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CONTENTS

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   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

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PUBLIC POLICIES, BUSINESS ENVIRONMENT, AND ECONOMIC GROWTH IN DEVELOPING COUNTRIES

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ABSTRACT

This paper examines the impact of public policies and the business environment on economic growth in developing countries. Based on data from the World Bank for the 2000-2011 period and a sample of fifty-six developing economies we find that the growth rate of per capita GDP is dependent on a country's economic management, its structural policies, its policies for social inclusion and equity, the number of procedures to build a warehouse, and the cost of starting a business as a percent of per capita income. We observe that the coefficient estimates of two explanatory variables, namely, the structural policies average and the number of procedures to build a warehouse, do not have their expected sign, possibly to the collinearity between the structural policies average variable and the economic management average variable as well as the policies for social inclusion and equity average variable. On the other hand, the cost of starting a business as a percent of per capita income is not significant using the t-test. We suspect that this is also due to the collinearity between this variable and three policies variables. Statistical results of such empirical examination will assist governments in developing countries focus on appropriate policies dealing with economic management, those of a structural nature, and those for social inclusion and equity while recognizing the importance of a good business environment in order to foster economic growth.

JEL CLASSIFICATIONS

O12, O15, O40

KEYWORDS

Doing Business Indicators, Public Policies and Institutions, Per Capita GDP Growth, Developing Countries.

I. INTRODUCTION

This study empirically examines the impact of public policies and the business environment on economic growth. According to the *2013 World Development Report: Jobs*, while the key engine of job creation is the private sector, being responsible for 90 percent of all jobs in the developing economies, governments also play a crucial role in ensuring that the conditions are present for robust private sector-led economic growth and in easing the constraints that prevent the private sector from creating good jobs for growth. The Report identifies the first stage in the approach to assist government meet these goals as policy fundamentals which include, among other things, macroeconomic stability and a business environment conducive to investment and hence to growth.

This paper attempts to estimate the impact of public policies and the business environment on economic growth. Based on data from the World Bank for the 2000-2011 period and a sample of fifty-six[i] developing economies we find that the growth rate of per capita GDP is dependent on a country's economic management, its structural policies, its policies for social inclusion and equity, the number of procedures to build a warehouse, and the cost of starting a business as a percent of per capita income. We observe that the coefficient estimates of two explanatory variables, namely, the structural policies average and the number of procedures to build a warehouse, do not have their expected sign, possibly to the collinearity between the structural policies average variable and the economic management average variable as well as the policies for social inclusion and equity average variable. On the other hand, the cost of starting a business as percent of per capita income is not significant using the t-test. We suspect that this is also due to the collinearity between this variable and three policies variables. Statistical results of such empirical examination will assist governments in developing countries focus on appropriate policies dealing with economic management, those of a structural nature, and those for social inclusion and equity while recognizing the importance of a good business environment in order to foster economic growth.

This paper is organized as follows. In the next section, a selected review of the economic literature on the effect of institutions and business environment on economic growth is discussed. This is followed by the formulation of a statistical model to be estimated. Theoretical underpinnings for the inclusion of explanatory variables are presented in this section. Statistical results are reported in the subsequent section. A final section gives concluding remarks as well as policy recommendations.

II. SELECTED REVIEW OF THE LITERATURE

Much of the research on identifying the key determinants of economic growth in developing countries recently points to differences in underlying public policies and institutions as the main factor. Empirical studies have used a myriad of variables as proxies for institutions, which include measures of the risk of expropriation, the limits to the power of the executive branch and the power of the rule of law (see, for example, Hall and Jones (1999) and Acemoglu, Johnson and Robinson (2001)). Frankel and Romer (1999), on the other hand, identify as a primary factor of economic development as measured by per capita income specific economic policies such as the extent to which a country is open to international trade, while Gallup, Sachs and Mellinger (1999) attribute development to geographical determinants such as differences in climate and coastal access.

