28	Argentina	0.37	Jamaica	0.52	Sri Lanka	0.55
29	Gabon	0.37	Uruguay	0.51	India	0.55
30	Kenya	0.36	Egypt, Arab Rep.	0.51	Togo	0.55
31	Guinea	0.36	Morocco	0.51	Turkey	0.54
32	Cameroon	0.36	Zimbabwe	0.51	China	0.53
33	Zimbabwe	0.36	India	0.50	Philippines	0.53
34	China	0.35	Tunisia	0.50	Mexico	0.53
35	Guinea-Bissau	0.34	Syrian Arab Rep.	0.50	Dominican Rep.	0.52
36	Tunisia	0.34	Ghana	0.50	Ecuador	0.52
37	Senegal	0.34	Colombia	0.50	Pakistan	0.52
38	Dominican Rep.	0.34	Ecuador	0.50	Vietnam	0.52
39	Jordan	0.33	Nicaragua	0.49	Egypt, Arab Rep.	0.52
40	Mozambique	0.33	Cote d'Ivoire	0.49	Indonesia	0.52

[8] South Asia's relatively low ranking is due mainly to Pakistan, Bangladesh, Sri Lanka and Nepal. India, whose score has substantially improved since the 1980s, occupies the middle range.

Table 2. (Continued)

Rank	1980-89		1990-97		1997	
41	Sri Lanka	0.33	Kenya	0.48	Yemen, Rep.	0.52
42	Jamaica	0.33	Indonesia	0.48	Zimbabwe	0.52
43	Algeria	0.32	Gabon	0.48	Kenya	0.51
44	Uganda	0.32	Dominican Rep.	0.48	Ghana	0.51
45	Egypt, Arab Rep.	0.31	Cameroon	0.48	Sierra Leone	0.51
46	Morocco	0.31	Algeria	0.47	Nicaragua	0.50
47	Tanzania	0.31	Tanzania	0.47	Paraguay	0.50
48	Nicaragua	0.30	Yemen, Rep.	0.47	Cameroon	0.50
49	Zambia	0.30	Paraguay	0.47	Algeria	0.50
50	Mali	0.30	Guinea-Bissau	0.46	El Salvador	0.49
51	Vietnam	0.29	Mozambique	0.46	Peru	0.49
52	Peru	0.29	Sri Lanka	0.46	Mozambique	0.49
53	Angola	0.29	Mali	0.46	Gabon	0.49
54	Panama	0.29	Sierra Leone	0.46	Niger	0.49
55	Pakistan	0.29	Peru	0.46	Tanzania	0.48
56	Ethiopia	0.28	Vietnam	0.45	Mali	0.48
57	Paraguay	0.28	Philippines	0.44	Panama	0.48
58	Ghana	0.28	Pakistan	0.44	Bolivia	0.48
59	Honduras	0.27	Zambia	0.43	Guatemala	0.47
60	Syrian Arab Rep.	0.26	Panama	0.43	Colombia	0.47
61	Nigeria	0.25	Bolivia	0.43	Zambia	0.47
62	Guatemala	0.24	Senegal	0.43	Angola	0.47
63	Yemen, Rep.	0.24	El Salvador	0.42	Guinea-Bissau	0.46
64	Indonesia	0.24	Nigeria	0.42	Ethiopia	0.46
65	El Salvador	0.24	Honduras	0.41	Cote d'Ivoire	0.46
66	Philippines	0.23	Angola	0.41	Bangladesh	0.45
67	Bolivia	0.21	Guatemala	0.40	Senegal	0.44
68	Haiti	0.20	Ethiopia	0.38	Nigeria	0.43
69	Congo D.R.	0.20	Bangladesh	0.38	Honduras	0.43
70	Bangladesh	0.19	Congo D.R.	0.36	Haiti	0.41
71	Benin	0.19	Benin	0.35	Congo D.R.	0.36
72	Nepal	0.19	Nepal	0.35	Benin	0.35
73			Haiti	0.32	Nepal	0.35
Average		0.35		0.50		0.53

Note: The B-F Index ranges in value from 1 (the most friendly and cooperative) to 0 (the least friendly).

