



Development Centre Studies

Public-Private Dialogue in Developing Countries

OPPORTUNITIES AND RISKS

by Nicolas Pinaud



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Foreword

This study is part of the Social Institutions and Civil Society research programme.

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Preface

Building a tradition of dialogue and – vitally important too – listening and often negotiating compromises, is one of the best ways for governments to learn about the local private sector’s problems and adjust their policies to ensure the sector’s growth and development. Dialogue is also a way for firms to foster a good business climate to help their operations.

Unfortunately, such dialogue is not very organised and sometimes barely exists in many developing countries, which is why aid donors are very keen on supporting it and why they are willing to channel an increasing amount of official development aid (ODA) to support it, within a wider context of efforts aimed at promoting the development of the private sector. However, development partners have realised that it is not sufficient merely to provide financial support to local initiatives of this kind, but are also reflecting on how public-private dialogue can be effectively conducted by local stakeholders and appropriately supported by the donor community. Identifying good practices in PPD was therefore the focus of an international workshop on public-private dialogue organised by the World Bank, the Department for International Development (DfID), the International Finance Corporation and the OECD Development Centre in Paris on 1 and 2 February 2006, at which a broad range of speakers – from business, civil society, developing-country governments and development partners – laid the foundation for a “Charter of Good Practice in using Public-Private Dialogue for Private Sector Development” and a “PPD Handbook: A Toolkit for Business Environment Reformers”¹.

The charter and toolkit ideas show that engineering such a dialogue is far from straightforward. Local stakeholders and development partners have often underestimated the difficulties encountered when the former are brought together to talk, let alone negotiate, without adequate preparation, and have overestimated their capacity to reach a meaningful consensus. Hostile

institutional conditions, weak local stakeholders, a lack of trust, experience and credibility, asymmetries of information, or the predominance of organised interests can sidetrack discussion and make it a screen for self-interest.

This book presents the achievements, complexity and difficulties of public-private interaction through a detailed analysis of the prerequisites for balanced, effective and long-lasting PPD. It points out that successful PPD cannot be guaranteed through procedural means and structures, and that good practice, however useful, cannot replace prior in-depth knowledge of existing institutional conditions, of the economic context in which this interaction takes place and of a thorough analysis of stakeholders' characteristics, negotiating relationships and incentives for reaching consensus. This study addresses in particular the obstacles to undertaking PPD in low-income countries, with a special focus on sub-Saharan Africa, and arrives at very tempered conclusions.

While highlighting the obstacles and risks involved in promoting public-private dialogue in the least developed countries, this study does not in any way advocate scepticism on this issue. It merely makes a cautious plea for governments in developing countries to opt firmly on behalf of a sincere dialogue while recommending that development partners adopt a pragmatic, restrained and well-informed approach to supporting the complicated process of PPD.

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1. See <http://rru.worldbank.org/Toolkits/PublicPrivatedialogue/>
and <http://www.publicprivatedialogue.org/>

Javier Santiso
Acting Director
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August 2007

Summary

The participation of civil society – consumers, private entrepreneurs, employees, citizens and community groups, etc. – in designing public policy is critical if the state and the government are to improve the transparency, quality and effectiveness of their policies, thereby consolidating their legitimacy. Similarly, private firms and the business community (who, it is now recognised, play a crucial role in the creation of national wealth) obviously have an interest in being involved in economic policy making. Lastly, development partners, who have recently put greater emphasis on private-sector growth, have been more and more stressing the need to foster a genuine policy dialogue between the authorities and the business community in developing countries in order to improve public policies.

Yet interest in public-private dialogue (PPD) is fairly recent and growing. Interaction between government and the private sector was largely studied by economic and political scientists in the 1970s and 1980s in terms of rent-seeking, collusion and corruption. Analysis in the early 1990s of the conditions and factors in the success of some Southeast Asian economies helped challenge this vision, by pointing to the role of the state in the economy and the scope for fruitful interaction between political elites, bureaucracy and the private sector. The growing influence of civil-society stakeholders in industrialised and some emerging and less-developed countries has supported this trend. In this context, calls for consultation in drafting government policies, especially the involvement of the private sector in the design and implementation of policies relating to economic strategy, have naturally arisen.

PPD is not a panacea. Its benefits have sometimes been overestimated and its risks played down. Efforts to use and promote it in situations where the most urgent priorities were to address issues of governance and private-sector development have sometimes led to misjudging the conditions needed for creating sound and fruitful PPD that results in a genuine improvement in

the business climate. This study argues that such dialogue is a complex transaction that involves substantial transaction costs and asymmetries of information. Also, where the rule of law (if it exists at all) and the (often merely formal) separation and monitoring of powers have only recently developed, interaction between government and private sector tends to become a process of collusion and mutual predation. This interaction, which may take the form of a dialogue, risks becoming nothing more than a screen for rent-seeking – the very opposite of what might be expected from fruitful PPD, i.e. the production of public goods, such as economic policies to increase national wealth.