Using instrumental variable regressions, Rodrik, Subramanian and Trebbi (2004) evaluate the main competing explanations, namely good institutions and good economic policies as well as geography and show that institutions measured as a variable defining the strength of the rule of law are dominant relative to both economic policy measured as the degree of openness to international trade and geography in terms of explaining cross-country variations in per capita income levels. Glaeser, La Porta, Lopez-de-Silanes, and Shleifer (2006), however, revisit the issue of whether political institutions lead to economic growth or growth and human capital accumulation cause to better institutions. They argue that most indicators of institutional quality are conceptually unsuitable for being used in explaining growth and also find flaw in some of the instrumental variable techniques used in the literature. Their basic OLS results suggest that education levels are a more basic source of growth rather than institutions. Djankov, McLiesh, and Ramalho (2006) use objective measures of business regulations in 135 countries find a positive relationship between better regulations as measured by the Doing Business indicator and economic growth.

More recently, Gillanders and Whelan (2010) argue that the emphasis on the primacy of legal and political institutions may be misleading and argue that business-friendly economic policies as proxied by the World Bank's Doing Business indicator are the main factor contributing to cross-country differences in per capita income levels. They find that the Doing Business rank is dominant over a range of measures of legal and political institutional quality in terms of explaining variations in per capita income. They also find the rank to be statistically significant in explaining cross-country differences in economic growth while observing that the significant role of educational attainment as found by previous studies is not supported when the rank is included in their growth regressions.

Building upon the first stage in the approach to help governments in developing countries meet the objectives of both insuring that the conditions are present for robust private sector-led growth and easing the constraints that prevent the private sector from creating good jobs for development, namely policy fundamentals that include sound policies and an enabling business environment, we next specify a statistical model relating public policies and business environment to the growth of per capita income. Empirical results are presented in a subsequent section. The final section gives concluding remarks as well as policy implications.

III. THE STATISTICAL MODEL

Following Djankov, McLiesh, and Ramalho (2004) and Gillanders and Whelan (2010), we use the World Bank's Doing Business indicators as proxies for business-friendly economic policies (also referred to as objective measures of business regulations)[ii]. To estimate the impact of public policies and institutions on economic growth we shall make use of the criteria set out by the World Bank Group's International Development Association (IDA). This organization helps the poorest countries reduce their poverty level by giving concessional loans and grants for those programs designed to foster economic growth and raise living standards. It assesses a country's performance using a set of 16 criteria that are grouped into four clusters: economic management, structural policies, policies for social inclusion and equity, and public sector management and institutions. Each criterion is rated on a scale ranging from 1 (low) to 6 (high). The economic management cluster includes the following criteria: macroeconomic management, fiscal policy, debt policy. The criteria which make up the structural policies cluster are: trade, financial sector, and business regulation environment. The policies for social inclusion and equity cluster includes the following criteria: gender equality, equity of public resource use, building human resources, social protection and labor, and policies and institutions for environmental sustainability. The criteria which make up the public sector management and institutions cluster are: Property rights and rule-based governance, quality of budgetary and financial management, efficiency of revenue mobilization, quality of public administration, and transparency, accountability, and corruption in the public sector. Rather than using every one of these 16 criteria as explanatory variables we choose to include the average score for each cluster.
To estimate the impact of public policies, institutions, and the business environment on economic growth we specify the following statistical model[iii]:

$$\begin{aligned} y_{pc} = \beta_0 &+ \underset{(+)}{\beta_1 PubMgt} + \underset{(+)}{\beta_2 SocIncEq} + \underset{(+)}{\beta_3 EcnMgt} + \underset{(+)}{\beta_4 StrlPol} + \underset{(-)}{\beta_5 CnstNum} + \underset{(+)}{\beta_6 CnstDays} \\ &+ \underset{(-)}{\beta_7 CntrctNum} + \underset{(-)}{\beta_8 Cntrct\ Days} + \underset{(-)}{\beta_9 InsolDays} + \underset{(-)}{\beta_{10} RegNumb} + \underset{(-)}{\beta_{11} RegDays} \\ &+ \underset{(-)}{\beta_{12} StartNumb} + \underset{(-)}{\beta_{13} StartDays} + \underset{(-)}{\beta_{14} StartCost} + \underset{(-)}{\beta_{15} ElectDays} + \underset{(+)}{\beta_{16} DiscIndx} + \epsilon \quad (1) \end{aligned}$$

