Evaluation of the Impact of State Business Relationship on the Economic Growth of Togo

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ABSTRACT
The lack of adequate business-led development policy is negatively affecting the development of free entry into more profitable business in Togo. Thus, this is negatively affecting the external competitiveness of the country. This paper before evaluating the correlation between State Business Relationship (SBR) and Gross Domestic Product (GDP) has investigated and explored the weaknesses in the business environment of Togo. This research has developed a formula for the calculation of SBR index and investigated the relationship between SBR and GDP by using Eviews version 6. This research finds that SBR is significantly contributing to GDP, hence strongly contributing to growth in Togo from 1960 to 2010. However, poor governance, administration deficiencies, bad state of infrastructure are the primary factors constraining business in Togo. Thus this requires the formulation of good institutional framework to facilitate free entry into more profitable business to enhance the development of Togo.

KEYWORDS: state business relationship index, gross domestic product, business environment.

JEL CLASSIFICATION: A11, E2, E3, M21

INTRODUCTION
After the attainment of independence in 1960, the economy of Togo performed well until 1980. This resulted mainly from good institutions that facilitated trade, investment and growth. However, the drying up of national resources that resulted from the decline in cash crops price compounded with adverse effects of the exchange rate overvaluation from 1980 to 1994 have negatively affected the balance of the current account. In Addition, the Structural Adjustment Programme that aims to enhance productivity and international competitiveness had also negatively affected growth and development in Togo. Contrary to the expectations of the Structural Adjustment Programme, Togo experienced negative growth rates in private consumption during the adjustment era (Hekpo, 1992). In addition savings, investment and both exports declined significantly in Togo. Furthermore, the socio-political crisis of 1990s led to significant degradation of the business environment in Togo. The overall consequences are drastic downturn in economic performance compounded with the deterioration of the living conditions of the people and loss of the global competitiveness ranking of Togo. For instance, Lomé the capital city of Togo was

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known as a regional trade hub before 1990 but it lost this well renowned position in favor of neighboring countries that offer more friendly business environment.

Togo is classified as a fragile low human development country, a country with poor economic freedom index and a coastal non-rich country respectively by the UNDP Report 2011, World Heritage report 2012 and Regional Economic outlook 2012. Togo’s business environment is deteriorating. For instance, Togo has lost four places in the ranking of the ease of doing business, declining from 158th to 162th out of 183 economies from 2011 to 2012. The value of the overall index of economic freedom has decline during the same period from 49.1 to 48.3. This represents a loss in performance which in turn negatively affects the ranking which declines from 96th to 97th out of the 155 economies. In terms of international comparison, Togo’s business environment is poor and its business environment performance is below the Sub-Saharan African (SSA) countries. For instance, the overall business score of its index of economic freedom 48.3 is below the Sub-Saharan average 53.7. The following questions can be raised: what is responsible for the prevailing poor business environment in Togo? What is the kind of relationship existing between the government and the private sector and what is the impact of state business relationship on Togo’s economic growth?

In Togo, there are both market and decision failures regarding the formulation of business-led development policy to ease business and involve private sector in the development agenda. As a consequence, there is misalignment of regulations to encourage and facilitate free entry into business in a country with very poor human development indicators and economic performance. It is important to improve Togo’s international competitiveness through the development of appropriate state business relationship agencies that enhance business and growth. Although most surveys (African Development Bank Reports, IMF, 2009, 2010, 2011; World Bank) on business climate are raising concerns about the persistence of a poor business environment in Togo, little effort have been done by policymakers to improve the ease of doing business and facilitate free entry into more profitable business. In addition, despite the facts that are four business promotion agencies, little had been said about the evaluation of the business promotion agencies efficiencies in enhancing public-private business dialogue for inclusive and sustainable growth. Thus little has been done to effectively enhance the state business relationship for contributing towards improvement of the ease of doing business in Togo. Furthermore, little research has been undertaken in Togo to evaluate the effects of SBR on the growth of Togo. This research on enhancing state business relationship for inclusive and sustainable growth tries to fill this avoid.