Table 3. Ranking of Regions by B-F Index

Rank	1980-89		1990-97	
1	East Asia	.40	East Asia	.58
2	South America	.36	South America	.51
3	Sub-Saharan Africa	.36	Middle East & N. Afr.	.51
4	Middle East & N. Afr.	.33	Sub-Saharan Africa	.50
5	Central America & Carib.	.31	Central America & Carib.	.46
6	South Asia	.27	South Asia	.43

Regions

Mexico	Sub-Saharan Africa	Middle East & N. Afr.
	Mozambique	Yemen, Rep.
	Ethiopia	Egypt, Arab Rep.
Central America & Carib.	Tanzania	Morocco
Haiti	Malawi	Syrian Arab Rep.
Dominican Rep.	Sierra Leone	Algeria
Nicaragua	Niger	Tunisia
Honduras	Burkina Faso	Saudi Arabia
Guatemala	Madagascar	Turkey
Jamaica	Uganda	Jordan
El Salvador	Guinea-Bissau	
Costa Rica	Mali	
Panama	Nigeria	East Asia
Trinidad & Tobago	Kenya	Vietnam
	Togo	China
	Gambia	Indonesia
South America	Benin	Philippines
Bolivia	Ghana	Papua New Guinea
Ecuador	Zambia	Korea, Rep.
Paraguay	Angola	Singapore
Colombia	Zimbabwe	Thailand
Peru	Guinea	Malaysia
Venezuela	Senegal	
Brazil	Cameroon	
Chile	Cote d'Ivoire	South Asia
Uruguay	Congo D.R.	Bangladesh
Argentina	Namibia	India
	Botswana	Pakistan
	South Africa	Sri Lanka
	Gabon	Nepal

In addition, there does not appear to be a close one to one relationship between government functional responsibilities and the B-F Index. Countries with a high as well as low degree of state control in the economy are on both ends of the B-F scale.[9]

[9] For example, China, with a strong state presence, has a relatively intermediate B-F score (.54 in the 1990s), while other economies in which the state also plays a large role (e.g., Ethiopia, Zambia and Pakistan)

Similarly, countries that depend more on markets are also found along the entire spectrum.[10] Thus, while market- oriented economies are, on average, likely to have higher B-F scores than economies that rely more heavily on the state, there are enough exceptions to warrant not taking this association for granted. Consequently, business-friendly should not be equated with market-friendly.

Finally it should be noted that of the 73 developing countries for which B-F scores were calculated in the 1990s, 35, or almost half, had scores below .50, and 54 countries (74 %) had scores below .55. While some of these countries are more business-friendly than others, none at this level are exactly a paragon of public-private sector cooperation. To the contrary, all represent serious dysfunctional associations. Thus, while public-private sector relationships are clearly improving, this relationship is still characterized more by mistrust than cooperation in many developing countries today.

4.2. Econometric Analysis

To estimate the significance of the B-F Index in explaining variations in the growth and development performance of developing countries after accounting for policy differences, multivariate regression analysis is used. A total of six economic performance or dependent variables are each regressed against the B-F Index and seven other independent policy variables.[11]

4.2.1. Variables

The six dependent economic performance variables include: (i) GDP growth (gdpgr); (ii) per capita GDP growth (pcgdpgr); (iii) manufacturing growth (mgr); (iv) the proportion of manufactures in total commodity exports (mx); (v) the savings rate (s); and (vi) financial depth (fd).[12] All of these performance measures are particularly important

have relatively low scores (.38, .43, and .44, respectively in the 1990s).

[10] For example, the market economies of Nigeria, El Salvador and Guatemala are ranked near the bottom on the B-F scale (.42, .42 and .40, respectively in the 1990s), while Singapore, Korea and Thailand are on the top (.79, .69 and .58, respectively in the 1990s). Even Nicaragua, despite recent efforts to move from a command to a market economy, continues to have a relatively low score (.49).

[11] The principal objectives of this specification are to test the significance of the B-F Index in explaining economic performance after controlling for policy differences and to use these estimated regressions to analyze the importance of the B-F Index in explaining variations in economic performance across countries with similar policy regimes. It is not to explain economic growth as such, for which the inclusion of some additional, non-policy independent variables might be warranted. However, including these other variables, some of which are themselves influenced by the policy variables, would tend to obscure whatever inferences could be drawn about the importance of the B-F Index and the effectiveness of economic policy.