This study also aims to identify as clearly as possible, with the help of numerous examples, the institutional conditions (quality of bureaucracy, level of private-sector organisation and development, influence of political system) for effective PPD that avoid the pitfalls of non-transparent and economically sub-optimal interaction. It stresses that the quality of dialogue depends on the structures of the institutions involved on both sides. Creating the conditions for productive PPD is a very sensitive matter. It is hard to establish the delicate balance required, where the integrity of stakeholders is maintained (i.e. the reciprocal autonomy of both the state and the private sector is preserved) while there still exists sufficient interaction for genuine dialogue. The adequacy of this interaction is a reflection of both the private sector's capacity to gain access to bureaucracy and government, and of the state's capacity to become involved in the national economy and build networks.

The discrepancies noted (especially in most LDCs) between the local institutional and economic situation and the optimal conditions for effective PPD should not, however, lead to scepticism about this complex tool for designing public policies, but to a well-informed, positive and cautious attitude to its use. This study looks at the possibilities for PPD, particularly in sub-Saharan Africa, and suggests practical ways in which donors can use this complex tool.

Introduction

The participation of civil society – consumers, private entrepreneurs, employees, citizens, associations etc. – in the design of public policies echoes the need of the state and the government to establish their *legitimacy* by improving the *transparency, quality and effectiveness* of their policies (OECD, 2001). Private firms and the business community – whose central role in the creation of national wealth is no longer a question for debate – tend to become involved in the design of *economic policies* in particular.

Public-private policy dialogue (PPPD), that is, consultation between firms and governments¹, is increasingly advocated as a way of improving government policies in developing countries (DCs). Because PPD is usually considered to be poorly developed or badly structured, a growing share of Official Development Assistance (ODA) is earmarked for it. A recent study by the OECD's Development Assistance Committee (DAC), which brings together bilateral OECD donor countries, states: "Objectives of PPD include building trust and bridging gaps and laying the foundation for joint problem analysis and identification of policies and institutional reforms that contribute to a more conducive environment for private sector development" (OECD, 2005, p. 3).

The abundance of serious efforts to achieve these objectives is evidence of the growing interest of multilateral and bilateral aid donors in encouraging interaction between government and private sector in DCs. Herzberg and Wright (2005 and 2007) have made an excellent "operational" summary with a broad survey of PPD efforts in DCs, and provide what is virtually a user manual and a guide to good PPD practices in DCs. They cite lessons learned from initiatives supported by the World Bank and many other donors in recent years that show the great interest of these organisations in PPD.

This is quite a recent trend in the history of development co-operation which, until the 1990s, largely ignored non-governmental stakeholders, especially private entrepreneurs. Donors and recipients are now showing enthusiasm for PPD since this lies at the heart of three of their current priorities – private-sector growth, participation and good governance.

As often happens with a new and fairly original approach, the benefits of PPD are sometimes overestimated and the risks played down. Efforts to use and promote this instrument in situations where the most urgent priorities were to address issues of governance and private-sector development have sometimes led to misjudging the conditions for creating sound and fruitful PPD that results in a genuine improvement in the business climate. This study aims to identify as clearly as possible the conditions, especially the institutional conditions (quality of bureaucracy, level of private-sector organisation and development, influence of political system), for effective PPD that avoids the pitfalls of non-transparent and sub-optimal economic interaction between government and business.

Our analysis stresses that while the potential benefits of PPD are considerable (Chapter 1), the risks involved are just as great; and so it is necessary to define clearly the conditions under which dialogue can be implemented (Chapter 2). The possibility that PPD can become a screen for corruption, collusion and seeking of self-interest by bureaucratic sectors, political circles and the private sector must not be ignored. Certain institutional conditions must be satisfied before PPD begins, especially minimum bureaucratic standards (with at least some “pockets of efficiency”) and a minimum of maturity in the local private sector. This study does not in any way imply that productive PPD in DCs is impossible or suggest that governments should be insulated from civil society, but it does recommend caution. It looks at the possibilities for PPD in sub-Saharan Africa (Chapter 3) and suggests practical ways in which donors can use this complex tool.

Note

1. Public-private policy dialogue is defined in a broad sense in this study to include all forms of interaction between the state and the private sector relating to the design of public policies – improving the business climate, short-term macroeconomic policy, medium- and long-term development strategy, sector regulation, and so on. This interaction can be more or less institutionalised (investment councils advising the government, formal discussion forums bringing together civil servants and business people, and informal social networks that include senior government officials, political decision makers and leading business figures).

Chapter 1.

Public-Private Dialogue in Developing Countries: Working for Better Governance

Language and dialogue do not only enable an exchange of views between stakeholders, but by introducing a public-policy issue (such as the fight against inflation or trade liberalisation) into a country's political, economic, social and cultural context, they also define what is politically, socially and economically possible, and in this way play a key role in policy design.

