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Informal state–business connections, institutions, and economic growth

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Abstract In today's world, continuous interactions between government officials and business people in market transactions are inevitable, opening the way for state–business cooperation and, consequently, various forms of state–business relations (SBR). This paper discusses informal SBR and their effect on economic growth. It does so while accounting for various institutional settings, arguing that studying the interaction between informal SBR and existing institutions is important in this regard. This is done both theoretically and empirically. Two questions are being tackled. The first is: which institutions—specifically governance institutions—help informal SBR in realizing higher levels of economic growth? The second is: can informal SBR correct the institutional deficiencies of some institutions and lead to better economic outcomes? After a theoretical discussion, an OLS cross-sectional regression model is used to answer the research question. The obtained results suggest that informal SBR do have a positive effect on investment (and ultimately economic growth) when good institutions are established. In this paper, those institutions are suggested to be voice and accountability, control of corruption/cronyism, and government effectiveness. The results also suggest that informal SBR, by building trust, can overcome some institutional impediments such as ethnic fractionalization and (with less certainty) some hierarchical cultures, leading ultimately to more investment and economic growth.

Keywords State–business relations · State–business networks · State–business connections · Institutions · Governance · Ethnic fractionalization · Legal systems · Hierarchical cultures · Economic growth

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1 Introduction

In today's world, the two extremes of (communist) socialist central planning and laissez-faire are tales of the past. Continuous interactions between government officials and businesspeople in market transactions are inevitable, opening the way for state–business cooperation and, consequently, various forms of state–business relations (SBR). At the heart of these relations are connections and networks that are expected to evolve as a result of repeated countless interactions and transactions between both parties. While it is easy to envision that both parties will benefit from these relations, it is rather more difficult to predict the effect of these relations on society.

It is believed that collaboration between the government and businesspeople can compensate for the deficiencies of each party. It can provide a way to overcome business failures, such as coordination externalities and the need for public inputs (Hausmann et al. 2008), as well as to overcome government failures such as imperfect information and foresight (Hausmann and Rodrik 2003). The result should be better economic outcomes. This is what the literature on developmental states and good governance suggests in one way or another. Nevertheless, the literature on rent seeking presents a totally different perspective. As argued by Olson (1982), in their search for distributional gains, interest groups such as businesspeople pressure the government and influence its policies and regulations. This ultimately leads to a loss of efficiency and lower economic growth. The impressive economic growth of Germany, Italy, and Japan in the aftermath of the Second World War arguably owes much to the devastation of their interest groups during the war. Choi and Thum (2007)—among many others—reinforce this claim empirically (Mueller 2003, 554–558).

Another point to consider is the difference between formal and informal SBR. While formal SBR (represented, for instance, by public–private dialogues, PPD) are now widely acknowledged by major international institutions such as the World Bank (WB) and the United Nations Industrial Development Organization (UNIDO) to lead to positive economic outcomes,[1] there is considerable doubt that this is the case for informal SBR. Informal SBR based on uninstitutionalized personal relations provide a means for connected businessmen to gain privileged access to public resources, regardless of efficiency. With this being the case, the positive effect of informal SBR on growth is questionable and interesting to explore.

Even though they are not the ideal form of SBR, informal SBR are arguably a core component of SBR, if not the most common form. Not every country is able, or in fact willing, to successfully institutionalize and formalize its informal SBR.[2] The economic outcomes of informal SBR (just like SBR in general) seem to depend on

[1] Check, for example, Herzberg and Wright (2005), and UNIDO (2000).

[2] See for instance OECD (2013) on the experience of the Middle East and North Africa (MENA) region, where state–business consultation is predominantly informal in many countries.

the institutional and economic settings present in each country. A classic example is the Cold War economic miracle of South Korea, with its unique experience characterized by close SBR with an informal SBR component. This example has long inspired the literature on developmental states. With German civil legal origins, authoritarian rule until the 1980s, high levels of cronyism and corruption, Buddhist culture and low ethnic fractionalization, close informal SBR (among other forms of SBR) led Korea to higher rates of economic growth from the 1960s to the 1980s. However, the outcomes were different in Sub-Saharan African countries. Many of the post-colonial ruling military juntas empowered businessmen who shared the same ethnic or clan origins,[3] resulting in close informal SBR based on bonds of blood and clan. They suppressed political opposition, had high levels of corruption and cronyism, inherited and adopted the French legal system, and had high levels of ethnic fractionalization. The outcome was barely satisfactory economic growth levels (Rock and Bonnett 2004), causing the region to become one of the poorest worldwide.

The difficulty associated with identifying which and how various factors are responsible for the economic growth resulting from informal SBR poses a challenge to academic research. This paper is an attempt to gain a deeper understanding of the effect of informal SBR on economic growth while accounting for institutional settings. Informal SBR are addressed by considering them to be aggregations of informal networks or informal state–business networks (SBN). These networks are analyzed based on the types of connections that bind their constituent members. The paper focuses on informal SBN based on what could be termed social and political connections (SPC): familial, tribal, common political party membership, and other similar connections that bind government officials and businessmen.

Based on the understanding that SPC interact with various institutional factors in each country, this paper accounts for the interactions between relevant institutional factors and SPC. The effects of these interactions on economic growth are then examined both theoretically and empirically. Thus, this paper attempts to answer two questions. The first is: which institutions—specifically governance institutions—help SPC to realize higher levels of economic growth? The second is: can SPC correct the institutional deficiencies of some institutions and lead to better economic outcomes? To answer the first question, the possible effects of the interactions of SPC with the rule of law, regulatory quality, voice and accountability, control of corruption, government effectiveness, and bureaucratic quality (independence) on economic growth are discussed theoretically and examined empirically. To address the second question, the interaction terms of SPC with some of the institutions that are suggested in the literature to have negative effects on economic growth (hierarchical cultures, ethnic fractionalization, and the French legal system) are examined to determine whether SPC are able to correct their effects.

This paper is a novel attempt to understand informal SBR while accounting for other institutional factors, both theoretically and empirically. It reveals that changing the institutional setting in which the SPC operate can lead to different

[3] See Mamdani (2001).

economic outcomes, and that pervasive SPC can correct for or worsen the effects of certain institutional factors. The approach used here differs from that used in a growing body of literature such as Sen and te Velde (2009) and Leftwich (2009), which evaluate SBR based on their "effectiveness." This paper instead takes a judgment-free (positive) approach that focuses on networks and the prevalence of connections as criteria for determining the intensity of SBR. It then assumes that the effect of SPC is dependent on the institutions in which the SPC are operating. It should be noted that the effects of the interactions between SPC and various institutions on economic performance have only rarely been explored empirically in the existing literature on SBR, meaning that this paper is among the first to address this issue.