[12] Financial depth is measured by the proportion of liquid assets (M_2) to GDP.

to developing countries, concerned with increasing their capital stock, transforming their industrial and trade sectors and generally accelerating economic growth.[13]

The independent variables include, in addition to the B-F Index: two macroeconomic policy variables - inflation (inf), as measured by the consumer price index, and the central government's fiscal balance, expressed as a proportion of GDP (fb); a trade policy variable, represented by the average tariff (tar); an exchange rate management variable represented by the real exchange rate (reer); a privatization policy variable, represented by the rate of disinvestment in state-owned enterprises, expressed as a proportion of total gross domestic investment (insoe); a financial policy variable, the real interest rate (rint), aimed at measuring the extent or absence of financial repression; and a human capital investment policy variable, represented by the amount of expenditure per primary school student as a proportion of per capita GNP (epspc).[14]

4.2.2. Regression Results

The regression results are presented in Table 4. In all the specifications, the B-F Index enters with the expected positive sign and is statistically significant. The partial scatter plots, with each of the six dependent performance variables regressed against the B-F index, are shown in Figure 1.[15] Clearly countries with higher B-F scores do better, in terms of economic performance, than countries with lower scores and the strength of this relationship is highly robust after controlling for a number of important economic policies.[16]

To further test the robustness of this relationship, a period dummy was introduced to see if there are any time-specific peculiarities associated with either of the two time periods (1980s and 1990s), and the composition of the countries in the sample was changed to determine if outliers might be influencing the result. With the inclusion of the period dummy, the results remain virtually unchanged.[17] To account for the influence of outliers, first the high performers (Singapore, Korea, Thailand and

[13] The data for all these variables are drawn from the World Development Indicators.

[14] The data for these variables, with the exception of the average tariff, taken from the World Bank's sectoral database, are drawn from the World Development Indicators.

[15] With all of the policy regressors in, the B-F index remains highly significant at the 1 percent level in the case of five of the six dependent performance variables and, in the case of the other performance variable, mx, it is significant at the 5 percent level.

[16] A test was carried out to determine to what extent these results and the B-F Index have been influenced or dominated by the subcomponent represented by per capita power consumption, as this variable also tends to be closely correlated with the level, if not the growth, of economic activity. The B-F Index, therefore, was redefined to exclude this subcomponent. However, even with this subcomponent removed, the B-F Index remained highly significant at the 1 % level and robust to the inclusion of all the right hand policy variables.

[17] Only in the specification with the dependent variable mx, does the B-F index lose its significance.

Malaysia) were excluded from the data set, and, secondly, all of South Asia, the region with the lowest average B-F scores in both decades, was removed. However, the exclusion of these high and low outliers does not significantly affect the results.[18] In general, these tests confirm the robustness of the B-F Index in explaining economic performance.

Table 4. OLS Regression Results

Variables	Dependent Variables					
	gdpgr	pcgdpgr	mgr	mx	s	fd
Constant	-9.02**	-12.78***	-18.71***	-27.09	6.91	-33.06***
	(-2.17)	(-3.02)	(-3.07)	(-1.19)	(1.14)	(-2.55)
B-F Index	20.46***	22.52***	27.42***	66.49**	43.16***	104.22***
	(3.77)	(4.12)	(3.91)	(2.23)	(5.95)	(5.27)
inf	-0.07***	-0.06***	-0.13***	-0.20*	-0.18***	-0.18**
	(-3.28)	(-2.72)	(-3.98)	(-1.86)	(-7.46)	(-2.15)
fb	0.22	0.26	0.90***	0.21	0.81***	0.29
	(1.23)	(1.39)	(3.28)	(0.21)	(4.34)	(0.47)
tar	0.21***	0.25***	0.39***	1.15***	0.37***	0.99***
	(3.25)	(3.75)	(4.09)	(2.89)	(4.48)	(3.85)
reer	0.02**	0.01	0.04***	-0.07	-0.05***	-0.03
	(2.21)	(1.48)	(4.67)	(-1.28)	(-2.50)	(-1.15)
insoe	-0.02	-0.03	0.01	0.14	0.10*	0.14
	(-0.40)	(-0.62)	(0.22)	(0.65)	(1.89)	(0.83)
rint	0.10*	0.12**	0.08	0.23	0.04	0.09
	(1.76)	(2.04)	(1.01)	(0.78)	(0.55)	(0.54)
epspc	-0.02	0.00	0.30	0.88	-0.36	0.69
	(-0.11)	(-0.03)	(1.01)	(1.09)	(-2.56)	(1.29)
R^2	0.32	0.33	0.45	0.28	0.71	0.46
obs.	78	78	77	74	78	78

Notes: [1] The *t*-statistics are in parentheses. White heteroskedasticity-consistent standard errors and covariance.
[2] *(** , ***) indicates significance at 10% (5%, 1%) level.