Apart from this function of defining context, dialogue between government and non-governmental (private) economic stakeholders must also be considered to be an institution, as understood by "New Institutional Economics" (NIE), see especially Williamson, 2000:

- i)* It defines some of the rules of the game governing the interaction between the private sector and the state. These rules are both formal (dialogue procedures) and substantive (agreements and commitments). From this point of view, PPD is a co-ordination mechanism consisting of an exchange system based on the possibility of mutual gains, as opposed to means of co-ordination based on a threat system or an integrative system¹;
- ii)* It is also a platform for interaction between state and private sector, and is hence an organisation (which can be very informal or very institutionalised).

For both of these reasons, a dialogue of this kind can lead to transparency and trust between stakeholders, enabling the market failures usually identified by neo-institutional authors to be overcome²: both parties then stand to gain.

For the state: more legitimacy for more effectiveness

In many DCs – much more than in industrialised countries – the state lacks credibility with local or foreign private sectors, especially where commitments over time are concerned. This problem of “time inconsistency” (see for instance Rodrik, 1989) in public decisions involves high transaction costs in the interactions between state and private sector: *i*) the impact of government policies is reduced because the private sector is cautious or systematically takes evasive measures; *ii*) business activity is negatively affected because government policy cannot be sufficiently predicted, a stable business climate is lacking and time horizons are shortened.

Borner *et al.* (1995) point out that government credibility with business³ is, more than other political variables, a statistically strong measure of economic performance (based on growth) in DCs⁴. Establishing credibility and trust with a naturally sceptical private sector is a challenge for governments, which must therefore send strong signals if they want the private sector to believe they are sincere.

PPD is one of the tools that the state has in order to change the private sector’s perception of it, gain credibility and establish a reputation for favouring private-sector development. Meisel (2004) describes how French governments, after World War II and until the 1973 oil crisis (a period known as the *Trente Glorieuses*), managed to co-ordinate and harmonise the growth expectations of social partners, create trust between trade unions, private firms and the public sector, and encourage investment through extensive dialogue between economic stakeholders. The World Bank (2001) reports how, in Mexico, consultative bodies linked to the Economic Solidarity Pact (a stabilisation programme in the late 1980s) helped in the 1990s to move from a situation of mutual suspicion to “generate greater understanding, trust and networking” between government and top business leaders.

When a country has no traditional democratic mechanisms such as universal suffrage, or else has only dysfunctional democratic institutions, PPD can be seen as a (partial) substitute for democracy. In democratic systems, it can be a key supplement to traditional liberal parliamentary democratic mechanisms, such as universal suffrage, which fail to cover all the consultation needs of civil society, especially those of private firms and professional associations (Box 1.1)⁵.

Box 1.1. Universal suffrage: a limited instrument for consulting civil society

The limits of universal suffrage can be summed up as follows:

- Democracy cannot merely be a question of putting a voting slip into a ballot box: this notion ignores the multiple links and allegiances of citizens⁷. The World Bank, in its 1997 World Development Report focusing on the state, points out that “citizens do not want to be represented only as voters, but also as taxpayers, users of public services, and, increasingly, as members of NGOs or voluntary organisations.” This also applies to the business community, who may want to be recognised as an organisation and, as such, have access to the government.
- Voting captures personal preferences only incompletely. On the one hand, elections and referendums are too infrequent to be an indicator of public opinion on a regular basis; and on the other, they fail to allow groups such as the business sector to voice demands regarding specific or technical matters that are rarely raised during election campaigns.
- In DCs where democracy has been introduced only recently, elections are no guarantee of good institutional performance. First, the truly democratic nature of elections is often questionable: there is little choice, there may be election rigging, and voting may rather reflect non-political loyalties. Second, mechanisms for holding governments accountable between elections often do not exist (no checks on constitutionality, no independent bureaucracy or public bodies exercising control over the state, and no real separation of powers, etc.).

The expertise of firms: a potential resource for designing public policies

The best way of guaranteeing the legitimacy and high quality of government policy is to ensure that it meets the needs of those concerned, but again, universal suffrage is not enough to represent the preferences of the business sector. Sharing of information and expertise between state and private sectors is hence clearly useful⁷.

Economic policies targeting private-sector decision makers will be more appropriate, relevant and ultimately effective if the private sector has supplied information that allows policy makers and bureaucracies to analyse and foresee correctly the expected responses to changes in economic policy. During Mexico’s negotiation of the North American Free Trade Agreement (NAFTA) with the United States and Canada, data provided by local exporters were extremely valuable for the Mexican negotiators, who had little experience in international trade talks (Schneider, 1997). In turn, information supplied by the government can prove equally valuable to the private sector (for forecasting,

investment planning and strategy development), providing the sector with increased predictability and visibility. Dialogue can therefore be an interactive learning process⁸. It is not simply an exchange of views, but also a means of persuading people to adjust their positions and a way of identifying state and private-sector actions that are complementary.