The next section starts with a discussion of SPC as a form of informal SBR and SBN, and the effect of SPC on growth. The effects of the interactions of the studied institutions with SPC on economic growth are then explored theoretically. This is followed by a methodological section that highlights an OLS cross-sectional regression model which is used to examine the arguments of the theoretical section. After that is a section providing the results and a discussion that brings together the theoretical reasoning and empirical findings. The paper ends with a conclusion that sums up the findings of this work, presents policy recommendations, and points out limitations of this research.

2 Theoretical discussion

2.1 SBR, SPC, and growth

Frequent interactions between individuals that are linked to each other in various ways create a richly connected network in which interests and beliefs converge (Moon and Prasad 1994, 371). In this context, a network refers to the relations between a set of actors with one or more connections, including formal relations, friendships, social interactions, workflows, and transfers of material (e.g., goods, money) and non-material (e.g., information) resources (Begley et al. 2010). Thus, frequent interactions and connections between state officials and businesspeople lead to state–business networks (SBN). These can be regarded as the core of SBR, which are all of the various SBN present in a society. We can list the players on both sides as follows:

State: Government officials, bureaucrats, ruling party politicians.

Businesspeople: Entrepreneurs, managers, corporate executive board members, major shareholders, etc., in the goods and services sector.

The connections that bind the resulting networks can be:

Social connections: A common background (i.e., educational, familial, ethnic, etc.).

Political connections: The engagement of businesspeople in politics, such as acquiring political party membership or the appointment of businessmen to official positions (e.g., cabinet ministers), and the engagement of officials in business activities, such as an official being appointed to the executive board of a private firm.

Public–private dialogues (*PPD*): Economic councils where businesspeople and state officials discuss, recommend, or monitor policies.

In this work, I am going to focus on the first two types of connections, which represent informal types of connections in SBN, in contrast to PPD, which represent formal connections. As mentioned before, there is much doubt surrounding the role played by informal SBR in economic growth, meaning that this topic is one that deserves further research. The two kinds of informal state–business connections presented above are grouped together and referred to as social and political connections (SPC). Combining them in this way highlights the fact that both types of connections result in commitments that are not instigated to generate economic benefits for the partners involved. In both social and political connections, the group's well-being is a common driving motive; for instance, the well-being of an ethnic group or social class is the motive for social connections, while the well-being of the ruling party or regime is the motive for political connections.

Both sides are expected to benefit from their mutual cooperation. From a public choice theory perspective, governments can be analyzed as a collection of different players including politicians, bureaucrats, and others. Each of these players seeks his own interest, while the actions of the government as a whole are simply the collective action of these interest-motivated players. By establishing new or utilizing pre-existing SPC with businessmen, a government player seeks to achieve one or more of his objectives. Businesspeople own the resources that allow them to stabilize the system by investing and creating better economic conditions. They can also help to reelect politicians either indirectly (by helping to improve the economy) or directly (by financing election campaigns). Moreover, they can help to enrich government players legally through taxes or illegally through corruption. Connected businessmen, on the other hand, benefit from their relations with politicians and bureaucrats by getting better policies, regulations, etc. for the few connected (i.e., cronyism) or for the whole private sector.

Whether society benefits from informal SBR or not is another question. Given the problems associated with governments and businesses, it is suggested that collaborations between governments and businesspeople allow each party to compensate for the deficiencies of the other party, leading to better economic outcomes. Examples of business failures include "information related market and co-ordination failures" in the fields of "skill development, infrastructure provision, technological development, and capital markets" (Leftwich and te Velde 2010, 6–7). Hausmann et al. (2008) pointed out that business failures include self-discovery externalities (identifying new potentially profitable products), "coordination externalities" (the need for coordination in new economic activities), and lacking public inputs (e.g., missing legislation, R&D, accreditation, infrastructure, and transport, etc.). UNIDO (2000) identified market failures as "impacted information" (i.e., information required by the business is either unavailable or costly), "managerial myopia" (i.e., shortsightedness, an inability to optimally use the available information), low provision levels of public goods (e.g., education, infrastructure, etc.), and coordination failures (i.e., information is available and understood but a lack of coordination among the actors inhibits action). On the other hand, government failures include imperfect information and foresight and moral hazard problems (Hausmann and Rodrik 2003), as well as rent seeking and misallocation potential (Leftwich and te Velde 2010; te Velde 2009). Moreover, UNIDO (2000) pointed out that the public sector, especially in developing countries, often lacks the administrative capacity, financial resources, and technological capabilities needed to target economic development.

The success of SBR (either all SBR or only informal forms of SBR) in addressing these failures and promoting better economic performance has been discussed in many works. Evans (1997, 67, 70), using the concept of "embeddedness," argued that SBR have positive effects on economic growth due to information exchange between state officials and businesspeople. Similarly, Haggard et al. (1997) believed that this information exchange improves policy design and lowers transaction costs.[4] This was also suggested by Haber et al. (2001) to be the case for SPC. Utilizing the concept of "political vertical integration" (through the engagement of officials in business activities and vice versa), they suggested that SPC benefits both sides and society in general. This integration is induced by information asymmetries between the two parties and, accordingly, their attempts to reduce opportunistic behavior from either side. For example, the enhanced knowledge of markets and technology possessed by businesspeople and the government's own agenda (which is unknown to the private sector) could both represent information asymmetries. The resulting integration can involve either recruiting executive officials (e.g., cabinet ministers) from the business world or appointing senior officials to the boards of private companies. According to the authors, what businesspeople would gain from such integration is the opportunity to influence policies which affect their activities and ensure that the government is following these policies. On the other hand, the government would benefit from gaining businessmen's confidence, which would mean encouraging them to put more resources into productive investment and hence generate more tax revenues. According to the works discussed above, one can highlight building trust, information exchange, and policy recommendations as possible routes through which SPC could lead to economic growth.

Nevertheless, as discussed before, the literature on rent seeking (e.g., Olson 1982) presents a totally different perspective. In this perspective, interest groups (e.g., businesspeople) seeking distributional gains would influence government policies and regulations, ultimately leading to loss of efficiency and lower economic growth (Mueller 2003, 554–558). Furthermore, given the potential for cronyism embedded in SPC (as discussed later), the proposal that SBR (specifically SPC) promote growth becomes more doubtful.

I conclude this section by saying that SPC—just like other SBR—can lead to economic growth, mainly through trust-building, information exchange, and by channeling policy recommendations. All of these should encourage investment due to increased trust or better policies motivated by the circulation of better information and recommendations. More investment should, in turn, lead to

[4] Among the other works that have discussed this issue for the whole economy or only for certain firms are Rojid et al. (2010), Ackah et al. (2009), and Slinko et al. (2005).

economic growth. There are still, however, valid doubts about the rent-seeking and cronyism that can be associated with SPC, which might counteract their assumed positive effect on investment. This ambiguity with regard to SPC and growth invites us to explore the issue further. I argue that the answer to this puzzle can be found in the institutional setting. In the following section, I argue theoretically that the success of SPC in promoting economic growth depends on the presence of certain institutions. This relation is twofold. While SPC can correct for the effects of certain institutions that are perceived to hinder growth, SPC require the presence of other institutions to yield better economic outcomes.