The main purpose of his research is to investigate and identify factors constraining business in Togo and evaluate the impact of the state business relationship on the economic growth of Togo. The rest of this paper is structured as follows. Section two consists of the literature review on SBR. Section three presents trade and investment promotion agencies, potentials and investing partners of Togo. Section four consists of the business environment and international competitiveness of Togo. The methodology, econometric specification and data analysis are presented in section five and section six consists of conclusion and recommendations.
1. LITERATURE REVIEW

Since last decade, great attention has been given to institutions that facilitate free entry into more profitable business. The economics of state business relationship became more concerned with the determination and evaluation of the kind of relationship that links public sector to the private. Thus, state business relationship is more concerned with the development of inclusive business-led development policy interaction between the public and private sectors for the convergence of competitiveness and growth priorities.

The State Business Relationship within a country shows the relevance, complementarily and effectiveness of business and economic development relationships that links public administration to the private sectors. Thus, effective and appropriate state business-relationship is to build strategic partnership between government and the public sector for poverty reduction, employment generation and leading to inclusive and sustainable growth.

Many growth and development opportunities arise in countries with good institutions that strengthen the development of good relationship with the private sectors. First, it contributes to increased productivity, competitiveness and profitability through the introduction of competition, reduction of dependence on non-diversified traditional commodities export, inclusion of the pro-poor in the production and market structure. Thus, this contributes to foreign direct investment attraction, savings and investment enhancement, employment generation, poverty reduction and growth. Consequently, active integration in the global market will result in the improvement of the population welfare. In this regard, the World Bank Group has developed Doing Business Report as a tool for cross-countries comparison of the ease of doing business. There is evidence showing that those countries offering better business opportunities are much likely to become more competitive under globalization and experience faster growth than countries that create unfriendly business environment. For instance, the favorable business environment in Mauritius, South Africa, Botswana, Rwanda and Ghana is significantly contributing to good economic performance in their respective countries.

The establishment of effective collaborative relations between state and the business sector is crucial for enhancing business and growth. Governments with low capital stocks and low investments level have to create attractive business opportunities for better life and business through the establishment of institutions that encourage entrepreneurship and free entry into formal business. The development of effective business relationship between the public and the private sector is very crucial for inducing institutional change, thus enhancing economic growth. Accordingly to the approach developed by Research Programme Consortium for Improving Institutions for Pro-Poor Growth, SBR plays primary role on both economic and political side and it emphasizes that:

"On the economic side, SBR comprises institutions framework that are formulated to addressing and coordinating market and government failures. Thus these institutions will promote efficient resources allocation, hence dynamic efficiency in the economy. On the political side, SBR reflects: “the way in which power among different agents, elites and coalitions of interest are shared. This manifests itself in both formal and informal institutional arrangements between the private sector (business associations, including organized farmer groups) and the public sector (different ministries or departments of state, politicians and bureaucrats)"."
Empirically and theoretically, the economic literature on the correlation between SBR and economic growth has been poorly examined. Although recently, there is a formula to calculate SBR index, however the literature on the quantification of SBR index is poorly developed. The Kaufman index of Economic Freedom that was established since 1999 highlights the importance of governance indicators for the ease of business and enhancing growth. However, growth is not only driven by good institutions. Technology, human capital, labor force, capital, natural capital, infrastructure, market size, access to international market, global competitiveness index are also important factors driving growth.

In 2002, the ease of doing business was established by the World Bank to evaluate factors enhancing and discouraging business with countries. However, this survey is undertaken using qualitative variables and although scores are attributed to SBR, there are limitations on how these variables effectively affects growth.

Acemoglu, Johnson and Robinson (2002) attributed the growth of (western) Europe between 1500 and 1850 to the Atlantic trade, non-absolutist initial institutions and colonialism. Accordingly, countries non-absolutist initial institutions were the drivers of trade and economic growth, and trade has contributed to institutional change and non-absolutist initial institutions have contributed to enhanced Atlantic trade by offering substantial profits to countries with non-absolutist initial institutions. Furthermore, the Atlantic trade has induced institutional changes by strengthening new merchant groups, hence facilitating changes in political institutions. Thus, this contributed to emergence of new production technologies and organizational production standards.

