In the traditional view of productive development policies (PDPs), the roles of government and the private sector are completely separated. Market forces are powerful, and largely lead to desirable outcomes. When a market failure does arise that requires government intervention, a public sector entity identifies the problem and designs a solution. Government sets the rules and conditions, pursuing some collective goals, and firms act within those rules and conditions, attempting to maximize profits. If the rules are well designed, the individual and profit-seeking behavior of the firms leads to good results. In that context, with very well-informed governments, there is limited room for public-private interaction in productive development policy. Each side can do its part independently of the other.

This chapter deviates from that view. At the very least, the public sector cannot hope to have all the required knowledge to assess the needs for intervention and design appropriate policy, for the fundamental reason that some of that information is held by private firms (Rodrik, 2008). In such cases, government needs to extract the information, yet the profitability of those firms is affected by the shape and size of the resulting policy. At the heart of this informational asymmetry lies a classic principal-agent problem: the challenge for government as the principal is to conduct this interaction in a manner that induces firms to provide their complete information truthfully, rather than manipulating it in order to bias the policy in their favor.
More generally, in many cases, the design, implementation, feedback, and redesign of policy cannot be done by the public sector without interaction and perhaps collaboration with private agents. The problem of lack of trust due to differing motivations of public and private agents is only one of the impediments to their interaction. This process is further complicated by other issues such as communication, coordination, and the manner in which private agents interact with one another, not only with government.

Actually, unlike the static theoretical exercises in which government is first faced with a one-shot problem and then posits a one-shot solution upon which firms react, some of the most interesting and successful policy efforts are often dynamic processes by which new questions and challenges emerge and are solved, and the relevant information is learned gradually by all participants. Yes, there is a danger of capture, which needs to be dealt with. ¹ But the main interest goes beyond just avoiding capture to understanding how private and public agents can truly cooperate in a constructive manner, especially as some of the PDPs with more potential require private engagement. The process of acquiring knowledge and using it jointly is an integral part of the policy question, and the nature of effective public-private interaction is one of the main topics of this chapter.

As Hausmann, Rodrik, and Sabel (2008: 5) emphasize, a government should evaluate its productive development policy framework by asking if it has “set up the institutions that engage the bureaucrats in an ongoing conversation of pertinent themes with the private sector, … has the capacity to respond selectively, yet also quickly and using a variety of updated policies, to the economic opportunities that these conversations are helping identify.” This approach turns on its head the traditional focus of productive development policy analysis, shifting it from static policy design in isolation to a discussion about the institutions of productive development policy and, in particular, about their ability to interact with the private sector. This chapter reexamines some of the issues discussed in the report through this lens, deepening the analysis of public institutional capabilities in chapter 10.
The Private Sector as a Partner

The manner by which government can engage the private sector to obtain the knowledge it needs, adequately implement policy, and react to new developments varies with the depth of the engagement. There is no best way of doing things: what is useful depends on capabilities and circumstances. In some instances, the public-private interaction is limited to government consulting with the private sector about its intended policies and attempting to extract from the private sector information relevant to policy design through informal dialogue. In other situations, the private sector is integrally involved in the design and/or implementation of policies. Sometimes, the involvement extends to the monitoring, evaluation, and redesign of those policies. Finally, as some cases later in this chapter illustrate, government may yield the initiative on certain PDPs, or even partial or total control and authority to make the relevant decisions, to the private sector. How the public sector interacts with the private sector is one of the keys to obtaining useful information and applying the policy effectively.

In a pure consultation process, by definition, the public sector “listens” to the private sector, but then makes decisions by itself. However, there is a continuum to the depth of the consultation process, as Devlin (2013) notes, that starts with “mere talk,” progresses to “consultation” in which issues are discussed but the government then makes decisions on its own, and culminates in “dialogue,” which aims to develop a consensus among participants so that the private sector will assume ownership and lend credibility and political support to the policy. Or, as Schneider (2010) puts it, the process ranges from “cheap talk” to “expensive exchanges” to “collaborative learning.” The scope of the consultation process can also vary widely. Very broad discussions about the whole policy spectrum include cases of public-private alliances around long-term, national development strategies, studied in Devlin (2013) and Devlin and Moguillansky (2009a, b). However, consultation like that performed in preparation of trade negotiations frequently involves much narrower and more technical issues; when effective, it empowers government not only with legitimacy but also
with superior information and wider options. Numerous examples of these narrower interactions, in which vertically specialized institutions engage in different degrees of consultation with their constituencies, are described by Schneider (2010).

Joint policy design takes the collaboration a step further, presumably under certain preestablished rules to prevent the pursuit of consensus from becoming a case of capture by the private parties of public roles. The more extensive process that Devlin (2013) calls “dialogue” can be thought of as straddling the divide between pure consultation and joint policy design. The differentiating element is that the private sector would not just be lodging complaints or raising issues reactively, but also be actively involved in assessing the main problems and designing possible solutions. This would require not just in-depth knowledge of the practical problems that they face, but also skills that would enable private actors to evaluate proposals made by the public sector and make technically sound proposals of their own. It would also require that private actors understand and value public policy objectives, just as the policymaker understands private goals. Other types of cooperation may include academia and third parties working together, for example, to design research programs aimed at increasing the productivity of a particular economic activity or to evaluate existing programs.

Successful international experience studied in Devlin (2013) offers useful examples along this range. For example, in South Korea up until the mid-1980s, a public-private council included only the business sector and the public sector. The government used the council to inform the business sector of the policies it would pursue and, in fact, impose on them. At the other extreme, in Ireland, a council that included business leaders, academia, nongovernmental organizations (NGOs), and labor unions engaged in an open dialogue to define a national development and competitiveness strategy. The Latin American cases studied in Schneider (2013) do not reach this level of interaction but do show substantial experience with public-private councils with economy-wide, competitiveness mandates, such as the Foro de Desarrollo Productivo in Chile in the 1990s, the Council for Economic and Social Development created in Brazil in 2002, and the National Competitiveness Council created in Colombia in 2006.
The scope and depth of public-private cooperation within public-private councils can vary enormously, from economy-wide to sector-specific and region-specific, and from a forum in which the government informs the private sector of its policies to one in which in-depth information sharing, policy design, and policy implementation take place. Whatever the modality of interaction with the private sector that appears useful and feasible in a given situation, the effective engagement of the private sector is fundamental for a robust portfolio of PDPs.