2.2 Institutional factors

How can institutions shape the effect of SPC on economic growth? Let's consider the following example involving a number of geographically close countries (see Table 1). Of the four Far East Asian countries South Korea, Indonesia, Malaysia,

Table 1 SPC, various institutions, and economic outcomes in some South East Asian countries (2011–2015) Source: author's calculations based on the same data sources used in the regression

	Indonesia	Malaysia	S. Korea	Thailand	Global	
					Average	Median
SPC	High	High	Below average	High	4%	2%
Governance institutions						
Control of corruption	Low	High	High	Low	0	−0.29
Government effectiveness	Low	High	High	High	−0.002	−0.11
Regulatory quality	Low	High	High	High	−0.002	−0.104
Rule of law	Low	High	High	Low	0.002	−0.144
Voice and accountability	High	Low	High	Low	0.012	0.029
Other institutions						
Legal origins	French	British	German	British	–	–
Religion	Islam	Islam (maj.) Buddhist (min.)	Buddhist and Protestant	Buddhist	–	–
Ethnic fractionalization	High	High	Low	High	0.32	0.3
Economic outcomes						
Gross capital formation (% growth)	High	High	Low	Low	3.52%	3.12%
GDP per capita	Low	High	High	Low	9917.27	9902.17

In this table, comparisons are made with the global average and median performance. Levels above the median or average were considered high and levels below them were considered low. A value between these high and low values is reported as being above or below average, depending on the level of the average. The values of the various indicators for the countries presented here were calculated from their average performance levels between 2011 and 2015 and by comparing them to the global average and median values for the same period and Thailand, all but South Korea have higher SPC levels than the global average, while South Korea has a level which is higher than the median but lower than the average. South Korea has a high level of GDP per capita, Indonesia has the opposite, while Malaysia and Thailand show high (albeit not far from the global average) and poor performance levels, respectively. Their institutional settings are completely different, raising the question of which institutional and economic factors are responsible for such different SPC outcomes for geographically comparable countries? South Korea has low ethnic fractionalization, German civil law, Buddhist and Protestant cultures, and high governance performance in rule of law, regulatory quality, government efficiency, voice and accountability, and control of corruption. The result is a high level of GDP per capita. Indonesia, however, has high ethnic fractionalization, French civil law, Islamic culture, and low governance performance in all of the fields stated above except for voice and accountability. Its economic performance is also the opposite to that of South Korea, with a low GDP per capita. Yet, Malaysia has a totally different institutional setting and a below-average GDP per capita. It has high ethnic fractionalization, British common law, Islamic (with a Buddhist minority) culture, and high governance performance except in voice and accountability. Thailand makes it even more difficult to draw any conclusions about the influence of the institutional setting, as it has a below-average GDP per capita (similar to Indonesia) but it shares with Indonesia high ethnic fractionalization levels and British common law, although it has a Buddhist culture. While it performs well in some governance indicators, this is distorted by relatively low levels of voice and accountability as well as weak rule of law and control of corruption.

Which of these mentioned institutions are responsible for the different economic outcomes of these countries, which have arguably comparable levels of SPC? And how? The following discussion attempts to answer these and similar questions. It is divided into two parts: the first explores which of the institutions could help SPC to promote growth, and the second focuses on institutions that are generally perceived to have a negative effect on growth and how SPC could counteract such effects, thus leading to positive economic results. The discussion focuses on the interactions of these institutions with SPC and the consequent effect on economic growth.

2.2.1 *Institutions that boost the economic growth potential of SPC*

I argue here that SPC require some institutions before they can promote economic growth in a society. The best examples of such institutions are those of good governance, which are widely suggested to have a positive effect on general economic performance. The definition of a good governance institution has been discussed extensively in the literature on governance. Countries are being evaluated and ranked as well as advised on how to reform their institutions with the ultimate objective of achieving good economic performance. In this section, we focus in particular on institutions highlighted by The World Bank (2010a, b) and the governance indicators of Kaufmann et al. (2009). Out of these six indicators, the most relevant to this discussion are: rule of law, regulatory quality, government effectiveness, voice and accountability, and control of corruption.[5]

Given the previously mentioned concerns about the relationship between informal SBR and cronyism, I am going to start by considering the *control of corruption*. I argue that SPC would be prevented from slipping into cronyism in a country where corruption is less tolerated (i.e., with strong control of corruption). Having minimized the danger of cronyism and its negative economic implications, the potentially positive impact of SPC on growth could then be realized through trust-building, by facilitating information exchange, and by channeling policy recommendations. Cronyism can be defined as preferential treatment offered by officials to old friends, associates, or (a few) politically connected businessmen, regardless of their qualifications, permitting them to generate extraordinary returns (Begley et al. 2010; Mazumdar 2008). As can be inferred from the definition, high levels of cronyism presuppose the presence of SPC. For instance, the literature on politically connected firms (e.g., Faccio 2006) suggests that crony relations result from these connections. The privileges that the state can provide to its cronies as pointed out in the literature are: preferential credit allocation, privileged market position, import licenses, subsidies, government contracts, and favorable taxation conditions.[6] In the literature, many works have argued for and empirically found a negative relation between cronyism (and generally corruption) on the one hand and growth on the other (Rock and Bonnett 2004, 999).[7] Cronyism is believed to augment transaction costs and to cause rent seeking and distortion in economic incentives (Kang 2003). Desai (2007) proposed that cronyism undermines markets by increasing the business costs for unconnected firms and by inducing less spending on innovation and more on building political ties.

On the contrary, Kang (2003) suggested that cronyism and growth are not necessarily conflicting outcomes; they can even have a positive correlation in some circumstances. What matters is lowering transaction costs, and effective cronyism (relying on personal relations) can lead to the circulation of better information, the creation of more opportunities, the enhancement of integrity and credibility, reduced monitoring costs, and can promote the enforcement of agreements. As argued by Rock and Bonnett (2004), newly industrializing countries (NIC) in East Asia are examples of countries that are experiencing higher levels of both corruption and growth. Nevertheless, one could argue that lots of the positive mechanisms attributed by Kang (2003) to cronyism actually originate from SPC, and that by fighting corruption and cronyism, SPC could even prompt greater economic growth.

A second important governance institution is *regulatory quality*. The World-Bank-sponsored Doing Business reports, which draw upon a huge body of

[5] The indicator of political stability and lack of violence was dropped due to it being less relevant to this discussion.