[18] Only with mx as the dependent variable and the high performers excluded is the significance affected.

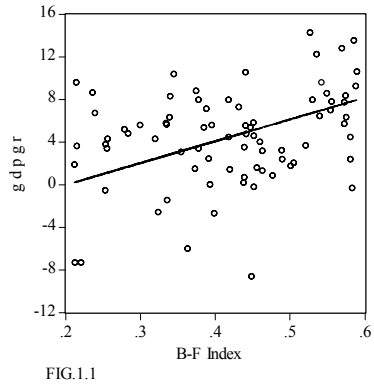

FIG.1.1

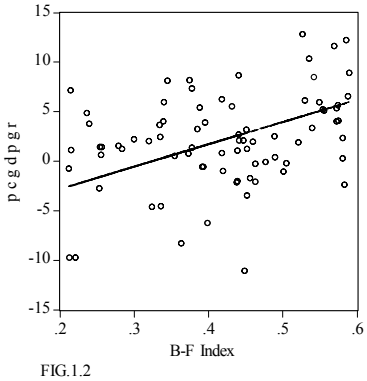

FIG.1.2

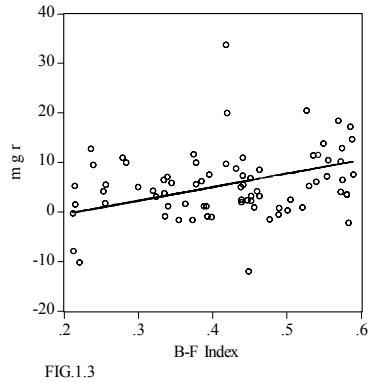

FIG.1.3

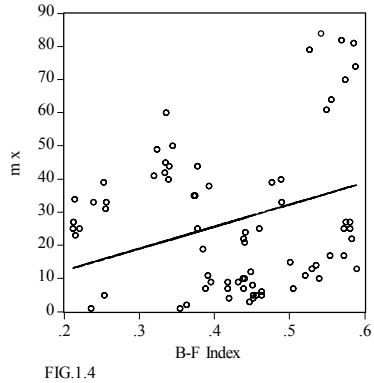

FIG.1.4

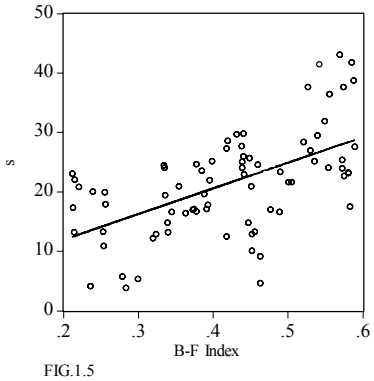

FIG.1.5

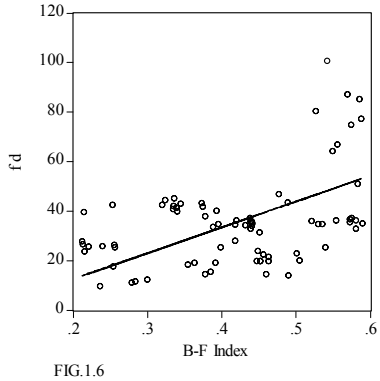

FIG.1.6

Note: The partial scatter plots show the relationship between the dependent performance variable and the B-F Index when all other independent policy variables in the multiple regression are held constant.

Figure 1. Partial Scatter Plots For B-F Index and Dependent Performance Variables

4.2.3. Simulations

To examine more closely the case of countries with similar policy regimes yet disparate economic performance, the following question was posed: how would economic performance have been affected had countries in the 1990s adopted the same policy regime, say, for example, as that in the most successful developing countries (i.e., Asian "Tigers" and NICs) but maintained their own public-private sector relationships, as reflected in actual B-F Index scores? The results, using the estimated multiple regression models, are presented and compared with actual outcomes for the 1990s in Table 5.