What the Private Sector Brings to the Table

The public sector has substantial uncertainty about both the what and the how of appropriate PDPs. In contrast to the private sector, it does not have readily available signals to guide its performance in fulfilling its objectives or a process of competition to automatically weed out ineffective decisions; the private sector receives information from prices, feedback from profitability, and benefits from the natural selection of the most efficient initiatives and firms through competition. Identifying and carrying out socially beneficial PDPs requires elaborate information that the government usually does not have, including detailed productive knowledge about the production, trade, and usage of goods and services. Such knowledge may reside in the private sector, mainly in firms and industry associations that own and use the technology in the market. They know by direct experience the problems they face or the cost such problems impose, and can better evaluate the repercussions that alternative conditions would have. While the public sector still needs to validate and integrate the pieces of information it may gather in a fragmented fashion from private sector sources, there is clearly much to be gained by engaging the private sector in public policy issues. The process of identifying policies and then implementing them through all its phases (design, execution, monitoring/evaluation) can substantially benefit from public-private collaboration, if only to guide the process at each stage.

Likewise, the private sector also has incomplete information. Information from both sectors is complementary: the private sector
benefits from the comprehensive public perspective on issues that are relevant for business but are outside the direct experience of individual firms or the sector. In some instances, the basis for collaboration may not even be information sharing, but “learning sharing.” In these cases, the motivation for public-private interaction may be the need to engage in co-exploration of new directions unknown to both the public and the private sectors, to their mutual benefit.

The private sector may also be interested in trying to influence the productive development policy selected by the public sector. For example, most activities require the provision of sector-specific collective inputs (such as certification, storage, or communications), and the private sector has an interest in demonstrating the need for such inputs to the public sector. In so doing, private demands may contribute to the cooperation of the relevant public sector units, usually in their own functional silos in the public administration. The private partner may be a coalescing force for the public sector.

Private sector engagement also helps to protect productive development policy from undue influences of the political cycle. This engagement may bring a long-term perspective to policy by providing a safeguard for the policies to survive changes in key public officials and, especially, election-induced reshuffling. Public-private collaboration can help create a consensus above the political fray (Stiglitz, 1998), and can be a substitute for the stability that a grand political agreement on state policies in this area would provide. It is not uncommon for governments to seek to engage the private sector simply to help preserve their policies over time. In the right proportions, engagement of the private sector may provide the balance between stability over the political cycle and a healthy flexibility to make room for the policy perspectives of new governments.

**The Perils of Private Sector Engagement**

For all its important benefits, private sector engagement in productive development policy also involves serious perils that need to be contained. The challenge is that those parties with the information
that the government needs also have a profit motive that may distort the information they may be willing to share. While good productive development policy is, for the most part, presumably also in the interest of the private sector subject to it, other inefficient but self-serving policies may be even better for their private bottom line. In that case, private sector engagement may not help and may hinder policy quality. In some cases, this contradiction is particularly salient. For example, the information advantage of the private sector may lead to biased information or half-truths that may impede the discovery and implementation of the best policies. In the extreme, private sector engagement may end up being a mechanism for seeking privileges, or rent seeking, rather than information sharing of any kind. In other words, the policymaker may be subject to capture, due to the informational asymmetry that governs the relationship.

Other potential problems range from the private parties assuming complete control of the policy instruments by political maneuver to the private sector never engaging, demonstrating enthusiasm, or developing sufficient trust in government agents to even participate. Lack of trust may stem from the firm’s own lack of information (it may doubt the intentions of the government, or fear that a competitor may end up being the main beneficiary at its expense), or its own pessimism about the effectiveness with which government does anything, especially if it requires coordination.

The risk of capture and rent seeking by the private party at the expense of the policymaker, and the risk of limited engagement due to trust issues, depends on the type of policy in question. Vertical policies, by design, can create benefits for some firms at the expense of others, and are therefore more prone to rent seeking. They also make capture likelier in the long run since a concentrated impact on a few agents gives them strong incentives to try to influence decision makers, because for them the stakes are very high. In this regard, vertical policies tend to be riskier than horizontal policies. Policies of market intervention are also risky because, by directly impacting firms’ financial bottom lines, they create a strong constituency against discontinuing promotional instruments even if they do not
work. For this reason, these policies are riskier than the provision of public inputs, which usually fulfill a permanent production need, and whose costs can be shared with beneficiaries. It follows that vertical market interventions are doubly risky. This is especially so in the case of strategic bets, which, in contrast to policies aimed at incrementally improving already established sectors, entail substantial uncertainty concerning their potential competitiveness. Conversely, horizontal public inputs, the least controversial policies, are also the least risky.

There are other margins along which this tension may rise or fall. Consider a case where government is trying to assess the size of the transfer to a particular sector to compensate for a negative externality that prevents the sector from growing to its optimal size. In this case, the objective of the firm would be to provide incorrect information that inflates the size of the externality and thus of the subsidy received. Alternatively, consider a government trying to figure out the technical specifications of a necessary public input, or a precise question that requires some research. In these examples, the best interest of the firm would be for the government to get as accurate information as possible, and there is no tension.

These perils are real because opportunities for capture abound. For example, consider the temporary credit subsidy for low-income housing in Panama studied by Fernández (2011). When the subsidy was due to expire, a powerful lobby for the construction industry made sure it was renewed. They also made sure that only families purchasing new housing—rather than existing housing—would be eligible for the credit subsidy. Thus, while the original intention of the subsidy was to help the lives of the poorest, it also turned into an instrument that ensures the profitability of the construction industry. Not surprisingly, there is skepticism about the advisability of implementing productive development policy in Latin America—even if the effectiveness of such policy in other regions is accepted. Skepticism hinges, in equal parts, on legitimate doubts about government’s ability to “pick winners” and on the likelihood that such policies will be used to transfer rents to private groups with privileged access to power, rather than to increase productivity (Rodrik,
Public-private collaboration needs to successfully deal with both concerns.