Most empirical evidence on the state-business relationship have been undertaken mostly in East Asia, Latin America and in some Sub-Saharan African countries. Te Velde (2006) in Measuring State Relations in a sample of twenty Sub-Saharan African countries ignored to include Togo. In addition, research on SBR in Togo is very scarce although SBR agencies are available in Togo and they receive the state primary attention.

Niosi (2008) emphasized on crucial role that science, technology and innovation play in socio-economic development. Accordingly, good institutional framework (low corruption, stability, good social infrastructure, human capital development) contributes to growth. Institutional economics for decades has investigated and examined the correlation among institutions, markets, and sustainable development. Therefore, efficient SBR is very crucial for credibility, effectiveness, accountability and transparency, hence sustainable development.

Lundstrom and Garrido (2010) finds that in Togo, more than 80 percent of firms think that competition with the informal sector and perceived the state business relationship as being a major constraints to business. The government relationship with business is revealed negative and turned on contrary to be hostile for business. This is a consequence of governance inefficiency and poor governance indicators in Togo that are very low in comparison to the ones in other African countries. As a contribution to the literature review, this research based on Te Velde (2006) surveys has developed representative tool for the measurement of SBR for Togo and evaluate the effect of SBR on the economic growth of Togo.
2. TRADE AND INVESTMENT PROMOTION AGENCIES, POTENTIALS TOGO

2.1. Trade and Investment Promotion Agencies

Trade and Investment promotion agencies have been established to ease business. These agencies can be considered as state business relationships agencies. One may distinguish the traditional business facilitation agencies from the modern agency. Togo Export Processing Zone which is supervised by the Free Zone Administration Company (Société d’Administration de la Zone Franche, SAZOF), the Industrial and Commercial Chamber of Togo, National Council of Employers (Conseil National du Patronat du Togo) can be regarded as a form of traditional business agencies. Recently, a lot of reforms have been implemented to enhance public-private dialogue through the creation of the Presidential Investment Advisory Council (2011). This council offers a better discussion platform for public and private sectors in order to include investors’ priorities in public policy formulation agenda by creating a more reliable and profitable business environment, facilitating free entry into more profitable business and enhancing productivity, competitiveness and growth of Togo.

2.2. Potentials and Investing Partners of Togo

2.2.1. Potentials of Togo: A Regional Trade hub and Banking Centre

The autonomous port of Lomé is the deepest natural port in the coastal western Africa, making this capital city an important transport hub for commerce to landlocked neighboring countries of Burkina-Faso, Mali and Niger. Lomé is therefore known as an important regional trading center.

Trade is an important activity in Togo. For instance, from 2008 to 2010, the average trade to GDP ratio and the average trade per capita were respectively 90.4 percent and USD 483 (WTO, online consultation 17 July, 2012). Togo imports mainly petroleum products, foodstuffs, fabrics, motor bicycles, clothes, vehicles, equipment. Ghana, Burkina-Faso, Germany, South-Africa, Benin, China, Mali, and France are some of the main import partners of Togo. The undiversified export of Togo are composed of cotton, cocoa, phosphate, cement, ferrous, and coffee. China, Netherlands, India, France, Thailand, Ghana are the major export partners of Togo.

Furthermore, Togo serves as a regional banking center. A lot of regional banks or stock markets are either headquartered or have either their branches in Togo. The ECOWAS’ Development Fund and West African Development Bank (BOAD), the ECOBANK, a Pan-African private bank are headquartered in Lomé. In addition, the African Development Bank and the Central Bank of West African States, and the Stock Market of West African States have their branches in Lomé.

2.2.2. Investing Partners of Togo

It is commonly agreed that countries with low capital stock are required to attract foreign investment to increase their capital stock. The major countries investing in Togo are China, India, Lebanon, France, Germany, and the United States. Inwards foreign direct investment (henceforth IFDI) to Togo is very low. According to the latest data from the World Bank World Development Indicators, from 1974 to 2010, the average share of inward FDI to
GDP ratio is 1.69 percent. The IFDI reached its pick in 1978 and accounted for 11.27 percent of GDP. Nevertheless, this ratio was declining on an annual basis and its contribution to GDP was 1.3 percent in 2010.