When government policy is implemented in an authoritarian and hierarchical manner, this vital ingredient of public-private interaction is neglected. The state is far from infallible and omniscient – a notion contrasting sharply with the “welfare economics” paradigm that was prevalent for a long time after World War II (approximately 1950-1970s) regarding state intervention in the economy. Welfare economics implied that in the case of market failures “the state has all relevant information for social-welfare-maximising intervention and is able to achieve what it sets out to do” (Chang, 1994, p. 25). Very many authors (notably Demsetz, 1969) reacted by pointing to serious limits on the effectiveness of public intervention (government failures), with particular reference to the limited ability of governments to identify market failures and remedy them. Realising the advantages of interaction with the private sector and the potential for mutual learning, many DC governments are actively seeking the advice of the private sector. Also, councils of foreign investors are increasingly being set up to provide advice to governments in the area of economic policy making. This type of initiative fits into the policy-dialogue process, and is often supported by donors.

Using firms to implement government policies: an option worth exploring

In many DCs, the private sector, despite its weaknesses, can serve as an intermediary and even provide solid backing for governments seeking political, social, industrial or financial support in implementing their policies. There are two aspects to this.

First, the private sector can serve as an *intermediary* for public policies by supporting or being actively involved in their implementation. By enabling more government transparency and responsibility towards firms, PPD encourages private-sector acceptance, and even ownership, of public policies. This helps to reduce companies’ avoidance behaviour – such as tax evasion, lawbreaking, bribing government officials and capital flight – and enables them instead to become involved in public-policy implementation: this is in turn beneficial to economic activity, and hence to political and social stability.

Box 1.2. Reform through dialogue

Many of the failures of structural adjustment policies in DCs in the 1980s and 1990s have highlighted the limitations of reform policies that were designed without taking account of social and political resistance by civil society, including sections of the business community opposed to the reforms. There is hence an extensive literature that looks at resistance to reform in DCs and tries to define political and social conditions leading to structural adjustment⁹; this “political economy” of reform stresses the need for information, consultation and dialogue in order to improve reform. The “*status quo* bias” model developed by Fernandez and Rodrik (1991) links resistance to reforms to uncertainty about their redistributive consequences. This model points out that part of the population, whose “vote” is key to the implementation of reforms, can oppose reforms beforehand even though it would in the end benefit from them. This “distortion” occurs because the population group concerned is unable to estimate the redistributive effects of the proposed reforms, and so fears losing out from any change. The government’s capacity for dialogue, education and persuasion is therefore crucial to winning decisive support from this population group (which may include parts of the business community) for implementing reform. Establishing “alliances for reform” is especially important when reforms are genuine “paradigm changes” involving visibly new policy directions. Politicians are disinclined to make such changes, which call for strong motivation and leadership to sustain them. However, a dialogue between business and political and bureaucratic reformers may very well lead to such alliances as well as to collective and cohesive provision of the leadership required for implementing radical changes. Dollery and Wallis (1999) describe how some business sectors (the heads of New Zealand’s biggest firms, who belong to a fairly exclusive lobbying group, the Business Roundtable) supported and communicated the radical (neoliberal) reforms which were proposed and finally implemented by the country’s Treasury in the late 1980s. The Treasury kept control of the formulation of the policy reforms as such, while the Roundtable provided “shock troops” and took part in designing the new paradigm. The Business Roundtable became the melting pot for a new “establishment” held together by similar ideologies. However, through links with the Treasury, the Roundtable also became the cornerstone of a social network composed of neoliberal reformers from the private and public sectors. The marked infiltration of the government apparatus (the Central Bank, the Treasury and the State Services Commission¹⁰) by Roundtable members following the “victory” of the reform agenda revealed the strong ties existing between the two circles. This example of reforms in New Zealand demonstrates the advantages of robust reform-oriented PPD, but it also raises problems. When a private-sector lobby can obtain radical government reforms by backing a small section of the state apparatus, citizen confidence in representative democracy can be undermined. Kelsey (1995) argues that the New Zealand reform experience left “a deep-seated scepticism about electoral politics and parliamentary democracy” (p. 297) as well as a long-term distrust of national institutions by groups that ended up paying for reforms imposed by an elite network of reformers (cited by Dollery and Wallis, 1999, p. 128). On the other hand, whatever the government’s determination and ability to create dialogue on reforms, it may be difficult to overcome general resistance to change – what Downs (1957) called the “coalition of minorities” – especially when the benefits are scattered while the costs are concentrated in well-defined (and sometimes well-organised) sectors of the population. In the example of New Zealand, the determined and powerful minority were the reformers, but this is by no means always so. This point is discussed in detail in Chapter 2.

Such private-sector “ownership” is crucial to the success of most government policies, especially programmes for economic reform (Box 1.2): although the private sector can be a lever for public policies, it can also be an obstacle to their implementation.

