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Book Review

Investment Climate Around the World: Voices of the Firms from the World Business Environment Survey

By Geeta Batra, Daniel Kaufmann, and Andrew H. W. Stone
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As a component of aggregate demand, investment is overshadowed by its consumption counterpart, quantitatively speaking. By the same token, it tends to lag the economic cycle, whereas consumption qualifies as a coincident indicator, albeit not as a leading one.

This notwithstanding, the importance of investment as a factor in the macroeconomic equation cannot be underestimated. It exerts a powerful influence on output growth, both actual and potential. It is also subject to wide swings and is thus a key determinant of macroeconomic volatility/stability. Nor is the importance of investment confined to the macroeconomic level. It is a major driving force at the firm or micro level, underpinning organizational dynamism and resilience and enhancing the value of the enterprise for shareholders and other key stakeholders. At the micro level, the behavioral dimension of investment, which is less relevant from a macro perspective, assumes greater significance. Yet, this dimension is seldom accorded the close scholarly and policy attention enjoyed by its economic counterpart.

The book under review is a welcome exception to the prevailing norm. It examines investment in a bottom-up fashion, rather than in a top-down manner. It also eschews traditional-style economic analysis in favor of an unconventional—that is, relative to the "norm"—behavioral-type inquiry. The title duly reflects the nature of the undertaking. It is a study of "voices," or perceptions (which qualify as "latent" voices), of firms regarding segments of the business environment (broadly defined) impinging on their investment decisions.

The study is the product of the World Bank Group's Innovation Marketplace initiative, launched in 1998 and implemented through the World Business Environment Survey (WBES) vehicle. The purpose of the project is to conduct systematic investment climate assessment via survey-based methods across countries/regions and over time. The book is merely 154 pages long, but it is distinctly ambitious in scope. The data presented are the result of a research effort encompassing 80 countries and one territory. At the firm level, they provide a summary of the responses of more than 10,000 enterprises in a highly standardized form.

The first substantive chapter focuses on general constraints affecting the growth and operation of the firms surveyed. Four such impediments are singled out as "major" or "moderate": taxes and regulations, financing, policy uncertainty or instability, and inflation. Worldwide generalizations obscure differences across regions, particularly between industrialized and developing countries. The latter appear to pose a serious challenge in terms of corruption and infrastructural support, elements which do not seem to hinder progress and activities in the industrialized world.

It should be noted that the constraints are reviewed in considerable detail, rather than touched upon succinctly. Financing is a case in point, because the discussion here revolves around several factors, including high interest rates, lack of access to long-term credit, collateral requirements, bank paperwork, and lack of credit information on customers. An interesting feature of the analysis is the attempt to draw conclusions which extend beyond the regional dimension or the industrialized versus developing country dichotomy. Firm size, for example, emerges as a relevant variable in that “large” enterprises apparently operate subject to different constraints than their “small” counterparts.

The second substantive chapter addresses the quality of public services. Overall government efficiency is explored in this context and so is the quality of specific public services. In developing countries, there seems to be a strong concern about the effectiveness of parliamentary institutions, departments responsible for public works and roads, and the judiciary and the courts. Again, firm size is identified as a factor facilitating/impeding environmental adaptation.

The third substantive chapter is perhaps the most illuminating. It dissects the relationship between environmental constraints or characteristics and enterprise performance in a quantitative fashion, employing sophisticated econometric techniques in the process. The findings illustrate that strong impulses link the latter (dependent variable) with the former (independent variable) and that the correlation is of the positive variety.

Once more, small firms seem the most vulnerable: Private ownership, recent origins, foreign direct investment (FDI), and domestic orientation reinforce the comparative disadvantage. By contrast, large, state-owned, older, and export-oriented firms, which attract FDI, are less adversely impacted.

This excellent and carefully-documented study has inevitable policy implications. Unfortunately, these are only tentatively explored in the book. The reason presumably lies in the fact that it represents “work in progress” and that, at the global level, normative statements cannot be entirely effective. It should be noted, however, that this may well prove to be an area where policy engineering will remain a far more elusive goal than structural diagnosis.

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