3. THE INTERNATIONAL COMPETITIVENESS OF TOGO

The international competitiveness reflects the business climate prevailing in Togo. In Togo, efforts are made to ease the business environment. The reduction in corporate income tax rate from 37 per cent to 30 percent, the reduction in the cost of starting procedures and setting one-stop shop and the facilitation of having access to credit can be mentioned. However, Togo’s ranking is not satisfactory regarding its natural and economic potentials according to the index of economic freedom and the ease Doing Business Report 2012. From 2011 to 2012, deterioration in the business environment has been observed in Togo. For instance, the index of Economic Freedom of Togo is very low, with an overall index Togo’s economic freedom; the country scored 48.3 and is ranking 97th out of the 155th freest in the 2012 Index. Its score is 0.8 point lower than the one in 2011. This increases awareness about corruption, business environment degradation, and the government inefficiency.
Table 1. Easy of doing business in Togo and the top 10 benchmark SSACs

<table>
<thead>
<tr>
<th>Doing Indicators</th>
<th>Business Indicators</th>
<th>Mauritania</th>
<th>Senegal</th>
<th>South Africa</th>
<th>Sudan</th>
<th>Tanzania</th>
<th>Togo</th>
<th>Uganda</th>
<th>Kenya</th>
<th>Ethiopia</th>
<th>Togo</th>
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<tbody>
<tr>
<td>DB2011 Rankings</td>
<td>Share of import (number)</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>3</td>
<td>2</td>
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<td>1</td>
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<td>0</td>
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<tr>
<td>Reform Undertaken</td>
<td>Share of import (number)</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>3</td>
<td>2</td>
<td>0</td>
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Starting a business

<table>
<thead>
<tr>
<th>Procedure / time (days)</th>
<th>Cost (% of profit)</th>
<th>Min. capital (% of profit)</th>
<th>DC - Procedure / time (days)</th>
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Getting Credit

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<tr>
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<th>Depth of credit information index (0-6)</th>
<th>Public registry coverage (% of adults)</th>
<th>Private bureau coverage (% of adults)</th>
<th>PI - Extent of disclosure index (0-10)</th>
<th>PI - Extent of director liability index (0-10)</th>
<th>PI - Ease of shareholder suits index (0-10)</th>
<th>PI - Strength of investor protection index (0-10)</th>
<th>PT - Total tax rate (% of profit)</th>
<th>TAB - Documents to export (number)</th>
<th>TAB - Time to export (days)</th>
<th>TAB - Documents to import (number)</th>
<th>TAB - Time to import (days)</th>
<th>TAB - Cost (number of days)</th>
<th>EC - Procedure time (days)</th>
<th>EC - Cost (% claim)</th>
<th>CB - Time (years)</th>
<th>CB - Cost (% of estate)</th>
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<td>CB - Recovery rate (1/100 US)</td>
</tr>
</tbody>
</table>

Source: Doingbusiness.org

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Where: DC – dealing with construction; RP – registering property; PI – protecting investors; PT – paying taxes; TAB – Trading Across Borders; CtoE- Cost to export (US$ per container); CtoI - Cost to import (US$ per container); EC – enforcing contracts; CB – closing a business; ICP - income per capita.

An overview of the top 10 best Sub Saharan-African countries ranked in the Ease of Doing Business publication indicated that effective and efficient institutions, better quality of infrastructure, appropriate customs, tax and revenue procedures, trade freedom and the ability to protect investors are factors attracting business and investors. These factors are making business much easier in some countries than in other countries. In addition, some of these countries had undertaken reforms to facilitate trade and investment (table 1).

There is a consensus that good governance and efficient rule of law are crucial for enhancing business and growth. Based on governance indicators, Togo’s ranking is below the average of the Sub-Saharan African (SSA) countries. Efforts should be made to restore efficient governance by improving the institutional framework in order to provide a sustainable business environment and boost socio-economic development.