Second, the financial and industrial involvement of the private sector is key to the successful implementation of government policies, particularly in DCs where the state often has very meagre resources. Policies to develop energy infrastructure, water management and transport are the best examples of where government and private-sector investments can be complementary, and so require the strong (mostly foreign) involvement of private-sector operators. Such public-private collaboration, known as public-private partnership (PPP), has however been only partially successful, and this is an indication that public-private contracts of this kind require prior in-depth dialogue between government and private operators that goes beyond purely legal aspects: the underlying economic, social and regulatory issues of such collaboration must be thoroughly discussed, and particularly how it fits into overall national strategies for growth, infrastructure development and poverty reduction.

This dialogue must further the success and viability of PPPs by promoting an understanding of the broader issues affecting their implementation. In a comparison of the privatisation and franchising of electricity supplies in Côte d’Ivoire and Senegal, Berthélemy *et al.* (2004, pp. 109-113) attribute dissimilar results (success in the former and failure in the latter) in part to different levels of government capacity and commitment with regard to prior involvement of the private sector (in this case, foreign investors) in drawing up the regulations for granting the franchises.

For the private sector: an improved business climate

Dialogue is a way for the private sector to press a government not only into improving its own performance and record of reform, but also into creating a better and more transparent business climate and intervening in areas of serious market failures.

Influencing the rules of the game

As “the sole source of the right to use violence”¹¹, the state is the seat of authority – codifying laws, making regulations and, for companies, creating the legal environment governing economic activity in a particular geographical area. The state also penalises offences and ensures that the rules are enforced. It is, moreover, a major economic stakeholder through public spending, taxation and industrial policy: it may intervene in order to stimulate growth (though this kind of Keynesian action has lost much of its credibility over the past two decades), or else to repair market failures. These goals evidently constitute a natural ground for PPD, in view of their implications for the private sector.

Moreover, companies have obvious reasons for influencing legislative and regulatory processes (and, so, for putting pressure on the government). The acceleration of globalisation over the past 30 years has not, despite theories of convergence, substantially removed this need (Box 1.3). Except perhaps in situations of monopoly or oligopoly¹² the private sector generally wants the government to create a business environment, regulations and public policies that are propitious to the development of business activity (transparency, security, predictability, expanding infrastructure and so on), and it expects the government to have the capacity to do this. The private sector can only rarely thrive without a dialogue of this kind with the government.

Reforming the state: the state as facilitator and strategist?

Dialogue between the government and the private sector can lead to “good policies” being adopted, but it also provides an opportunity for redefining the state’s role in the economy. The private sector can for example use dialogue to demand more transparency and integrity on the part of the government. Doner and Schneider (2000) point to the active part that professional associations can play in reducing corruption in the state apparatus. Kraus (2002) describes how Nigeria’s main professional associations helped liberalise exchange and credit policies in the 1990s under the dictatorship of General Sani Abacha, when representatives of the associations were allowed to sit with government officials on the committee that allotted foreign exchange quotas. This victory for business meant shutting off a source of economic rent for the Nigerian bureaucrats in charge of these allocations; however, Kraus

comments that the associations could not prevent wholesale looting of the country's wealth by Abacha and his aides, and that some associations were even in league with the government.

A more fundamental effect of PPD is that it can become a way of defining (and hence *curbing*) the state's role in the economy according to the *principle of subsidiarity*; that is, only allowing the government to do what the private sector cannot do so effectively. As has already been pointed out, the state is not omniscient, necessarily benevolent or better informed than individuals (especially about people's preferences); nor is it better at defining their property rights or more efficient at managing its administrative overheads than the private sector is at managing bilateral transaction costs¹³. It is also not necessarily as good as the market at co-ordinating economic stakeholders.

The implicit presumption of the "perfect" state underlying welfare economics means that government intervention is indispensable to repair all market failures. Welfare economics and the market-failure paradigm tend to put forward a *normative* view of the state, not as it is, but as it ought to be (that is, omniscient and benevolent), and to contrast this with a *positive* view of an imperfect market which is unable to allocate wealth effectively. This dichotomy, opposing a normative theory of the state against a positive conception of the market and then drawing conclusions about government policies, is, as Dollery and Wallis point out (1999, p. 30), "quite untenable in the realm of policy prescription and accordingly needs to be augmented by a positive theory of how real governments actually behave." Some supporters of New Institutional Economics have formulated a comparative approach to institutional analysis, stressing the need to make a positive (rather than a "normative") comparison of the efficiency and deficiencies of real and/or realistic alternative institutional arrangements based either on market predominance or on state intervention.