[6] With regard to credit allocation and how state–business connections drift towards cronyism, see Faccio (2006). For preferential market position as a crony privilege, see Djankov et al. (2002) and Mazumdar (2008). For tax privileges, see Desai (2007).

[7] For example, Knack and Keefer (1995), as well as the literature on rent seeking, find a negative relation between corruption and growth (Rock and Bonnett 2004, 999).

theoretical and empirical literature,[8] suggest that good regulatory performance (e.g., less regulation of entry, facilitation of credit, facilitation of trade, etc.) brings more investment and growth. However, the effect of regulatory quality on the growth outcome of SPC requires closer examination. On the one hand, connected businessmen could benefit from some bad regulatory settings that provide them with privileges over the non-connected in practices that could be referred to as cronyism. This is the case, for example, with strict regulation of entry, as suggested by Djankov et al. (2002). The effect of this on economic growth would be similar to the effect of cronyism in general on growth, an issue that has been already discussed. But, on the other hand, good regulations should be expected to benefit connected firms, as they should benefit all businesspeople. This is the case, for instance, with trade facilitation through the simplification of the procedures associated with importing inputs and exporting outputs. So the effect of the interaction of good regulatory performance and SPC on economic growth is rather unclear.

Voice and accountability should lead to better economic outcomes, especially if the focus is on the two main aspects of democracy and the freedom of the mass media. Democracy is suggested to lead to economic growth through the creation of a better business climate (Clarke et al. 2004) and the encouragement of capital inflows (Alfaro et al. 2008). In a democracy, politicians who care about public opinion are motivated to implement good policy recommendations suggested by SPC, thus indicating another SPC-based mechanism for growth. Public opinion also induces politicians to avoid inefficient allocation of privileges to connected businessmen, minimizing the dangers of cronyism. However, there are some concerns over the election campaign funding required by politicians, as this could encourage cronyism. Inefficient allocation should result in reduced economic performance, and the growth outcomes in a democracy will depend on which of the motives is dominant. Freedom of the media, on the other hand, has a positive effect on growth through its positive effect on human development, as discussed in the World Development Report (2002) and in Djankov et al. (2003). Media freedom fosters transparency, as it allows the media to monitor the allocation of privileges to connected businessmen (Farlam 2005). Through its information arsenal and presumedly unbiased stance, it can be society's check on unjustifiable growth-suppressing preferential treatment of connected businessmen, again minimizing the danger posed by cronyism in SPC.

Government or bureaucratic efficiency is another major governance factor that is believed to lead to better economic outcomes (Alfaro et al. 2008; Doner et al. 2005). One of the best bureaucratic qualities is bureaucratic independence, as indicated by the meritocratic recruitment of bureaucrats, which should free bureaucrats from political pressures (Dahlström et al. 2011). Such independence should minimize cronyism since (arguably) bureaucrats that are free of political influence should not have an interest in providing privileges to politically connected businessmen. As

[8] See, for instance, the Doing Business yearly reports, Alesina et al. (2005), and Klapper et al. (2006). These are examples of works that show the negative relationship between regulation of entry and growth either directly or through the former's effect on foreign direct investment, investment, productivity, human capital, and the upgrading of technology.

long as this leads to improved allocation of resources and policy implementation and minimizes the potential of SPC for cronyism, it should lead to more growth. More generally, an efficient bureaucracy is better equipped to implement the policy recommendations of connected businessmen and address their business concerns.

Finally, it is argued that the *rule of law*, including safeguarding property rights and contract enforcement, is crucial to economic growth. According to Clague et al. (1999), sophisticated transactions necessitate the presence of governments as third-party enforcers in situations where neither the market nor reputation mechanisms can perform this function, otherwise investment expansion, innovation, the acquisition of new technology, and thus economic growth would face serious impediments. North believed that growth was fostered by the state's protection of property rights and enforcement of contracts (among other factors), which helps to reduce transaction costs. This has been confirmed empirically by many studies (Shirley 2005).[9] Arguably, strengthening the rule of law could minimize the potential for cronyism in SPC. Protecting the property rights of all businesspeople results in fewer opportunities for connected businessmen to use their connections to predate on the rights of the non-connected. However, an important point to make here is that, in a society characterized by poor enforcement of rule of law, SPC could be an alternative. Haber et al. (2001) argued that its ability to build trust between connected businessmen and officials could allow SPC to substitute for the rule of law in investment and growth. Granovetter (1985), for instance, argued that strong interpersonal ties (e.g., SPC) act as a substitute for formal contracts by offering a "social control mechanism" based on trust (Peng and Zhou 2005).

2.2.2 *Institutions that SPC could counteract*

As argued before, SPC could lead to growth by building trust, facilitating information exchange, and channeling better policy recommendations. These positive attributes could possibly counteract the effects of institutions that are widely perceived as having negative effects on growth because they lack one or more of these attributes. Here, I suggest the following institutions: French civil law (from the set of legal institutions) and hierarchical and ethnically fractionalized cultures (from the cultural group of institutions).

French civil law is argued to have unfavorable effects on economic growth. The literature suggests that British common law, in comparison to French civil law, promotes economic growth (Mahoney 2001; La Porta et al. 2008; Djankov et al. 2002; Klapper et al. 2006). This is attributed mainly to the protection of property rights, which limits the government's actions and power and encourages investment. In contrast, French civil law places the government in a powerful position with regard to businesspeople and their property claims. Moreover, the British legal system (but also the German legal system), in comparison to the French legal system, is suggested by Beck et al. (2003) to be growth-inducing due to its adaptability to new economic conditions (the relative importance of jurisprudence in

[9] For instance, Barro (1991) and Knack and Keefer (1995) show empirically that protecting property rights leads to economic growth (Glaeser et al. 2003).

law-making). Arguably, as for the rule of law, SPC could substitute for French civil law by providing an alternative mechanism for encouraging investment. This is because SPC enhance the trust of connected businessmen in government intentions regarding the safeguarding of property rights. Nevertheless, French legal system's relative lack of adaptability implies that the use of SPC as a channel for suggesting policies could be impeded by institutional rigidity, denying society one of the mechanisms by which SPC can promote growth (i.e., via policy recommendations).

Cultural values that build distrust and discourage cooperative working among society members arguably hinder economic growth. According to the works of La Porta et al. (1997) and Pellegrini and Gerlagh (2008), *hierarchical cultures* based on hierarchical religious structures are examples of such institutions. La Porta et al. (1997) propose that hierarchical structures discourage the development of horizontal connections among society members, ultimately leading to less trust in society. Arguably, by building horizontal links between the parties involved, SPC could help to generate the trust missing from hierarchical cultures, leading to better economic outcomes.