According to the logistics performance index of Togo, Togo's ranking is below the world's average (figure 3). Tax rates and its administrative burden are very high. The overall numbers of taxes are 53, 37 and 13 in Togo, Sub-Saharan average and OECD high income average (World Bank Doing Business Report, 2012), respectively. The fact is that government revenue highly depends on taxation, failure to enhance competitiveness and increase earnings from state own companies. For instance, from the government revenue that accounted for 16.9 percent of GDP, tax revenue contributed significantly to 15.37 percent of GDP in 2009 (figure 4). In order to promote business, efforts are required to develop the state of infrastructure to enhance business and formulate an appropriate tax policy that will attract people operating in the informal sectors to become formal and facilitate free entry into a profitable business environment.

Figure 3. International Logistics performance Index (Togo and World, 2012)
*Source:* Author after World Bank World Logistic Performance (2012)
4. METHODOLOGY, ECONOMETRIC SPECIFICATION AND DATA ANALYSIS

Two different steps are observed in this research. This first one consists of the calculation of the state business relationship (SBR) index of Togo from 1960 to 2010 and the second one presents the econometric specification used to evaluate the nature of the correlation between SBR and GDP during the same period.

4.1. SBR index and Data Sources

4.1.1. The State Business Relationship Index of Togo (1960-2010)

To the best of one’s knowledge, there is no appropriate formula to calculate SBR index. This survey tries to enrich literature review by filling this void. Dirk Willem Te Velde (2006) did not properly explain how the index of SBR has been computed for 20 Sub-Saharan African countries and Togo was not considered in his sample. The methodology about the SBR index computation has not been clearly defined. This research contributes to calculation of the SBR index by taking into consideration the ease of doing business based on countries grouped according to their ease of doing business, ranging from the most hospitable to the most hostile for business.

The SBR index is therefore given by the addition of the score of the Logistic Performance Index score and the index of Economic Freedom. The formula of the BSR index is expressed as follows:

\[ SBR_t = SL_t + SEF_t \]

(1)

Where:

- \( SBR_t \) denotes the state business relationship;
- \( SL_t \) gives the score of Logistic Performance Index; and
- \( SEF_t \) denotes the score of the index of economic freedom.

The computation of this index is based on two assumptions. Firstly based on the Logistic Performance Index ranking methodology, Togo has an index of 2.6 and belongs to the second lowest group. Thus 0.5 score has been given to Togo from 1960 to 2010. Secondly, based on the index of economic freedom, two indexes of economic freedom have been
attributed to Togo based on the assumption that prior to 1990, Togo business environment was much better hospitable and it has deteriorated even more. Based on the index of Economic Freedom methodology, score of 0.2 was attributed to each of the five groups ranging from mostly free to repress. From 1999 to 2010, Togo had an average index of 47.62 and an associated index of 0.2 was associated to Togo during 1990 to 2010. On the other hand, an index of 0.4 was associated to Togo from 1960 to 1990. As previously mentioned, the SBR index is computed by adding the score of the Logistic Performance Index and the index of Economic Freedom and the results for Togo are summarized in the following Table.

<table>
<thead>
<tr>
<th>State Business Relationship Index (1960-2010)</th>
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<tbody>
<tr>
<td>Period</td>
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<tr>
<td>---------------</td>
</tr>
<tr>
<td>1960-1990</td>
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<tr>
<td>1991-2010</td>
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</tbody>
</table>

*Source: Author*

4.2. Econometric Specification, Data sources and Data Analysis

Based on endogenous growth model, the following model deduced for this survey can be represented as:

\[ \ln Y_t = c + \alpha_1 \ln K_t + \alpha_2 \ln L_t + \alpha_3 SBR_i + \epsilon_t \]  \hspace{1cm} (2)

Where:

- \( \ln Y_t \) is the GDP;
- \( c \) the intercept;
- \( \ln K_t \) denotes the logarithm of the capital stocks;
- \( \ln L_t \) denotes the logarithm of the total labor force;
- \( SBR_i \) is the index of state business relationship;
- \( \alpha_1, \alpha_2 \) are the elasticity of output with respect respectively to capital and labor;
- \( \alpha_3 \) is the coefficient associated to the SBR; and
- \( \epsilon_t \) is the error term.