The perils of private sector engagement concerning capture are in the nature of the system everywhere; it is not a problem specific to Latin America. Recent empirical research on lobbying activities to Congress in the United States shows that the exchange of contributions for rents, as opposed to the exchange of information for the benefit of Congressional committees or “information lobbying,” is central to what lobbyists do (Bertrand, Bombardini, and Trebbi, 2011). Lobbyists not only take advantage of superior information, but once the lobby contacts the policymaker, then it can offer a reward in exchange for a policy that is more favorable to the sector. Private sector engagement may actually create the opportunity for rent seeking and capture.

Most countries have made progress in modernizing the state and deepening democratic transparency and accountability. Improvements have also been made in policy design and evaluation. However, an antidote for capture has not been found. Capture remains an important peril for more ambitious PDPs, which invite more opportunities for abuse. It would be naïve to assume that the risk of capture has disappeared—and open the floodgates to private engagement without appropriate institutions to keep tabs on it. In particular, some of the more ambitious vertical policies discussed in chapter 9 are more susceptible to capture—and require sufficient capabilities and institutional design to run them well.

**Matching Public and Private Counterparts**

It takes two to tango. Public-private collaboration requires strong counterparts with compatible characters. The success of PDPs is in good measure dependent on the quality of the counterparts.

**The Private Sector Counterpart**

Successful public-private collaboration requires appropriate private sector capabilities. If the private sector has weak capabilities, fails to
trust the government counterparts, lacks enthusiasm about the possibility of success, or is represented by the wrong parties, it will be difficult for effective policy to emerge. The key question in this section is: How can the capabilities and expertise of the private sector best be fostered for this purpose?

In practice, motivation is a key problem: how can individual firms be encouraged to develop expertise and become involved in costly engagement with the public sector that will benefit all firms in the sector? Individual firms would like to free ride on the others to support information exchange. Industry organizations have multiple ways to solve this coordination problem among member firms and to assess the quality and intentions of government, and for this reason are often suitable counterparts. The government may want to help such organizations “upgrade” so that they become better counterparts for collaboration.

However, the reliability of business associations for public-private collaboration is unclear. On the one hand, Doner and Schneider (2000) provide numerous examples of business associations that have contributed significantly to economic development both by pushing for better market-supporting institutions, such as property rights, and by participating in the provision of market-complementing services, such as setting standards and coordinating joint efforts to upgrade quality. For example, the association of Colombian flower exporters, Asocolflores, has been very effective in dealing with coordination failures and promoting collective inputs that allowed the sector to take off as a competitive exporter (see Box 11.1). On the other hand, this optimistic picture contrasts with the view that business associations are rent-seeking interest groups, usually associated with Mancur Olson and others, which is often confirmed by experience. There are plenty of examples of industry associations that focus on lobbying for short-term matters, whose association executives are less aware of the long-term matters than individual firms themselves. Lack of expertise may also limit the usefulness of business associations. For example, industry associations play a constructive role in some trade agreements, but the truly detailed information useful for elaborating negotiation positions must come from individual firms themselves.
Box 11.1 The Smell of Success in Colombia’s Flower Sector

The “discovery” of the Colombian flower sector can be traced to the evolution of the US flower industry. Growing flowers is intensive in land and labor, requires long sunny days and moderate temperatures, or, alternatively, costly airtight greenhouses and high heating costs. Yet until the 1940s, production in the United States was concentrated in the northeast: New York, Pennsylvania, and Massachusetts. Why? Because flowers are delicate and perishable, there was no air transportation, and that is where the market was. As air transportation developed, production moved to warmer locations, but conditions were still not ideal. US growers were looking for alternative locations.

In 1966, a student at Colorado State University, David Cheever, wrote a thesis identifying the Sabana of Bogotá as the ideal place to grow flowers for the US market: fertile soils, long sunny days, cheap land and labor, and proximity to the airport made Bogotá an irresistible location. Three years later, Cheever put his money where his mouth was, and, together with other partners, founded Floramérica, the flower export pioneer.

The pioneer was soon followed by many others, and flowers in Colombia became a huge success. By 1980, Colombia was the most important exporter to the United States. By the late 2000s, exports exceeded $1 billion. But on the way to success, several key obstacles had to be overcome, from phytosanitary problems to air transportation, to reception and storage at the Miami airport, to ensuring access to the US market. Solving these problems required coordinated action. Asocolflores, created in 1973, played a predominant role in addressing them.

Take air transportation, for example: Colombia was served by few airlines, most of them with relatively old planes. Flowers were transported in the luggage hold, since there were no dedicated cargo planes. Narrow cabins and doors required manual loading and unloading, adding to transportation costs. Asocolflores hired a charter, and asked each exporter to commit to sending a certain number of flower boxes to Miami at the same time. Once this proved profitable, other US-based cargo carriers jumped in.

Flowers at the Miami airport were frequently damaged due to the lack of special equipment to unload them, or cold facilities to keep the flowers in storage awaiting inspection by the US Department of Agriculture. Through Asocolflores, exporters established a joint company (Transcold) responsible for loading and unloading and keeping flowers in refrigerated rooms. Colombian growers had to face protectionist pressures from US growers, who filed claims with the US Department of Commerce asking for countervailing duties. Asocolflores responded by creating the Florida
Importers Association, an independent US entity, to protect the interests of flower growers outside the United States. In addition, it hired lawyers and technical advisors to lobby US authorities, and has since had a permanent presence in Washington, DC.

Undoubtedly, industry associations can and do engage in rent-seeking activities to benefit their firms, sometimes at the expense of the state. But, as the case of Asocolflores clearly shows, they can also be a powerful instrument of collective action in pursuit of needed collective public inputs.

Source: Arbeláez, Meléndez, and León (2012)

What leads some associations to serve constructive roles while others engage largely in rent-seeking activities? Why in some countries (Brazil) do industry associations serve as the government counterparts in deliberations on productive development policy, while in others (Chile), “representative” firms or individuals are preferred? The answers to these questions are important in order to understand the role of business associations in public-private collaboration.