In the case of *ethnic fractionalization*, a combination of racial, linguistic, and religious diversity and interethnic tensions have a negative effect on the growth prospects of a society. Many works, such as Treisman (2000) and Fisman and Gatti (2002), have suggested that heterogeneous populations with "competing social groups" do not tend to reach a "cooperative solution." Accordingly, a lack of consensus on the provision of public goods is commonly invoked as a reason for the suppressive effect of fractionalization on economic growth, as argued in Alesina et al. (1999) and Fosu et al. (2006). In a continent witnessing major ethnic tensions, Easterly and Levine (1997) found that ethnic diversity harmed Africa's growth prospects, and was responsible for about 28% of the growth differential between this continent and East Asia. Being unable to work cooperatively arguably reflects low levels of trust among the population. Since SPC are based on family and ethnic (among other) ties, such state–business connections are more likely to develop in ethnically fractionalized societies. As far as economic outcomes are concerned, SPC can encourage investment when state officials and businessmen are from the same ethnic group, but it can also be argued that political connections (e.g., membership of the same political party) between ethnically different groups might help to build trust, leading to better economic outcomes.

3 Methodology and empirical testing

As a complement to the theoretical discussion provided above, the effects on economic growth of the interactions of SPC with the various institutional variables mentioned above are tested in the empirical part of this paper. I begin this section by highlighting the methodology used in this empirical study.

First, the intensity of informal SBR in a country is measured here by the number of informal state–business networks (SBN) that bind state officials to businesspeople. In turn, informal SBN are measured by the number of connections that bind the players involved. Consequently, informal SBR is a function of the number of social and political connections that exist between state officials and businesspeople.

Second, the connections are considered from the perspective of the business players. Thus, connections are considered to flow from a business player (e.g., a firm or businessman) to state officials, and are counted accordingly. A businessman is either connected or not, and the number of connections is the same as the number of connected businessmen. On the other hand, the same official can be engaged in more than one connection with businessmen. So, for instance, an official could be a family relative to one businessman (social connection), while the official could also be a member of the same political party as another businessman (political connection). As long as they are different businessmen, this official's relations are regarded as two SPC. Moreover, the intensity of the relationship between the players is disregarded, although it could be argued that this could be an important aspect (e.g., a brother as compared to a university colleague). Furthermore, depending on the proxy used (as described shortly), each firm is regarded as being only one business player through its top officers, managers, and shareholders. On the government side, however, each official or parliamentarian is regarded as one player. Finally, in the dataset used here, the sample of firms studied varies from one country to another, so the percentage of connected firms rather than the number of connections is used as a proxy.

As briefly mentioned in the "Introduction," this is a totally different approach from that usually used in the SBR literature. In works such as Sen and te Velde (2009) and Leftwich (2009), the effectiveness of SBR is calculated according to various criteria such as how business players interact with each other and organize, how business players interact with each other with regard to their relation with the government, and finally the form of the SBR that link the two parties. This is a normative approach in which a value is assigned to each country studied based on the abovementioned criteria. The approach used here, on the contrary, focuses on the intensity of connections without providing any normative judgment.

The dataset used is the one provided by Faccio (2006) and her subsequent works. She used a huge dataset of large shareholders or the top management in tens of thousands of firms in 47 countries and matched them with available lists of politicians (e.g., members of parliament, ministers, people closely related to top politicians). Among the indices she developed, the "percentage of firms connected with a parliament member, minister or a person with a close relationship with top politicians" is of the greatest relevance, and is the index used here as a proxy for SPC (note that the "person with a close relationship with top politicians" fits the description used here for social relations). The values used for different countries are listed in Table 2.

The effects of the interactions of SPC with the discussed institutional variables are examined using an OLS cross-sectional regression that includes SPC, the institutional variables, and the terms representing interactions of SPC with institutional variables. The regression is conducted using the Gretl program. In this regression, the following equation is considered:

Table 2 Data from Faccio (2006) used as a proxy for SPC
Source: Faccio (2006)

	Political connections	Sociopolitical connections		
	A	B	C	D
Argentina	0	0	0	0
Australia	0.7	0.7	0	0.32
Austria	0.91	0.91	2	0.25
Belgium	3.82	3.82	8	18.77
Brazil	0	0	0	0
Canada	1.31	1.31	2	2.53
Chile	2.25	2.25	4	1.43
Colombia	0	0	0	0
Czech Rep.	0	0	0	0
Denmark	3.07	3.07	6	2.52
Finland	1.52	1.52	0	0.14
France	1.75	2.19	10	8.03
Germany	1.31	1.55	2	1.2
Greece	0.65	0.65	0	0.09
Hong Kong	0.74	1.98	6	2.33
Hungary	3.7	3.7	3.85	2.81
India	2.79	2.79	2	1.83
Indonesia	7.79	22.08	24	12.76
Ireland	2.44	2.44	4	22.83
Israel	3.64	3.64	4.26	8.13
Italy	10.3	10.3	16	11.27
Japan	1.29	1.34	2	1.34
Luxembourg	4.35	4.35	4.55	10.48
Malaysia	5.17	19.78	44	28.24
Mexico	6.38	8.51	12	8.14
Netherlands	0.42	0.42	0	0.01
New Zealand	0	0	0	0
Norway	0	0	0	0
Peru	0	0	0	0
Philippines	0.88	4.39	8	16.16
Poland	0	0	0	0
Portugal	2.97	2.97	4	2
Russia	12	20	36.36	86.75
Singapore	7.86	7.86	4	2.59
South Africa	0	0	0	0
South Korea	2.24	2.56	4	8.95
Spain	1.5	1.5	0	0.82
Sri Lanka	0	0	0	0
Sweden	1.07	1.07	4	1.02

Table 2 continued

	Political connections	Sociopolitical connections		
	A	B	C	D
Switzerland	2.47	2.47	4	0.69
Taiwan	0.84	3.38	10	12.74
Thailand	8.24	15.05	34	41.62
Turkey	1.19	1.19	0	0.14
UK	7.17	7.17	46	39.02
US	0.08	0.2	6	4.94
Venezuela	0	0	0	0
Zimbabwe	0	0	0	0

A % of firms connected with a minister or MP, *B* % of firms connected with a minister, MP, or a person with a close relationship to top politicians, *C* % of top 50 firms connected with a minister, MP, or a person with a close relationship to top politicians, *D* connected firms as a % of market capitalization

$$\text{Economic growth} = c + \beta\,(\text{SPC}) + \lambda\,(\text{institutions}) + \alpha\,(\text{SPC} * \text{ institutions}) + \rho\,(\text{control variables}) + \mu.$$