This approach fits in with the idea of Coase (1964, p. 195) that "until we realise we are choosing between social arrangements that are more or less all failures, we are not likely to make much headway." PPD can assist this process of comparison, by providing a suitable platform for discussion and analysis so as to determine the comparative advantages of public and private sectors in the attribution of economic prerogatives. In this way, it can help to establish a more efficient division of labour between the public and private sectors, or in other words, a more optimal definition of a mixed economy. Instead of a maximalist view of the state's role inherited from welfare economics and the Keynesian approach, or a minimalist concept based on neoliberal ideas, public choices and even libertarian theories (see especially Nozick, 1974),

Box 1.3. Has globalisation made the state a mere auxiliary of the private sector?

Is it still useful for the private sector to lobby governments and engage them in PPD? Some literature, dubbed “business-as-capital” (Lindblom, 1984), has contested this view of the relations between state and private sector, and holds that since the late 1970s, the deterritorialisation of economic phenomena challenges governments’ autonomy with respect to economic policy, and even their capacity and legitimacy in the area of economic policy design. Governments, they say, no longer have any room for manoeuvre in making laws and regulations about such matters as capital movements, company taxation or foreign direct investment. In other words, the state is *endogenously* obliged to create a favourable environment for the private sector. The constraints of economic performance and the inevitable convergence of economic policies are factors that help to discipline governments and turn them into auxiliaries of the private sector. The *exit/voice* analysis framework suggested by Hirschman (1978) explains this. Financial liberalisation and increased possibilities of delocalisation allow firms immediately to develop an *exit* strategy (moving to another economy) when faced with an uncompromising or poorly performing government, without ever having to exert pressure (*voice*) for a change in economic policy. So the idea of dialogue and interaction between state and private sector loses its meaning, as the state has no choice but to establish a business environment that is propitious to private-sector development, while the private sector has no need to lobby for it. However, this convergence theory is debatable, and does not take sufficient account of the complexity of government/private-sector relations, especially in DCs:

- i) The meaning of convergence varies with countries and regions of the world. In many cases the least-developed countries (LDCs) are excluded from the worldwide financial and trade integration process and have little hope of benefiting from it in the short term. Convergence may therefore not be a major incentive for these governments to adopt endogenous policies in favour of the private sector.
- ii) The balance of power between state and private sector also depends on the structure of the economy and so is not necessarily favourable to the private sector, even in DCs that are well integrated into the world economy. Therefore, in a highly specialised (and often, well integrated) economy, local and foreign private investors who dominate key sectors will in practice have significant power to pressurise the government, since it is vulnerable to the threat of exit (delocalisation)¹⁴. In a diversified economy, however, investors will not have such power, and the more attractive a country is for local and foreign investors – for example, China, because of its huge market – the less the government will care about the departure of investors who are already present.
- iii) Nothing guarantees that the private sector’s interests will converge entirely over public policy (due to divisions between sectors, and between exporters and suppliers of the local market, etc.). This means that the state can rely on some elements of the private sector to counter the influence of those who are hostile towards the government, and in this way keep some room for manoeuvre in defining its economic policy.

Box 1.3. continued

iv) Not only are governments faced with the obligation of creating a pro-business environment: they must also adapt to “electoral and social” pressures (Przworski, 1985). The government is therefore not a mere auxiliary of the private sector, but must seek a compromise between the social stakeholders (voters, employees, business circles and civil-society groups) and its own interests, both in its role as an institution and the theoretical incarnation of the public good, and as a bureaucratic organisation with its own particular interests.

At national level, therefore, the private sector does require to maintain contacts with the government and to promote in-depth dialogue with it. However, the convergence theory stresses the need to link national forms of PPD to a second dialogue, this time between the private sector and governments at international level. A “global” dialogue of this kind demands prior co-ordination by governments in order to implement inter-governmental rules for regulating “*exit*” strategies. But defining these rules (by the OECD or the World Trade Organization (WTO), for example) cannot be done at international level, any more than it can at national level, without dialogue with the private sector. The emergence of world public opinion on issues such as poverty reduction, the environment and, on a more general level, the social responsibility of private firms, is another reason to include civil-society representatives in a national or international dialogue of this kind. This is what happened with the UN’s “Global Compact” (<http://www.unglobalcompact.org>) that aims to obtain commitment from private sector firms (mainly large multinationals) to agree to and respect ten principles of social responsibility. It also encourages civil-society representatives to join the Compact and use it as a platform for debating controversial aspects of globalisation and development.

PPD is likely to lead to a vision of a state whose role (especially in DCs) is defined by its capacities (World Bank, 1997). In practice, this concept of the state is an argument for a strategist and arbiter state, that is a state providing a forward-looking vision by setting up appropriate institutions, co-ordinating externalities (such as research, training and the environment) and private initiatives, identifying public-private investment complementarities and, finally, acting as arbiter in conflicts of distribution of the dividends of growth.