The strength of business associations is certainly important for their effectiveness to reach their own objectives—but not necessarily for their socially beneficial contribution to PDPs. Strength is defined in terms of their degree of representation and capacity to execute different actions by inducing its members to commit resources and abide by association rules and decisions. Strength derives mostly from the ability to provide crucial benefits only to members, thereby making membership valuable and making exit costly. It is precisely this ability that allows associations to resolve the free-rider problem and coordinate collective actions—a critical feature of an effective counterpart in productive development policy. However, strong business associations can direct their efforts to productive development activities or to lobbying for rents. The negative example of Costa Rican rice, described in chapter 2, is the result of a strong industry association, so the characterization of strong associations as the best counterpart is not always applicable. In summary, institutional capability is neutral: associations can use it for good or ill depending on circumstances (Doner and Schneider, 2000).
The behavior of industry associations may actually be shaped by public sector capabilities. Associations may fail to be geared toward constructive productive development policy when they expect little from the public sector’s ability to deliver. Perhaps associations are organized for rent seeking because they have found too few opportunities for constructive interaction and too many for capturing rents. The bottom line is that the public sector may hold the key to orient strong business associations to collaborate by being more responsive to legitimate demands and by not offering channels of communication for undue demands. The paucity of collaborative business associations in Latin America and the Caribbean may be a reflection of low public sector capabilities.

**Picking the Right Private Sector Partner**

The private sector is not monolithic; firms across and within sectors may have not only different capabilities but also different interests and, consequently, different policy preferences. As Pritchett and Werker (2012) note, some segments of the private sector may not be interested in sound productive development policy. Schneider (2013) makes the case that public-private collaboration and policy outcomes depend on the structure, capabilities, and preferences of the main business interlocutors. A series of country studies by the IDB on the political economy of PDPs, and the accounts of experienced consultants for competitiveness-enhancing programs, show how different groups split in favor of or against particular policies, and display different abilities, attitudes, and roles. The importance of selecting the appropriate counterparts at the outset is one of the key determinants of the policy’s eventual success or failure.

Private sector heterogeneity should be carefully considered when designing the process by which the public sector interacts with the private sector. In particular, constituencies must be built to make sure that policies will be supported over time. Supportive constituencies may collaborate in policy identification and design, but would also be useful even in those cases in which the public sector had already identified, from the start, what needs to be done. Private sector ownership of good productive development policy is critical for
success, and sometimes the leadership of some private sector actors provides legitimacy, as they can convey the credibility of policy to other firms better than government officials. Nevertheless, constituency building may be particularly hard for policies that aim to transform the productive structure of an economy, which are likely to be opposed by those who may lose importance or assets from the transformation. Deeply transformational development strategies may require the public sector to enjoy considerable independence from the private sector (as in the cases of the Republic of Korea and Taiwan), or a widespread social consensus regarding the strategy (as in the case of Ireland) (Khan and Blankenburg, 2009 and Paus, 2005, respectively).

The question of how to interact with the private sector is key for modern productive development policy. One option is for the government to adopt an “open architecture” (Hausmann and Rodrik, 2006) that gives great latitude to the specifics of the organization and relies on the self-selection of private sector participants, which are supported in their technical capabilities and encouraged to take the initiative.

On occasion, private-private coordination may be a problem that the public sector can help solve. As mentioned, firms in an industry often vary widely in terms of their interests and levels of access to policymakers, which makes it difficult to create a cohesive private counterpart that reflects all views. The public sector may play a role in helping the sector articulate a unified view. A good illustration is the case of the tourism cluster in Colonia (Uruguay), where public officials in charge of the program spent much of their initial energy overcoming differences and grudges among the private sector actors. Some actors, such as the Buquebus transportation company, the Hotel Chamber, and the Gastronomy Chamber, were well-established and organized actors; some had good access to the local and national authorities. Other cluster participants, such as the association of handicraft makers and the rural tourism providers, did not have their voices heard. The public sector was instrumental in making sure that the interests of these weaker actors were taken into account. Their success has been one of the most important and durable successes of the program (Pittaluga et al., 2014).
In some cases, and notwithstanding its best efforts to pursue an open process, the government may have to pick the sectors or actors that have the capacity to interact with the public sector. In other words, the priority of which sectors/policies to engage first may be influenced not only by the value and urgency of the actions involved, but also by the feasibility that the interaction will lead to the desired policies in the first place. Sectors with a less confrontational history, stronger leaders, a more concrete knowledge of their problems and opportunities, better coordination and communication skills, or stronger relations with academia and other institutions may take priority.

Another way to facilitate interaction with a poorly organized private sector counterpart could be to partner with economically dominant firms or conglomerates. However, this is a risky strategy because these firms may be in the best position to capture the public sector because of their economic and political influence. Korea’s experience of structuring productive development policy through very close collaboration with economic conglomerates (chaebols) was successful because it was led by a strong public sector able and willing to negotiate performance conditions and enforce them. This is not an argument necessarily for interaction with large counterparts, but rather with effective counterparts.

The modality of interaction with the private sector depends on the type of policy it is meant to support. Horizontal policies call for private counterparts cutting across sectors, be they broad collectives (such as chambers of exporters), well-selected representative individuals from various industries, or private sector organizations that are well positioned to promote certain strengths or attributes (such as innovation councils). By contrast, vertical policies call for sector-specific or subsector-specific private counterparts that match the selectivity of such policies. These councils or ad hoc consultation groups are often regional rather than national, which helps confirm and amplify the specific information that is shared.

Vertical policies concerned with solving coordination problems, often around the provision of public inputs, typically rely on narrow public-private councils delimited by the type of coordination problem that the policy is designed to address. These public-private
councils can deal with the firms to which the vertical policy is applicable, through parallel links (as in similar firms in need of a collective input), backward/forward links (as in the case of a cluster or productive chain), or the need for investment coordination to resolve a “chicken-and-egg” problem. Which public-private councils are worth forming? The process must contemplate listening to private demands and setting up specific councils to deal with problems that may require policy solutions. At the same time, the public sector may unilaterally identify certain councils that appear to offer good opportunities for productive development policy. For example, the criteria suggested in chapter 9 to identify productive transformation anomalies meriting further study (good business opportunities that the market misses) may be a good basis for setting up certain councils to explore opportunities collaboratively.