In this equation, “SPC” stands for informal social and political connections, “institutions” is a matrix of the discussed-above institutional variables, “SPC $*$ institutions” is a matrix of interactions between SPC and each of the considered institutions, and “control variables” are variables used (without interaction terms) in order to sharpen the results of the regression. Below is a discussion on each of the considered variables and the sources from which they are obtained. The regression conducted here builds on a massive body of empirical works that have regressed institutional variables, including the institutions discussed in this work, on economic growth. For instance, the effect of corruption on economic growth and investment is tested in Rock and Bonnett (2004), the effect of property rights on growth is considered in Barro (1991) and Knack and Keefer (1995), the influence of bureaucratic quality on growth is addressed in Evans and Rauch (1999), the impact of regulations on investment is explored in Alesina et al. (2005), and the effect of ethnic fractionalization on growth is studied in Easterly and Levine (1997) and Alesina et al. (2003). Governance institutions are treated as exogenous here, just as they are in many of the studies mentioned above. Luckily, most of the countries included in the Faccio (2006) dataset used as a proxy for SPC are developed countries, minimizing concerns over endogeneity. In order to further assuage these concerns, data on gross capital formation annual growth obtained from the World Bank Database are used here as a proxy for economic growth. This relies on the conventional assumption that investment is a positive determinant of growth, as described in Barro (1991), among many others. It also matches the identified ways in which SPC lead to economic growth, namely through trust-building, information exchange, and policy recommendations: all three of these should encourage investment as well as economic growth.

Regulatory quality, control of corruption, rule of law, voice and accountability, and government effectiveness are all obtained from the dataset on World Bank Governance indicators. A short description of what each of these indicators measures is provided in Table 3. Bureaucratic quality is obtained from the PRS

Table 3 Governance indicators Source: World Bank Governance Indicators

Indicator	What it measures
Voice and accountability	"Captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association and a free media"
Government effectiveness	"Captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation and the credibility of the government's commitment to such policies"
Regulatory quality	"Captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development"
Rule of law	"Captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police and the courts as well as the likelihood of crime and violence"
Control of corruption	"Captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests"

The definitions are quoted from the World Bank Governance Indicators website at http://www.info.worldbank.org/governance/wgi/index.aspx#doc

Group's International Country Risk Guide (ICRG). The indicator reflects the expertise, strength, and autonomy of bureaucrats. It reflects the indepedence of bureaucratics more strongly than the government effectiveness variable does. It is worth noting here that these governance indicators are based on surveys that measure subjective views about the performance levels of the relevant institutions; they do not directly measure performance. Any inferences made from the results obtained from these indicators on their own or in interactions with SPC should be considered in this context.

Legal origin is obtained from the World Bank's Lost Decades Social Indicators updated via the dataset of La Porta et al. (2008). Given the countries that are included in the data sample, only two hierarchical cultures are examined here: the Catholic and Orthodox cultures. To measure these variables, the percentage of the population of each country that adheres to each of these churches is obtained from the UN's statistics on ethnocultural characteristics, the CIA Factbook, the Association of Religion Data Archives (ARDA), and other sources. Ethnic fractionalization is obtained from the ethnolinguistic fractionalization index presented in the Quality of Government Dataset and from Alesina et al. (2003). Real interest rates and GDP per capita are used as control variables, and their values are obtained from the World Bank WDI. A summary of the statistics for the data used here is given in Table 4. It is to be noted that SPC, gross capital formation (annual growth), religion-related variables and ethnic fractionalization are represented in decimal numbers instead of percentages. The governance indicators (e.g.: control of corruption, rule of law) are measured in units ranging between −2.5 and +2.5, while the ICRG bureaucracy quality is measured in only positive units with the maximum score of 4. French legal system is a dummy variable.

Table 4 Summary statistics

Variable	Mean	Median	Std. dev.	Min.	Max.	Skewness	Ex. kurtosis
Gross capital formation (annual growth)	0.08	0.07	0.09	−0.15	0.36	0.74	1.8
SPC	0.04	0.02	0.05	0	0.22	2.23	4.2
Control of corruption	0.85	0.97	1.1	−1.33	2.55	−0.14	−1.22
Government effectiveness	0.94	1.1	0.93	−1.3	2.25	−0.54	−0.76
Regulatory quality	0.86	1.11	0.89	−1.96	1.95	−1.05	0.73
Rule of law	0.78	0.95	1.02	−1.73	1.98	−0.65	−0.64
Voice and accountability	0.7	0.94	0.8	−1.54	1.64	−0.81	−0.23
ICRG bureaucracy quality	3.1	3	0.9	1	4	−0.62	−0.58
SPC × control of corruption	0.01	0.01	0.05	−0.18	0.17	−0.99	5.34
SPC × government effectiveness	0.03	0.02	0.05	−0.09	0.24	1.8	6.32
SPC × regulatory quality	0.02	0.02	0.04	−0.08	0.14	0.63	2.3
SPC × rule of law	0.01	0.02	0.05	−0.19	0.13	−1.54	6.28
SPC × voice and accountability	0.01	0.01	0.05	−0.18	0.11	−1.7	6.07
SPC × ICRG bureaucracy quality	0.1	0.06	0.13	0	0.59	1.98	4.19
French legal system	0.43	0	0.5	0	1	0.3	−1.91
Catholic	0.39	0.26	0.38	0.001	0.96	0.36	−1.63
Orthodox	0.05	0.001	0.19	0	0.98	4.31	17.09
Ethnic fractionalization	0.32	0.3	0.22	0.002	0.75	0.34	−1.15
SPC × French legal system	0.02	0	0.05	0	0.22	3.29	10.58
SPC × Catholic	0.01	0.001	0.02	0	0.09	2.93	9.04
SPC × Orthodox	0.004	0	0.02	0	0.14	6.07	34.87
SPC × ethnic fractionalization	0.01	0.002	0.03	0	0.16	3.27	10.55

Imputation is used to account for missing observations (averages of the available data were used as the missing observations). In order to facilitate analysis, variables other than the governance indicators are rescaled to range from 0 and 1. Governance indicators are left to range from 2.5 to −2.5, and the ICRG bureaucracy to range from 0 to 4 (see Table 4). The general-to-specific method is used in the regressions to exclude insignificant variables and to make the results more precise. First the unreduced model with all the variables discussed above is regressed. Then the sequential elimination of insignificant variables is performed in stages, starting with variables with $p > 90\%$ and later eliminating variables with lower p values. This is done as long as the results of the regression are not altered by eliminating insignificant variables. To ensure that this is the case, a F test is applied to the reduced form of the regression (after eliminating insignificant variables).[10] The

[10] For more on the general-to-specific method and the reduction theory on which it is based, see Campos et al. (2005).