For about a third of the total countries, the changes are dramatic. These countries recorded at least a 3.5 percentage point acceleration in GDP growth (gdpgr).[19] For these countries, policies clearly matter. About another third of the countries showed moderate growth responses and, in the remaining third, the response was small or negligible. The countries in this latter category registered less than a 1.5 percentage point acceleration in GDP growth (gdpgr).[20] If the more comprehensive indicator, per capita income growth (pcgdpgr) is used to measure performance, this list of countries with low response rates expands to include four more countries.[21] For the other performance variables, the results are similar, with the proportion of countries showing little or no response ranging from 33 to 38 %.[22]

In general, most of the countries with low performance responses also have comparatively low B-F scores. To examine this relationship more closely, an elasticity coefficient was calculated which measures the absolute percentage change in a country's performance, as represented by each of the six performance variables, in response to the absolute percentage change in the sum of all the policy changes. The formula is:

[19] These countries include: Nicaragua, Jamaica, Costa Rica, Trinidad and Tobago, Venezuela, Brazil, Mexico, Morocco, Algeria, Saudi Arabia, Sierra Leone, Niger, Burkina Faso, Madagascar, Togo, the Gambia, Angola, Guinea, Cameroon, the Democratic Republic of the Congo, Namibia, Botswana, South Africa and Papua New Guinea.

[20] These countries include: Honduras, Guatemala, El Salvador, Panama, Bolivia, Peru, Argentina, Yemen, Syria, Tunisia, Turkey, Jordan, Mozambique, Ethiopia, Uganda, Guinea-Bissau, Nigeria, Benin, Ghana, Senegal, Indonesia, the Philippines, Bangladesh, India, Pakistan, Sri Lanka and Nepal.

[21] This includes the Dominican Republic, Columbia, Uruguay, and Egypt.

[22] In the case of industrial change, measured either by mgr or mx, the number of countries showing little or no response to the assumed policy changes is even slightly larger (28 countries or 38 % in the case of mx). The pattern is similar for financial depth (fd), with 24 countries or 33 % showing little or no response to the policy changes. Only in the case of saving rates (s), do most of the countries show a fairly large response.

$$e(Y_i) = \frac{\left| \%\Delta Y_i \right|}{\left| \%\Delta \sum_{j=2}^{8} X_j \right|}, \qquad (2)$$

where: $Y_i = i^{\text{th}}$ performance variable (and $i = 1,\ldots, 6$),

$X_j = j^{\text{th}}$ policy variable (and $j = 2,\ldots, 8$),

$e(Y_i)$ = policy response elasticity of Y_i.

The countries are then ranked by these elasticity estimates for each performance variable and these rankings are compared and correlated with the ranking of countries according to the B-F Index. Table 6 presents these rankings and the estimated rank correlation coefficients. The rank correlation coefficients range from 0.95 and 0.96 for the growth performance variables (gdpgr and pcgdpgr, respectively) to 0.90 for some of the structural variables (s and fd), confirming a strong positive correlation between performance responses, especially in terms of economic growth, and the B-F Index.

These results demonstrate that when countries, with very different public-private sector relationships, adopt the same pro-growth and development policies, even at the dosage levels found in the world's most successful developing countries, the performance response among the countries is likely to be mixed and significantly muted in those countries with unfriendly or uncooperative public-private sector relationships. The relevance of this case is underscored by the fact that many countries did, in fact, move towards more open, competitive and market-friendly policy regimes during the last decade, but often the expected spurt in growth did not occur. This has given rise to disappointment and disillusionment, sometimes with the policies themselves. However, the results presented here suggest that one possible cause for this stubbornly sluggish response may be a mistrustful or non-cooperative working relationship between the public and private sectors. This may help to explain in part the less than stellar performance of some of the growth laggards of late (e.g., Pakistan and Bangladesh in South Asia, Nigeria in Africa, Guatemala in Central America and Bolivia in South America), despite recent concerted policy reform efforts. All of these countries have low policy response elasticities as well as low B-F scores. Rather than abandoning the policies, these countries would be well advised to improve public-private sector relationships in order to realize the full impact of the policy reforms that are introduced.

5. THE RELEVANCE OF THE EAST ASIAN EXPERIENCE

The B-F scores indicate that the governments of the high-performing East Asian economies did maintain strong business-friendly ties with the private sector. Although these findings apply only to the last two decades (1980-97), other accounts (Leipziger and Thomas (1993)) suggest that these countries probably had close and productive

public-private sector relationships almost from the beginning of their economic ascent in the 1960s. Stiglitz (1996) notes that throughout most of this period, these governments proactively coordinated and administered selective industrialization strategies that required a close working relationship with the private sector. What is striking is that these moderately interventionist industrial policies succeeded for the most part (Rodrik (1995)), whereas in many, if not most, other countries they failed. While many reasons have been given, one factor frequently cited is the high caliber of the East Asian government bureaucracies, which relates directly to the issue of public-private sector relationships.