Vertical market intervention policies, however, may call for broad private counterparts when they involve strategic bets, typically designed to foster sectors that are not yet established. These kinds of transformational policies may call for private counterparts such as the successful public-private alliances outside the region analyzed in Devlin and Moguillansky (2009a). This high-level collaboration may validate criteria used for selecting priority sectors to be promoted and generate consensus around a development strategy. A good basis for identifying interesting cases for further study are the criteria suggested in chapter 9 for identifying potentially good candidates for high-value strategic productive transformation that the private sector can be expected to miss.

However, the ability to engage the relevant private sector counterpart in productive interaction cannot be taken for granted. To support a productive exchange of information and collaboration in policymaking, the public sector initiative must be seen as credible, meaning that there is a credible commitment to pursue the resulting policies. Otherwise, the private sector has no good reason to engage and participate in it. More generally, productive dialogue requires mutual trust, or at least a trust-building process. The case can be made that lack of trust (or outright mistrust) between the public and private sectors has limited public-private collaboration in many countries in the region (as in Chile) and compromised the depth
and success of public-private alliances in Latin America (Devlin and Moguillansky, 2009b).

Making the Public Sector a Better Partner

Given the importance of the private sector to productive development policy, the public sector needs to adapt in order to engage constructively with the private sector. The nature of public sector participation is driven by the productive structure of the relevant private sector counterpart, so that the public sector must have the organizational capacity to coordinate among various relevant agencies (as discussed in chapter 10). In this case, coordination means the ability to provide a consistent public sector counterpart that can latch onto the private sector (so that it is able to “speak the same language”) and adapt (so that it supports integral solutions to productive problems as they actually occur, not as they are reflected in the organizational chart of public sector agencies). This requires public sector managers who share the culture of their private sector counterpart and have access to the network of public sector agencies for support and delivery. As discussed in chapter 10, there are alternative choices for the authority structure of the public sector counterpart to ensure that specific PDPs are delivered. In all cases, the very participation of the private sector may act as a catalyst to induce public sector engagement, empowering the industry-oriented institution in charge of designing the PDP to influence the stronger, more broadly oriented institution that holds the ways and means necessary to implement the PDP.

All productive development agencies need to be imbued with some measure of private sector culture. For example, as discussed in chapter 6, smart development banks may also exploit their relations with producers to uncover bottlenecks and view the potential development impact of various policies from a wide perspective. Development banks with a vocation for learning may be able to aggregate private sector needs and advise on productive development policy on par with other top public sector agencies.7

The case of emerging sectors is perhaps the most demanding in terms of the public sector fine-tuning its ability to engage, because
these sectors suffer from weak representation and low visibility. At the same time, providing public inputs to help them establish themselves and develop may offer a very high policy payoff. This case may merit creating a specialized intelligence unit charged with the task of searching for information and identifying promising emerging sectors, with whom it can then interact and mainstream the dialogue.

Public-Private Interaction in Practice

This section draws heavily on case studies conducted by the IDB on the subject of public-private collaboration for productive development. The experiences analyzed are from Argentina, Chile, Colombia, Costa Rica, and Uruguay. The cases display an interesting diversity: different countries; some successes and some failures; some featuring task forces to address a very specific problem in limited time, and others involving permanent development programs; and some umbrella efforts ranging across the whole economy with involvement at the highest level, other programs addressing horizontal policies, and other industry-specific projects. The following is a short summary of some of the main observations about how public-private collaboration is conducted in practice.

An Extensive Menu of Options and Results

Public-private interaction takes multiple forms. In some instances, it assumes a consultative role, where government simply informs the private sector about its policy choices and decisions through dialogue and in a participatory process. Instead of just soliciting information, the government sometimes engages private agents in the discussion about what to do, through the joint design of the policy instruments and joint implementation. In some interesting and perhaps the most successful instances, the public-private cooperation and implementation of policy is a dynamic process with joint learning, and amounts to a long-term effort with evolving policies and objectives.

In extreme cases, on one hand, the roles of the public and private sectors may be reversed, with the latter having a majority or a
leading role over the institutions in charge. Public-private agencies are sometimes used successfully to combine private expertise with public control or oversight. For example, the Costa Rican Institute of Tourism is an autonomous public institution, but industry leaders are always represented in its board of directors (Cornick, Jiménez, and Román, 2014). On the other hand, some private entities are entrusted with public policy tasks, perhaps with public sector representatives on their boards of directors, as is the case of Fundación Chile (Agosin, Larraín, and Grau, 2010) or CINDE, the Costa Rican agency tasked with attracting FDI. In between is a whole range of mixed agencies and task forces that are often created as tools of public sector authorities in charge of productive development policy.

The degree of engagement of the private sector in the policy-making process is influenced not only by the nature of the policy, the sector, and the problem, but also by the political traditions and expectations of the population in place. In some countries, such as Costa Rica, business is expected to be near the policy design process on matters that affect it directly. In others, such as Chile, government (especially high-level officers) keeps a distance. As a result, policies in Chile tend to be top-down, while policies in Costa Rica tend to follow a more participatory, bottom-up approach.

Interestingly, the by-products of public-private interaction may turn out to be more valuable than their explicit objectives. For example, the value of the process may stretch beyond the resulting policy and impact on intangibles like trust, market expectations, or the disposition for future policy engagement. Dialogue in itself is valuable, and in some instances the policy in question may simply provide a platform to initiate deeper interaction between the parties. In practice, the existence of a flexible means of engagement among the parties facilitates responses that can expand upon or modify the original purpose. For example, it was the trust and goodwill generated by public and private agents jointly administering the temporary incentive program to develop tourism in Costa Rica (discussed in chapter 9) that made it possible to launch the world-class country initiative “Costa Rica: No Artificial Ingredients” down the road.
Dangers of Lack of Coordination in Both Sectors

The organizational structure of most governments is largely—but not exclusively—to blame for coordination problems impeding public-private interaction. Small, industry-specific ministries and institutions oversee the interaction with private agents in the industry, and are tasked with their progress, but the policy instruments to do so are not at their command. The example discussed in chapter 10, of the Chilean decentralization program creating regional development agencies that went awry for lack of effective coordination mechanisms across national agencies, is a typical case. Another related problem is the possible coexistence of two public counterparts: one formal, technical dialogue and the other informal interactions that may be dominated by political concerns at odds with the technical interaction (see the Colombia study by Eslava, Meléndez, and Perry, 2014).