Table 5 General economic growth regressions

	Dependent variable: gross capital formation annual growth
Constant	0.26*** (0.04)
Real interest rate	−0.35** (0.15)
SPC	−3.48* (1.73)
Government effectiveness	−0.11*** (0.02)
French legal system	0.07* (0.03)
Ethnic fractionalization	−0.14* (0.07)
SPC × control of corruption	5.21*** (1.1)
SPC × government effectiveness	4.05*** (1.3)
SPC × rule of law	−9.96*** (2.18)
SPC × voice and accountability	3.32*** (0.86)
SPC × French legal system	−4.56*** (1.29)
SPC × Catholic	−2.53** (1.03)
SPC × Orthodox	7.38*** (2)
SPC × ethnic fractionalization	7.85*** (2.71)
Number of observations	37
Parameters	14
Mean dependent variable	0.09
Sum of the squared residuals	0.07
R^2	0.82
$F(9,35)$	8.18
SD-dependent variable	0.1
SE of regression	0.05
Adjusted R^2	0.72
P value (F)	8.01e−06

The general-to-specific method yielded an F test result of $F(10,13) = 0.87$ after excluding many insignificant variables as described in the "Methodology" section of the paper. Excluded variables were GDP per capita, SPC × regulatory quality, SPC × ICRG bureaucracy quality, Catholic, Orthodox, regulatory quality, rule of law, voice and accountability, ICRG bureaucracy quality.

The regressions were conducted using OLS. *** 1%, ** 5%, and * 10% significance. Variables that were removed using the general-to-specific method are reported in the last part of the table

variables eliminated and the results of the F test are reported in the footnote of Table 5.

4 Results and discussion

By focusing on the terms for the interactions of SPC with institutional variables, and discussing only statistically significant terms, this work yielded the results shown in Tables 5 and 6. Table 5 presents the results from the regressions while Table 6 shows the economic significance of each statistically significant variable along with

Table 6 Economic significance based on regressions

Variable	Percentage change in the variable needed to cause a 1% (0.01) increase in the independent variable (depending on the range of the data source)	Percentage change in the variable needed to cause a 1% (0.01) increase in the independent variable (depending on the range of the sample values)
SPC	−0.29	−1.3
Government effectiveness	−1.81	−2.55
SPC × control of corruption	0.04	0.55
SPC × government effectiveness	0.05	0.76
SPC × rule of law	−0.02	−0.32
SPC × voice and accountability	0.06	1.04
SPC × ICRG bureaucracy quality	–	–
French legal system	15.03	15.03
Ethnic fractionalization	−7.08	−9.44
SPC × French legal system	−0.22	−0.99
SPC × Catholic	−0.39	−4.26
SPC × Orthodox	0.14	0.96
SPC × ethnic fractionalization	0.13	0.78

The range of the data source is the range between the maximum and minimum values in the dataset. For example, the values of the governance indicator variables range from +2.5 to −2.5, making the range equal to 5.

Sample value ranges are obtained from the difference between the maximum and minimum values observed in the sample used in the regression. These can be found for each variable in Table 4

the percentage change in each independent variable that is needed to cause a 1% change in the dependent variable.[11]

The interactions of SPC with all of the governance institutions aside from regulation quality are statistically significant. All of these statistically significant interactions have positive effects on investment growth, except for the interaction with rule of law. The economic significance of these interaction variables, and other variables, is shown in Table 6. For instance, a change of around 0.049% in the interaction between SPC and government effectiveness leads to an increase in investment growth of 0.01 (or 1%). The interactions with French legal system and Catholic have negative effects on investment growth. However, the interactions of

[11] To determine the economic significance of each of the interactions, some manipulation of the slope equation was performed: $\partial y/\partial x = \beta$; $\partial x/\partial y = 1/\beta$. To measure the percentage change in a variable that was needed to cause a 1% change (0.01) in Y, we used $\partial x/\partial y = 1/100\beta$.

SPC with Orthodox and ethnic fractionalization have positive effects on investment growth.

Another consideration is the total effect of each independent variable on investment growth; in other words, the effect of each independent variable both with and without its interaction terms.[12] Given the reduced form of the model obtained after using the general-to-specific method, only three variables can be examined. The first is French legal system, and its total effect on investment growth is negative. On the other hand, government effectiveness and ethnic fractionalization both have positive effects.

Hence, ethnic fractionalization and orthodoxy do appear to have negative effects on investment, as suggested in the literature, when SPC are present. The SPC interaction terms with both are economically significant, suggesting that SPC could build trust in societies that strongly need more trust. In doing so, SPC lead to more investment and consequently cause growth. The opposite is true of French legal system, where the presence of SPC seems to aggravate the suggested negative effects of this legal system on investment. SPC do not appear to alter the effect of a powerful state on businesspeople, causing relatively low protection of property rights and less adaptability of societies with French legal systems (it should be noted that the overall effect of the French legal system is negative). SPC also does not seem to promote trust-building or to improve the effect of Catholic cultures on investment. The economic significance of the interaction of SPC with Catholic cultures to investment growth is, however, much smaller upon using the sample range. Another note of caution: the exact percentage of Catholic or Orthodox adherents among the population is not very important, and this percentage should only be taken into account if it reflects the dominance of either cultures. Hypothetically, a large difference in the percentage of adherents between two countries reflects a high likelihood of a significant difference between the countries in the strength of influence of those churches. On the other hand, a narrow difference in the percentage of adherents probably explains nothing. For instance, would a country with a 90% Catholic population be more culturally dominated by Catholicism than one that is only 85% or even 80% Catholic. The percentage of adherents in the population is not a perfect proxy for cultural dominance, and should therefore be treated with caution.

Turning our attention to governance institutions, interactions with control of corruption, government effectiveness, and voice and accountability all have economically significant effects on investment growth. The least strong influence of the three is that of voice and accountability (an increase of 1.04% causes a 1% increase in investment growth using the sample range). However, the results provide evidence that democracy, freedom of the media and speech, and all of the ways in which accountability is fostered do help to obtain the best economic potential from SPC. This view is further strengthened by noting the positive and economically significant effect of the interaction of control of corruption with SPC. This

[12] The formula conventionally used for this is: total effect of X on $Y = \beta_1 + \beta_2 Z$, where β_1 is the coefficient of X without including interactions, β_2 is the coefficient of an interaction term that X is part of, and Z is the other variable involved in the interaction (the mean value of Z can be used).

interaction term can be considered the reciprocal of cronyism—corruption that is attributed to close state–business relations rather than to bribery. The positive effect on investment growth means that achieving close relations between the state and businessmen while controlling cronyism will allow the economic potential of SPC to be most fully realized. This means establishing information flow, trust, and understanding between both sides, but also that the state refrains from providing privileges based on connections. Reinforcing the two institutions of voice and accountability and control of corruption would block the use of SPC to accrue privileges, misallocate resources, and discourage non-connected businessmen from investing. As for the interaction with government effectiveness, the evidence supports the idea that a more effective government administration is more capable of realizing the economic potential of close relations with businessmen along with the accompanying exchange of information and policy recommendations.