where y_{pc} = Average annual growth rate of per capita GDP, 2000-11.
PubMgt = Public sector management and institutions average, rated on a scale of 1 (low) to 6 (high), in 2010.
SocIncEq = Policies for social inclusion and equity average, rated on a scale of 1 (low) to 6 (high), in 2010.
EcnMgt = Economic management average, rated on a scale of 1 (low) to 6 (high), in 2010.
StrlPol = Structural policies average, rated on a scale of 1 (low) to 6 (high), in 2010.
CnstNum = Number of procedures to build a warehouse, in June 2011.
CnstDays = Time required to build a warehouse, in days, in June 2011.
CntrctNum = Number of procedures to enforce contracts, in June 2011.
Cntrct Days = Time required to enforce contracts, in days, in June 2011.
InsolDays = Time required to resolve insolvency, in days, in June 2011.
RegNumb = Number of procedures to register a property, in June 2011.
RegDays = Time required to register a property, in days, in June 2011.
StartNumb = Number of procedures to start a business, in June 2011.
StartDays = Time required to start a business, in days, in June 2011.
StartCost = Cost of starting a business as a percent of per capita income, in June 2011.
ElectDays = Time required to get electricity, in days, in June 2011.
DiscIndx = Disclosure index, from 0-10 (least to most disclosure), in June 2011.

We use the 2000-2011 per capita GDP growth rate at market prices based on constant local currency for y_{pc}. We expect the coefficient estimates for all four public policies and institutions variables to have a positive sign. On the other hand, with the exception of the disclosure index variable, we expect the coefficient estimates for all other Doing Business indicators to have a negative sign.
Data for all variables are from the *2012* and the *2013 World Bank Indicators.*

V. EMPIRICAL RESULTS

Table 1 gives least-squares estimates of regression coefficients in equation *(1)* for a sample of fifty-six developing countries. We observe that three of the explanatory variables are statistically significant at the 10 percent or lower level and only eight coefficient estimates do have their anticipated sign. The goodness of fit of the model is quite good as indicated by the value of 0.455 of the regular coefficient of determination. However, the low value of the adjusted coefficient of determination (0.231) suggests that many explanatory variables are not significant and must be removed from the statistical model.

TABLE 1 – DEPENDENT VARIABLE: PER CAPITA GDP GROWTH RATE

	Coefficient Estimates	*t-Statistics*
Intercept	-7.641	-1.100
PubMgt	-1.924	-0.995
SocIncEq	3.041	1.876**
EcnMgt	1.723	1.646*
StrlPol	-1.056	-0.747
CnstNum	0.132	1.733**
CnstDays	-0.0009	-0.293
CntrctNum	0.060	0.714
InsolDays	0.124	0.383
RegNumb	0.057	0.275
RegDays	-0.004	-0.473
StartNumb	-0.109	-0.653
StartCost	-0.007	-1.231
StartDays	0.015	0.834
ElectDays	-0.003	-0.700
DiscIndx	0.067	0.265
CntrctDays	0.0005	0.346

R^2 = 0.455
Adjusted R^2 = 0.231
*Significant at the 10 percent level.
**Significant at the 5 percent level.

All else equal, a one-index point increase in the policies for social inclusion and equity average is expected to lead to a 3.04 percentage point increase in per capita GDP growth. On the other hand, as the economic management average increases by one index point, we expect per capita GDP growth rate to increase by 1.72 percentage points, ceteris paribus.

A backward elimination stepwise method was applied to arrive at a revised model, the regression results of which are reported in Table 2. We note that the goodness of fit of the model to the data is better as indicated by the higher value of 0.337 of the adjusted coefficient of determination.