Private-private coordination may also be a problem for interaction with the public sector. As mentioned, the tourism cluster in Colonia (Uruguay) was mired with internal friction that the public sector helped to repair. The presence of heterogeneous, sometimes conflicting interests is common in cases in which public-private collaboration involves different actors within a product’s value chain. In Santa Fe, Argentina, for example, the dairy cluster brings together milk producers and processing plants. While they both want to develop the sector, they have been engaged in a deep-rooted conflict over the producer’s price of milk. Distrust in such cases can be difficult to overcome.

Collaboration Free from Capture Is Commonplace

In the case studies prepared for this report, capture was indeed an issue but not a prevalent one. In most of the cases, the private sector was so keenly interested in the implementation and success of sound policy that the information exchange that took place was direct and frank. Such was the case, for example, of Empleartec, a collaborative program between Argentina’s Software and IT Services Chamber of Commerce and the Labor Ministry focused on overcoming the most
salient constraint faced by the rapidly growing industry: the lack of adequately trained human resources (Bisang et al., 2014). More generally, in efforts whose sole purpose is to achieve a very specific, short-term objective—like the Empleartec case, the rice case in Entre Ríos discussed in chapter 2, or the case of Asocolflores in Colombia in Box 11.1—private and public parties exchange information easily, commit resources, trust one another, and play fewer games. There is ample scope for effective PDPs in small endeavors, especially the provision of specific collective inputs, implemented with limited regard for private gamesmanship. For this set of policies, collaboration appears to flow naturally, without the need for restrictive institutional designs to align incentives.

In other cases, collaboration is more open-ended, taking the form of co-exploration. For example, in the case of the sugarcane sector in Tucumán, Argentina, farmers must replace their plantings with new varieties every five or six years to control disease. Farmers, sugarcane processors, and others came together with the state government and research center, the Agricultural Experimental Station Obispo Colombres (EEAOC), to develop new hybrid varieties well adapted to the local conditions, multiply them in order to obtain seedlings under strict scientific protocols, and distribute them to farmers. While the EEAOC is a public institution, it operates under a private board, using private sector administrative procedures. Funding for the research center comes to a large extent from a tax on sugarcane sales. As in the case of Empleartec, the collaboration was fruitful, leading to a drastic reduction in diseases and a 3 percent per year increase in yields.

Some of the key aspects of public-private collaboration that determine success or failure relate to practical problems of organization, communication, and trust. As long as they trust the public sector’s intentions and abilities, private agents are willing to incur significant costs and dedicate significant human resources to collaborative efforts, even when their direct reward is not obvious and there are incentives to free ride. In fact, payoffs can be high because sometimes cooperation leads to virtuous cycles by which private and public actors bring out the best in each other to their mutual benefit. Because so often in the past, especially in times of more heavy-
handed interventionism, mistrust has emerged between the parties, many barriers are removed only with constructive attitudes on all fronts.

The Risk of Capture Is Alive

The studies revealed limited capture but did not turn up policy features designed to control it that could account for this finding; the observation of scarce capture in this set of case studies may simply indicate that it includes mostly safe policies, perhaps because riskier ones are seldom attempted. A closer look reveals a latent risk of capture.

The studies show that whether things work out well in this regard depends largely on the underlying design, as well as the circumstances that shape the incentives of the private sector to engage in productive collaboration or revert to demands for protection. The Street Design Circuits program in the fashion design sector in Argentina is illustrative in this regard. The program, which created a series of urban tours centered on fashion design stores, with the goal of positioning Argentina as a fashion design hub, brought together the textile chapter of the National Institute for Industrial Technology (INTI) and Pro-Tejer, an NGO created in 2003 to promote the interests of the country’s textile and apparel industry. Pro-Tejer initiated the program and provided a substantial portion of the funding for what turned out to be a constructive and successful collaboration. But by 2011, the government of Argentina had increased its protectionist stance through a stringent system of discretionary import licenses. Under these circumstances, Pro-Tejer lost interest, which led to the termination of the program. This case illustrates the latent risk that exists if policy design and circumstances are not appropriate.

Designing and implementing appropriate PDPs in declining sectors is also at higher risk of capture.

In particular, when a country has a competitive edge (actual or latent) in a particular activity, and the need for policy emerges from the desire to bring about, enhance, or take advantage of that edge, the gains from doing so are potentially large enough for the participants
to engage with fully aligned objectives. However, when an industry is declining, uncompetitive, or phasing out, although feasible policies that increase productivity and reduce/minimize the problems would be valuable, it is far more tempting for the private sector to aspire to transfers or distortions that help it at the expense of others, rather than pursuing solutions that truly strengthen its prospects. The cases in Costa Rica studied by Cornick, Jiménez, and Román (2014) illustrate this disparity clearly: a competitive sector like coffee prompts constructive collaboration, while declining sectors, such as fisheries and rice, breed rent seeking.

Making the Marriage Work

Relationships are never easy; public-private collaboration in PDPs is no exception. A system abused by capture and riddled with rent seeking—as was often the case in the past—is clearly faulty; avoiding these risks by severing the private sector from the process of productive development policy would also be a failure. Both “public-minded” and “rent-seeking” behaviors can be rational responses by private counterparts; the key for government is to create an environment that favors the former and discourages the latter. In this regard, the first task is to determine whether existing institutions for public-private interaction offer a good foundation to build on.

Ideally, the incentives for collaboration on the part of the private sector would be self-enforcing—meaning that the environment for interaction is shaped in such a way that it is in the self-interest of the private sector to engage, collaborate in the design, and then support sound productive development policy. This section will discuss a number of ideas to help align public and private incentives in this way. Alternatively, monitoring and carrots/sticks—depending on observed behavior—may be needed to stimulate private sector collaboration. This section also offers ideas in this regard.