Defining the profile of this strategist state and how it works as a “governance focal point” (Meisel, 2004) clearly requires in-depth dialogue with civil society, including the private sector. It calls for the switch that has been observed by Phillips and Orsini (2002) in some industrialised countries (North America and Scandinavia), from vertical, hierarchical and authority-based governments to horizontal governance built up through the participation of non-governmental stakeholders in policy design. If we are willing to admit that the state’s role should be that of strategist, arbiter and facilitator, then this

will lead to the delegation of some public-service supply functions to the private and community sectors (privatisation, delegation of public services, PPP, etc.)¹⁵, in which case we can again see PPD as a suitable, even indispensable, tool for defining practical ways of sharing tasks, within a wider context of government strategies for growth, development and poverty reduction.

Notes

1. Boulding (1978).
2. Market failures refer to the market's inability to provide an optimal allocation of resources. For example, a market that is monopolistic or oligopolistic engenders market failures, especially with regard to economic activity, because this will be marked by increasing returns to scale and strong barriers against the entry of new competitors, leading to the creation of natural monopolies. The market's inability to absorb externalities and produce public goods is another common source of market failures.
3. Government credibility with business was measured here through replies to questionnaires sent to a broad sample of entrepreneurs in DCs, with questions mainly about the predictability of government-led policy changes and the credibility of government statements and commitments.
4. An extensive literature, mostly following New Institutional Economics (NIE), has since stressed the importance of institutions in the broad sense (the rule of law, credibility, fulfilling contracts, transparency, trust, predictability, and so on) in development matters. See especially Borner *et al.* (2004), Burki and Perry (1998), and Clague (1997).
5. Democratic mechanisms imply: the separation of executive, legislative and judicial powers; the government's accountability to parliament; and the election of parliament by universal suffrage.
6. This individualist notion of democracy was popular with political thinkers during the Enlightenment and the 19th century, and arises from a view of a rational citizen-voter without social, community or religious ties who votes wisely and freely.

7. Information is rare and thus costly, especially in DCs, and involves a transaction cost in the relationship between government and private firms that may compromise the quality of government policies.
8. Some authors (such as Kahler, 1990) describe “social learning” as the acquisition of this expertise and knowledge through public-private interaction. Social learning has been important in persuading many governments that the advantages of adjustment and successful insertion into the world economy are greater than the short-term costs involved.
9. See especially Haggard *et al.* (1995).
10. The State Services Commission was responsible for monitoring public-sector reforms.
11. Weber (1919), defines the state as the “only source of the right to practice violence”.
12. See Chapter 2 for a detailed analysis of the characteristics of the local private sector and how these impinge on the quality of public-private dialogue.
13. Coase (1960) highlights the limitations of state intervention, even in apparently legitimate areas such as the provision of *public goods*.
14. Borner *et al.* (1995).
15. The need to assign the effective provision of public services to the private sector (after setting public-policy limits and priorities) has been stressed by the New Public Management (NPM) school of thought (Barzelay, 2001). This thinking is found in the World Bank’s influential 1997 World Development Report, which discussed the state’s role in DCs: it underlined the need to encourage competition within the state sector, hand provision of “questionable” services over to the market and assess bureaucracies on the basis of their performance.

Chapter 2

The Test of Reality for Public-private Dialogue: A Complex Tool

A realisation of the limitations of universal suffrage can lead quickly, sometimes hastily, to enthusiasm for dialogue between the state and civil society. The expected advantages of dialogue and co-operation between government and business must not conceal the risks, especially in countries with weak institutions, that such interaction could be misused and simply end in the distribution of economic rents through collusion, corruption and predation.

As soon as it reaches the stage of commitment exchanges, PPD is susceptible to the uncertainty associated with any transaction (in the neo-institutional sense) in a situation of incomplete information (Box 2.1). It also raises some special problems that stem from the characteristics of the stakeholders involved, i.e. the state and the private sector.

The State, A Difficult Partner

Despite the theoretical benefits that a government can expect from dialogue with the private sector, the actual involvement of business in policy making may be difficult for bureaucracy and political leaders to handle, because it is a source of uncertainty. Is it therefore always in the state's interest to associate the private sector with political decision making? Is there not a risk that the uncertainties of dialogue, along with political imperatives, will cause the government to renege on its promises? In other words, what is required in order to create a sustainable dialogue with a partner as unique and complex as the state?

Is dialogue with the state always an uncertain process?

Reluctant participation

The involvement of the private sector in designing and implementing government policies is not merely a technical and bureaucratic process: it possesses an intrinsically political dimension, and is hence potentially problematical. It constitutes in fact a possible source of uncertainty and complexity for the government: "Policy change is inherently threatening to public-sector actors, as are participatory approaches. It's hard to manage, it has uncertain outcomes and it produces new voices." (USAID, 1994).

This is especially true of weak and/or predator states¹ and of states that, as often in the post-colonial era, were at the heart of development strategy for several decades: opening up to private stakeholders may then be interpreted as a signal of veiled disengagement, and be seen by civil society as an admission of the powerlessness of the state. Where, as happened in many DCs, a nationalist movement has transformed itself after independence into the sole ruling party (absorbing the state and the bureaucracy), opening up the economy will be understood as heralding a major challenge to the existing political system and as opening the door wide to political change. This is why many regimes oppose it.