TABLE 2 – DEPENDENT VARIABLE: PER CAPITA GDP GROWTH RATE (REVISED MODEL)

	Coefficient Estimates	*t-Statistics*
Intercept	-4.964	-1.537
SocIncEq	2.037	1.635*
EcnMgt	1.564	1.769**
StrlPol	-1.745	-1.672**
CnstNum	0.145	2.375***
StartCost	-0.005	-1.269

Adjusted R^2 = 0.337
*Significant at the 10 percent level.
**Significant at the 5 percent level.
***Significant at the 2.5 percent level.

We observe that three explanatory variables are statistically significant at the 5 percent or lower level, while the coefficient estimates of two of them do not have their expected sign. Ceteris paribus, as the economic management average increases by one index point, we would expect a country's per capita GDP growth rate to increase by 1.56 percentage point, while a one index point increase in the policies for social inclusion and equity average results in an expected increase of 2.04 percentage points in the per capita GDP growth rate. On the other hand, a one-percentage point increase in the share of the cost of starting a business in per capita GDP leads to an expected decrease of 0.005 percentage point in the per capita GDP growth rate, all else equal.

We suspect that due to the extent of the multicollinearity problem among explanatory variables, some of them are not statistically significant based on t-tests while the coefficient estimates on a few others do not have their anticipated sign. We report this extent in table 3 in the form of a sample correlation coefficient matrix. We observe that the cost of starting a business as a percent of per capita GDP is linearly related to the economic management average, the policies for social inclusion and equity average, and to the structural policies average, while the three policies averages are also linearly correlated with one another.

TABLE 3 – SAMPLE CORRELATION COEFFICIENT MATRIX

	SocIncEq	*EcnMgt*	*StrlPol*	*CnstNum*	*StartCost*
SocIncEq	1				
EcnMgt	0.777	1			
	9.066				
StrlPol	0.748	0.634	1		
	8.270	**6.032**			
CnstNum	0.083	-0.017	-0.042	1	
	0.614	-0.123	-0.309		
StartCost	-0.483	-0.340	-0.463	-0.215	1
	-4.048	**-2.661**	**-3.837**	-1.616	

Note: Bold t-statistics imply statistical significance at the 10 percent or lower level.

V. CONCLUSION

In this paper we use an econometric model to examine the effect of the business environment as well as public policies and institutions on economic growth using data from a sample of fifty-six developing economies. From the statistical results we are able to draw the following conclusions:

1. Within the set of fifty-six developing economies used in this study, three out of four World Bank's public policies and institutions clusters have a significant impact on economic growth. Governments in these countries need to have in place structural policies, as well as those that address economic management and social inclusion and equity, in order to facilitate economic growth.
2. Governments in developing countries need to provide an enabling business environment to encourage further growth.

NOTES

[i] The sample consists of the following countries: Algeria, Angola, Armenia, Azerbaijan, Bangladesh, Benin, Bolivia, Bosnia and Herzegovina, Burkina Faso, Cambodia, Cameroon, Central African Republic, Chad, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Ethiopia, The Gambia, Georgia, Ghana, Guinea, Haiti, Honduras, India, Kenya, Kosovo, Kyrgyz Republic, Lesotho, Liberia, Madagascar, Malawi, Mauritania, Moldova, Mongolia, Mozambique, Nepal, Nicaragua, Niger, Nigeria, Pakistan, Papua New Guinea, Rwanda, Senegal, Sierra Leone, Sri Lanka, Sudan, Tajikistan, Tanzania, Togo, Uganda, Uzbekistan, Vietnam, Republic of Yemen, Zambia, and Zimbabwe.

[ii] We also included the World Bank's enterprise surveys as measures of the business environment in an earlier econometric model but found these to be statistically insignificant and thus chose to remove them from the model. These results are available from the author upon request.

[iii] In an earlier model, we included the share of gross capital formation (formerly known as gross domestic investment) in the GDP, the share of public health expenditures in total health expenditures used as a proxy for investment in human capital, trade openness measured as the share of exports and imports in the GDP, net foreign direct investment as a percent of GDP, net official development assistance as a percent of GDP, and the initial (2000) level of real per capita GDP used to capture the tendency for poor countries to grow faster than rich countries (termed β-convergence). We found none of these variables to be statistically significant and thus removed them from the statistical model. These results are available from the author upon request.

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