Abstain from Riskier Policies

As discussed, in well-conceived PDPs, firms benefit from the provision of a public input only to the extent that they use it in production,
and in so doing increase productivity. Firms would reap benefits only from succeeding in the marketplace. A market intervention policy, in contrast, may yield profits for the firms without productivity gains or any effort at all on their part. By barring or discouraging the demand for risky policies, risk is controlled and the incentives for collaborating on sound policies increase.

The Productive Transformation Program in Colombia, which organizes public-private collaboration in a number of selected sectors, is an example of preventing capture by excluding risky policies from consideration for public-private collaboration. The program requires that the conversations relate to public inputs, coordination problems, and other initiatives that contribute to the sector’s productivity. By design, subsidies and protectionist measures are not part of the conversation. Countries with weak institutional capabilities may need to restrict vertical public-private councils to a discussion of productive bottlenecks and coordination problems that can be addressed with the provision of public inputs and refuse to consider policies of market intervention that would open up the discussion to requesting subsidies.

**Share the Burden**

Some policies may impose a bigger cost on the government than the benefit perceived by private agents. That makes them inefficient, yet firms may still demand them. If a cost-benefit analysis is conducted to guide decision making, firms would have the incentive to exaggerate the benefit. Given their informational advantage, they stand a good chance of convincing the public bureaucracy. While this may not be the prevalent case, it is important to address this risk.

The incentive-compatible solution to this problem is to ask the private counterpart to engage and contribute to the costs or sacrifices necessary for the policy, thus confirming its worth. While cost sharing also saves fiscal resources, which are costly to raise, the argument here is not so much about fiscal costs but rather about how to align incentives to ensure that only sound policies are carried out. Ideally, the share of the cost that the private counterpart would contribute should correspond to the benefit it would enjoy; if benefits are
concentrated and the private sector counterpart covers all beneficiaries, the input should be fully paid by the private sector. In practice, an arrangement to share a substantial portion of the costs would go a long way toward introducing discipline in the demand for public inputs, based on willingness to pay. This cost-sharing principle can also be applied to signal the intensity with which firms may demand a variety of alternative public inputs and in this way prioritize their provision.\textsuperscript{14}

The key problem with burden sharing is coordination. Individual firms benefiting from a collective input (“a club good”) would rather not contribute and let the rest pay for the cost. The private sector can participate in cost sharing only if it is able to coordinate among its firms to agree on this collective action, because otherwise no individual firm would be willing to pay. If individual firms can be excluded from the benefits of a collective input (such as certification of product quality), cost sharing can be implemented through user fees or a “member-only” restriction. If that is not the case (for example, a research center), then an external incentive is needed to compel individual firms to contribute. The authority of the public sector may be the solution to this coordination problem. Box 11.2 discusses an institutional innovation proposed by Paul Romer (1993) that would address these issues in a precise way.

### Box 11.2 Self-Organizing Investment Boards

Problems of collective action can sometimes be a severe obstacle for the development of an industry. Even if industry participants were able to identify a set of collective goods that would benefit the sector as a whole, in the absence of some coordinating device each individual firm would have incentives to free ride on the efforts of others, resulting in underprovision, or outright non-provision, of the collective good. In 1993, noted American economist Paul Romer proposed an institutional innovation designed to facilitate collective action at the industry level. He called this innovation “self-organizing investment boards.”

To use the generic example provided by Romer, consider a sector producing widgets. Widget makers come together and identify one or more collective inputs that would be in the interest of the industry as a whole.
Perhaps different participants disagree on what the most important inputs would be. Some argue that what is needed is to help fund research regarding widget design at the local universities. Others think that it would be more valuable to stimulate the development of suppliers of specialized widget-making equipment, or to train the labor force in appropriate widget-making techniques.

Romer’s proposal would have the sector petition the state to impose a tax on their sales in order to fund the vertical collective inputs selected. After certifying that the collective inputs in play address genuine collective needs, the state would hold an election among industry participants to vote on whether the tax should be imposed. With sufficient support, a tax would be imposed and the self-organizing investment boards would be set up, one for each collective input identified and validated by the sector.

Each firm would decide how to allocate its tax money among the various boards depending on how much it values each of the collective inputs identified. Members elected to manage each board would autonomously decide how to spend resources for the specified purpose. Boards linked to collective inputs that are no longer deemed necessary would not receive any funding, which effectively implies that there would be a sunset clause.

Romer’s proposal creates a very flexible and potent instrument of collective action through which the sectors decide what they need, provide the necessary financing, and thus contribute to solve their own problems. The state’s role, beyond perhaps contributing to provide (but not finance) some of the collective inputs identified, is to help solve the free-riding problem, through its capacity to enforce the tax.

Sectors actually petitioning to be taxed? Does this sound far-fetched in Latin America? The example of rice in Entre Ríos, Argentina, discussed below and in chapter 2, suggests that it is not.

An example of such an alignment of incentives is that of a collaboration in Argentina between PROARROZ (a corporation of rice growers in Concepción in the province of Entre Ríos) and INTA, discussed in chapter 2. To secure funding for INTA’s efforts to develop a new rice variety in a way that would solve free riding, PROARROZ asked the government of the province to levy a tax on rice producers. The receipts were to be used to finance research efforts (otherwise, presumably, any grower could benefit from the new seed without making a contribution). Since rice growers will be paying for a
significant part of the research, this should reduce their incentives to ask for an investment that is larger than what is socially desirable. It is interesting to note that while the government could unilaterally enact a tax scheme of this sort, in this case PROARROZ asked to be taxed; this clearly added legitimacy and facilitated the enactment of the tax. A private counterpart would ask to be taxed only if it believes that otherwise the public input would not be provided. It is important to note that cost sharing requires not only private sector coordination to pay but also commitment by the public sector not to fund the public input in the absence of the tax.

**Conditionality or Performance-Based Policies**

The social value of a productive development policy may be enhanced if private beneficiaries of the policies are induced to maximize the social benefits. This may be achieved by aligning incentives of the private parties to policy goals. For example, productive development policy to boost firm innovation and spark positive spillovers through dissemination would be more effective if incentives were added to make dissemination more attractive. For instance, subsidies to foster innovation may favor research done by a consortium, as discussed in chapter 3. A market-friendly mechanism could be to calibrate the size of the subsidy to the number of firms that adopted the research and entered the market; that is, the greater the number of followers, the larger the subsidy. The proposed policy to favor self-discovery discussed in chapter 2 is an example in this regard. Yet another mechanism could be to condition the benefit to sharing the innovation research or adoption with would-be followers.