4.3. Data Sources and Data Analysis

Data on GDP is obtained from World Development Indicators database. Capital stock and human capital data of Garrido were used. The data on total labor force was collected online from Earth Trend and World Development Indicators 2011 data base. Data on SBR index is computed by the author. Regression on equation (2) is done using Eviews 6. The results of the regression can be summarized as follows.

\[ \hat{y} = 0.214161 + 0.21307 \hat{K} + 0.97847 \hat{L} + 1.02573 \hat{SBR} + 1.02573 \hat{e} \]  \hspace{1cm} (3)

\( (0.8834) \hspace{1cm} (0.0000) \hspace{1cm} (0.0000) \hspace{1cm} (0.0083) \hspace{1cm} (0.0083) \)

\[ R^2: 0.926555 \]
The probabilities are in parenthesis, all the explicative variables except the intercept are significant at 1 percent. The insignificance of the intercept can be explained by the rigidity in the specification. The state business relationship, the labor force and the capital are positively correlated to GDP. The estimated coefficient of SBRi is the highest in this specification. An improvement in the state business relationship of one percent will enhance GDP growth for 1.025 percent. An increase of the labor force of 1 percent will lead to an increase in the GDP of 0.978472 percent and the same percentage increase in capital will lead to an increase of 0.213071 percent of GDP.

4.4. Limitations and Directions for Future Research

This survey contributes to the establishment of the measure of SBR in Togo and has empirically investigated the effects of SBR on growth. However, the suggested model is too rigid. In future, research will be undertaken to improve the model specification about the measurement of SBR index and the evaluation of SBR effect on growth.

5. CONCLUSION AND POLICY IMPLICATIONS

5.1. Conclusion

This research finds that the SBR is positively correlated to GDP and efforts leading to improvement in the business environment of one percent will induce growth of more than 1 percent. This implies that the formulation of good institutional framework is more than required for enhancing growth in Togo. It is therefore imperative to develop an inclusive and sustainable SBR not only for enhancing business prosperity but also for a betterment of people’s living standards without causing significant damages to the environment. The formulation of effective SBR that prioritize business-led development is necessary for easing business and facilitating free entry into a more profitable business. The development of effective state business relationship is very crucial for contributing to poverty and unemployment reduction, promoting external competitiveness and growth. This will enhance private sectors development by inducing transparency in state owned companies, facilitate access to appropriate production technology, hence reducing technology dependence, government revenues will be diversified and will not only be dependent on tax revenue. The financial sector will be developed through the development of culture of savings and capital accumulation.

5.2. Policy Implications

It is very important to develop state business relations by improving institutions and enhancing public-private mediation in order to develop a sustainable business-led development policy. Judiciary reform is required to enhance investors’ protection. The redefinition of the role of business promotion agencies and their annual evaluation are required to improve the ease of business and promote business competitiveness and profitability. It is important to direct the activities of firms operating under Togo’s Export Processing Zone in order to promote their business. This will generate more jobs with acceptable revenues and more tax revenue for government. In order to safeguard better production and consumption environment, it is very important to manage negative externalities arising from firms operating under TEPZ activities.
In order to reduce high cost associated with trade and improve Togo’s global share of trade, infrastructure quality should be improved. In addition, restoration of transparency and accountability in the administration will provide credible institutions that facilitate trade and investment.

It is very imperative to improve the financial institutions efficiency by facilitating private sector access to credit. Addressing this challenge is very important to improve private sector productivity and competitiveness, hence enhancing entrepreneurship and private sector development. In addition, the reduction of the cost of starting business, the minimum cost required to start a business, time required to assess the approval of construction permits is required to improve business environment in Togo. Furthermore, a decrease in corporate tax, the costs for cross-border trade and investor's protection improvement will attract more investors.

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