These government bureaucracies, comprising highly trained civil servants, not only provided policy advice to the country's leaders, they also served as instruments of coordination and interface with the private sector. In some countries, deliberation or business councils were introduced with the aim of promoting public-private sector collaboration (Stiglitz (1996)). These councils went a long way towards creating an atmosphere of cooperation and trust. Furthermore, by fostering a professional work environment, these bureaucracies, or meritocracies as they have been called, remained largely insulated from political interference and corruption. Recruitment and promotion were based largely on merit and to attract and retain the best staff, compensation packages, including salaries and benefits, were maintained at highly competitive levels (World Bank (1993)).

However, in the aftermath of the Asian financial crisis, evidence has emerged suggesting that several governments may have recently slipped into less healthy ties with the private sector. Problems of cronyism, corruption and general rent seeking are cited. The B-F Index values for these countries, during the few years leading up to the Asian financial crisis (1994-97), however, present a more mixed picture, with Korea recording a small decline in B-F scores, Thailand a leveling off from the previous upward trend, and both Malaysia and Singapore showing a small but steady improvement. Thus, although the evidence is not overwhelming, some deterioration in the quality of public-private sector relationships appears to have taken place in at least some of the East Asian countries during the 1990s.[23] These changes highlight the risk of state capture and of the need for countries to adapt to changing conditions. As the East Asian economies grew and the private sector developed, instead of shifting to a less

[23] Some have concluded that one of the major causes of the Asian financial crisis was, in fact, such changes (Yoo (1997), Krugman (1998), and Frankel (1998)). They argue, although from different perspectives, that in several countries, the government and the private sector became too closely allied, leading to moral hazard and a host of related adverse selection problems. Others (Radelet and Sachs (2000)) maintain that moral hazard, while a factor, cannot adequately explain the onset of the Asian financial crisis or the virulence of the contagion that ensued. However, while the specific role and relative importance of cronyism in the Asian financial crisis is still debated, it is probably safe to conclude that public-private sector relationships did deteriorate to some degree in the 1990s.

nurturing, albeit business-friendly relationship, many East Asian governments continued to maintain the same close associations with the private sector. Eventually this led to a degree of state capture, suggesting that the appropriate or optimal public-private sector relationship probably varies with a country's stage of development.[24]

However, overall, the East Asian experience illustrates the advantages of forging close and cooperative public-private sector relationships. Throughout most of the period, during which the high-performing East Asian economies grew at unprecedented rates, strong and collaborative public-private sector relationships thrived and were actively promoted. East Asia's business-friendly model appears to have served these countries extremely well. More recent events, which highlight the risks of state capture, should not obscure this more fundamental positive lesson.

6. CONCLUSIONS

Developing countries with business-friendly governments have generally performed better than countries where this relationship has suffered. In addition, countries with more business-friendly public-private sector relationships have responded more positively to pro-growth policy reforms, which may explain, in part, why some countries, with similar liberalized policy regimes, do not perform as well. Thus, contrary to the conventional wisdom in industrialized countries, which holds that governments should remain at arms-length distance, the findings presented here suggest that benign neutrality is probably not an optimal model of governance for many developing countries. It is not enough for governments in developing countries to adopt policy reforms; they must also seek to forge effective partnerships with the principal agents affected by those reforms.

However, at the same time, governments need to learn how to avoid capture and be able to support the private sector without having this relationship degenerate into the all too familiar forms of corruption, cronyism and nepotism. As the early experience of many East Asian countries indicates, maintaining a merit-based, well trained and competitively compensated government bureaucracy can help to minimize this risk. Unfortunately, governments in many developing countries often either fail to avoid capture or operate at the other extreme where they are antagonistic or openly hostile to

[24] At an early stage, the private sector may be relatively underdeveloped; or businesses and entrepreneurs may lack critical information and experience; or investment opportunities, vital to the development of the country, may go unrealized because there is no effective coordination. In these cases, strongly supportive public-private sector relationships may be required. As countries grow and develop, less supportive relationships may be more appropriate. However, as the Asian experience indicates, such transitions are difficult to accomplish and may explain in part why developed countries tend to recommend a more neutral stance in the first place.

the private sector. Neither of these two extremes appears to work. The most successful developing countries have been able to find the right middle ground. In part, this is the essence of good policy stewardship or governance.

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