**Information and Policy Demands**

The private sector party has better knowledge than its public sector counterpart, but does not share the same objective; it is a biased expert, in economics jargon (Grossman and Helpman, 2001). Thus, it is critical to devise methods that encourage the flow of better knowledge, while controlling for biased distortions. One possibility is to utilize peer-to-peer monitoring, including additional experts
with opposing biases, so that they check on each other. Additional experts may be from competing sectors, academia, or perhaps the same sector in other countries (or even individual firms or individuals within the sector that may have particular reasons to collaborate with the public sector). In particular, cross-sectoral programs introduce checks and balances by bringing in sectors with different interests, making collusion between the private sector and the authorities more difficult.15

Another approach could be to invite the private sector counterpart to present proposals to express policy demands and make it accountable for their content in light of ex post performance evaluation. This approach would work best if proposals need to comply with certain standards. For example, if the policy demand is justified based on expected positive spillovers, the proposal should state so and provide indicators of performance after the policy is put in place. Such an approach would facilitate ex ante evaluation of the proposed policy, conditioned on the information provided, and would also facilitate testing the accuracy of such information based on ex post performance. Unbiased experts would conduct the testing and reach a conclusion about the accuracy of the information based on the relevant circumstances. If the test is favorable, the private counterpart could be rewarded with continued collaboration; if the test is not favorable, future interactions would be more guarded, and less accommodating. This “trust but verify” approach would in turn provide better incentives for less biased proposals, since high-balling benefits would be costly.

**Good Performance before Renewing Policy**

Even without any biases or impediments to collaboration, it is technically difficult to select the right policies. Thus policymakers willing to try PDPs ought to be prepared to fail sometimes. However, it should be feasible to spot failed policies after the fact. This is an area where private agents may play a role. It is important to define evaluation methods that are suitable to assess the degree to which the original policy justification was verified in actual performance and how the policy could be improved. All too often, there are no
clear goals or evaluation criteria for productive development policy, let alone actual evaluations. A sound system would allow a reasonable number of policy experiments to go wrong and also have a systematic way to weed them out (Rodrik, 2007a).

Policies involving market intervention tend to generate “addiction,” that is, an interest in prolonging the promotional policy ad infinitum, regardless of performance. To stop those policies that are not justified, evaluation is key. One solution is to apply sunset clauses so policies expire unless reapproved.¹⁶ For this system to work, both the process of evaluation and acting upon evaluation need to be systematic. It is important to include all policies under this system so that policies benefiting private interests do not find refuge in loopholes to avoid scrutiny. In practice, the policies more hidden from scrutiny are often those that provide implicit subsidies in the form of tax exemptions, a favorite of rent seekers. Sunset clauses should apply to both explicit and implicit benefits. These evaluation checks are critical to contain the risk of capture because the benefit of rent seeking diminishes in a system in which only sound policies survive over time.

Evaluation must be strict and binding. Independent participants are often needed to ensure there is no conflict of interest to cover mistakes, or, worse, capture. Negative evaluations should have consequences: within the learning paradigm, it is critical that evaluation be a learning experience leading to redesign. Beyond the technical aspects of evaluation, stronger collaboration requires the kind of political capabilities discussed in chapter 10 to ensure that evaluation is not pro forma, but an instrument to effectively separate the wheat from the chaff.

Checks and Balances

Appropriate internal controls in the public organizational structure may be useful to check capture. The distribution of authority across agencies, such as separation between design and implementation or regional delegation subject to central oversight, may provide desirable checks and balances. At the same time, there is a trade-off between controls and effectiveness. These mechanisms should not take
forms that excessively weaken the public sector, impede action, or make the already challenging public-public coordination problems unmanageable.

Providing appropriate incentives to public officials is also important. Compensation (both monetary and career pride) must be sufficient to protect against some forms of capture. While it is reasonable for the public sector to hire experts with specialized, sector-specific knowledge originally developed in the private sector, if the career path of technocrats and managers who have moved to the public sector entails a quick return to the private sector, the integrity of their work may be compromised. To avoid this, once the transition to the public sector has been made, an attractive career path should lie ahead, and a cooling-off period, with adequate compensation, should be mandatory before key public servants responsible for a certain PDP can return to work for the segment of firms with an interest in it. The bottom line is not necessarily that “revolving doors” should not exist, but when they do, the rules and standards should be clear.

**Transparency and Accountability**

All of the steps described would greatly benefit from transparency. Just as sunlight is a good disinfectant, exposing policy proposals, the way policies are chosen and costs shared, and performance evaluations to interested parties and the wider public would shine light on issues worth probing and allow scrutiny from adversarial viewpoints. Ideally, transparency standards for productive development policy would be established, and an independent agency would regulate and monitor them.

However, informal consultations may in some cases be necessary, either as a preliminary step to more formal collaboration or as a complement to formal processes. In fact, complete openness is not always the best environment for exploratory dialogue. But caution is necessary: The tension between probity in the use of public resources and responsiveness/discretion on the part of bureaucrats is especially high in these instances. Since responses to specific problems of productive sectors cannot be codified in advance, officers...
need room to maneuver and react, albeit at the cost of some risk. This kind of flexible interaction will be accepted as legitimate and incorporated in mainstream policymaking only if it is known and transparent. This requires well-known rules and procedures for participation in the dialogue and for receiving policy benefits, as well as transparency in their application. Transparency should not be confused with an undue formality that impedes fluid dialogue, or with inclusiveness with no clear purpose.

Accountability is a necessary complement to transparency. The results of the interaction process should be evaluated credibly, and the evaluation should be disseminated to key stakeholders and the public at large. Every collaborative scheme ought to make sure that there is a mechanism for the private sector to hold the public sector accountable for following up on the decisions that are reached and for receiving feedback during the implementation of policies in response to perceived needs.
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