A seemingly surprising result is the effect of the interaction of SPC with the rule of law, which has a negative effect on investment growth, in contrast to the conventional view that strengthening the rule of law should lead to economic growth. However, an argument could be made that while both the rule of law and SPC are investment-inducing mechanisms, they are moving in different directions. Could this mean cronyism? In other words, could a strong rule of law block crony privileges (such as stopping the connected from predating on the property rights of other non-connected businessmen) from flowing to SPC, ultimately leading to less investment? If this was the case, it would contradict the results obtained from the interaction between SPC and control of corruption. Another possible explanation may be provided, however, by the definition of the rule of law. I argue that the explanation for this puzzling effect lies in contract enforcement. In countries with a weak rule of law, businessmen find it difficult to enforce contracts, which may discourage them from investing. When connected businessmen use their SPC with officials to enforce their rights, this may be a privilege based on connections but it is not cronyism, since it is not necessarily done at the expense of other non-connected businessmen. The same is true of the facilitation of rapid enforcement of contracts in countries that generally have high levels of red tape. It could also be the case that connected businessmen recommend policies and mechanisms for facilitating the enforcement of contracts in certain sectors, which could be selectively implemented without the other components of the rule of law being altered (property rights, police, etc.), meaning that the rule of law in the country is generally still relatively weak. This agrees with the perspective presented in Moore and Schmitz (2008) and Abdel Latif and Schmitz (2010). In the former work, it is argued that under conditions where weak contract enforcement and the rule of law are prevalent, informal SBR lead to positive effects on investment and growth. This will not necessarily lead to crony capitalism, and may actually eventually lead to institutional reform if connected businesspeople find that protecting property rights will safeguard their wealth. The latter work regarded some aspects of the predominantly informal SBR in Mubarak's Egypt as a "growth alliance" that positively affected industrial performance. This was attributed to its capacity to help investors get over institutional barriers and to foster cooperation between connected businessmen and officials in establishing specific rules for new sectors and improving the existing regulatory framework. One could argue that even if this was the case, in the long run, improvements in contract enforcement and the rule of law should arguably benefit all businesspeople, connected or not, and should lead to better economic outcomes.

5 Conclusion

This paper discussed the effects of the interactions of various institutions with SPC on investment and economic growth. This meant investigating whether governance institutions can help to realize the economic potential of SPC. This work also attempted to explore whether SPC can help to correct the deficiencies in some institutional settings with regard to growth. After a theoretical discussion of the issue that focused on governance, cultural, and legal institutions, the proposals of the theoretical discussion were tested empirically using an OLS cross-sectional regression model. The results of the regression show that the interactions of SPC with government effectiveness, control of corruption, and voice and accountability from among the set of governance institutions have economically and statistically significant positive effects on investment growth. On the other hand, the interaction with the rule of law has a negative effect on investment growth. In terms of the other institutions considered, interactions of SPC with Orthodox culture and ethnic fractionalization have economically significant positive effects on investment growth, suggesting that, through trust-building, SPC improve the institutional deficiencies that have been suggested in the literature for these variables on their own. This was not the case, however, in the interactions of French legal system and Catholic culture, which had economically significant negative effects on investment growth. The results obtained for the interaction terms of the Catholic and Orthodox cultures should, however, be treated with caution given the proxies that are used for the two variables.

This work suggests that SPC do have a positive effect on investment when good institutions are established. In this paper, those institutions are suggested to be voice and accountability, control of corruption/cronyism, and government effectiveness. It also suggests that SPC can overcome some institutional impediments such as ethnic fractionalization and (with less certainty) Orthodox culture. Also, by building trust, SPC should promote investment and economic growth. Even though the proxy used for SPC shows a sharp contrast between the institutional settings of predominantly developed countries and those of developing countries, the same policy recommendations are arguably relevant to both. State–business relations help growth when there are good governance institutions. International organizations should devote more of their attention to linking their developmental aid to major reforms in these key institutions. Improving the performance of governance institutions is likely to help ensure that resources that are intended to assist developing countries out of economic hardship are efficiently used. By increasing governmental commitment to fighting corruption and ensuring high levels of transparency and accountability to the public, thus safeguarding the SBR-channeled policy recommendations of businesspeople from being warped into cronyism, and by increasing the efficiency of government agencies to make them more capable of effectively carrying out the suggested policies, it should be possible to waste less international aid due to poor planning and implementation or corruption.

An important point to be made here is that this discussion does not conflict with the perception that formal SBR is important for obtaining better economic outcomes. Developing good governance institutions leads to better outcomes from existing informal SBR, but formalizing SBR and engaging most businesspeople in such relations could further multiply their benefits. In fact, PPD—a type of formal SBR—could be regarded as a form of collaborative governance.[13] PPD are acknowledged by international organizations to be institutions that should lead to better economic outcomes. Since 2006, the World Bank has sponsored international workshops on PPD to discuss experiences from around the world in this field, while the International Association of Economic and Social Councils and Related Institutions (AICESIS) has members in dozens of countries and acts as a platform for the exchange of views among its members.[14] There is a body of literature supported by the World Bank and UNIDO as well as others that describes how PPD could help economic growth. PPD are additionally believed to minimize the prospect of cronyism, which is often a major concern with SPC. Herzberg and Wright (2005), for instance, argued that PPD help to expose corruption (generally speaking) by allowing the private sector to monitor the performance of the government.[15] Thus, building good governance institutions could also mean establishing PPD and channeling all the positive growth potential of SPC through this formalized and more transparent form of SBR.

Finally, it is important to point out the limitations of this research. Its greatest limitation is the valuable yet limited dataset available for SPC and obtained from Faccio (2006). A dataset that included more countries and covered a wider time interval should lead to greater and sharper insights into the topic discussed here. This would considerably expand the horizon of research into this very important subject and allow better policy recommendations to evolve from the literature. Another point is that the results obtained here explore only some of the mechanisms by which informal SBR affect economic growth. This is an exploration that is limited not only by the characteristics of the proxies used, but also by the small number of variables considered. Many of the variables used could be unbundled into their constituents, allowing us to gain a much better understanding of the data. For instance, which of the constituents of voice and accountability would help SPC the most to achieve better economic outcomes—democracy, freedom of the press, civil rights, availability of official documents to the public? A similar question could be asked for control of corruption—is it fighting cronyism, state capture, or bribery? Also, with regard to government effectiveness, we might wonder whether the independence of the bureaucrats, their education and training, their age and experience, or any other differences are the most important influences on the

[13] See Ansell and Gash (2007).

[14] For more details, see the website of WB-sponsored PPD workshops (http://www.publicprivatedialogue.org), as well as the AICESIS website (http://www.aicesis.org).

[15] For more on this discussion, see Sabry (2013).

attainment of better economic outcomes through SPC. It is plausible to think that expanding the data available for these and other variables would extremely be beneficial to research in this field, which is still a challenging one that invites further investigation and research.

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