The state as both judge and judged

Moreover, in attempting to establish a sustainable dialogue between the state and the private sector, certain fundamental characteristics that are specific to the state must be taken into account. North (1990) points out that, in a transaction between two private parties, a contract may actually be implemented because of the threat of reprisal by each side. The same result can also be achieved through implicit codes of conduct and social sanctions, or else through guarantees by a third party (the state) with coercive powers.

As soon as the transaction involves the state itself, however, implementation guarantees are no longer valid. There is no longer a third party to oblige the state to keep its promises, and the transaction's validity depends entirely on the state's ability to respect its commitments and to exercise self-discipline. In other words, whatever the quality of PPD may be at any given moment, the private sector remains exposed to the risk of the state behaving inconsistently over time.

Box 2.1. Transaction costs and non-co-operative equilibria: the difficulty of establishing co-operation between state and private sector

Using the term “transaction cost” which is found particularly in neo-institutional literature, Williamson (1979 and 1985) highlights some aspects of the PPD transaction. Briefly, this involves:

- i) information asymmetry about measuring performances that may be achieved (*ex ante* assessment) and that have been achieved (*ex post* assessment) by firms. The impossibility of measuring a partner’s performance exactly (because exhaustive assessment would be too costly) encourages the partner to manipulate the information exchanged. For example, the private sector might falsify performance indicators in order to justify government subsidies received;
- ii) information asymmetry about the implementation of previous agreements. It costs too much for one side to ensure full implementation and systematically monitor the other partner so as to prevent opportunistic behaviour;
- iii) future uncertainty: when the future is highly uncertain (and not just risky), in-depth dialogue between private and public sectors – with formal goals and agreements – is more difficult because unexpected events may occur that were not anticipated during early negotiations, and drawing up contingency contracts and agreements to cover all possible eventualities may be impossible or prohibitively expensive.

Game theory analysis tools show why state/private sector relations are very likely to be non-co-operative and thus socially sub-optimal.

The relation between bureaucrats and the private sector in a situation of information asymmetry can be modelled as a game that results in a non-co-operative (stable) Nash Equilibrium, also known as the Prisoner’s Dilemma. In other words, where each party may be tempted to adopt an opportunistic stance and break agreements made (because there is information asymmetry), the best individual strategy for each party is in fact to behave opportunistically.

In a game with two stakeholders, A and B, breaking an agreement is a very profitable strategy for A if B has kept to the agreement, but it is also the best strategy for A if B has also adopted an opportunistic stance. (A’s strategy can then be seen as an insurance mechanism against opportunistic behaviour by B.) This is a Nash Equilibrium because neither player would gain from changing his behaviour unilaterally: however B behaves, A’s best strategy is to take an opportunistic stance (and vice versa).

Nevertheless, although this non-co-operative equilibrium is rational and relevant from the point of view of the individual player (who is assumed to be anticipating risk), it is sub-optimal from the social point of view in comparison with a situation of co-operative equilibrium. It is not even a reciprocally optimum (or “Pareto optimal”) situation, since the situation of either of the two stakeholders taken individually could be improved: in other words, a social optimum could be achieved through a co-operative equilibrium without either of the two parties being worse off compared to the situation of non-co-operative equilibrium.

The establishment of long-term trust through sustained, in-depth dialogue between the two players (the state and the private sector) is a way to reduce information asymmetry, to overcome mutual distrust, to make individual risk-aversion compatible with co-operative behaviour and, in the end, to move towards the social optimum.

Box 2.1. continued

At this point, the advantages of the situation are likely to make an opportunistic (i.e. profitable only in the short term) exit strategy of leaving the co-operative equilibrium sufficiently costly as to make this permanent.

How can the state and the private sector exit from a non-co-operative equilibrium involving mutual distrust? Since the state is a difficult dialogue partner for the private sector (cf. below), the quality of the bureaucracy and its ability to send clear and unambiguous signals of its goodwill and sincerity will probably be decisive.

This is due to the nature of the state – no stakeholder can force it to keep its promises, or guarantee that they will be kept². Moreover, the risk that a state will not only break its commitments but resort to outright predation cannot be entirely ruled out: therefore, any dialogue with the state is intrinsically uncertain.

This risk is especially high in countries that have only recently – and often, precariously – established the rule of law. Zimbabwe is a very good example. Bräutigam *et al.* (2002) show how productive dialogue between the main (white-dominated) private-sector organisations and the government in the late 1980s³ quickly gave way to a rush towards authoritarian government in the 1990s. When economic problems began to mount and threaten the hold on the country of the ruling ZANU-PF (Zimbabwe African National Union – Patriotic Front) party, then, for political reasons, President Robert Mugabe’s government merely abandoned the growth coalition that had been built up over the previous decade. Bräutigam *et al.* say that: “Two essential features of business-state collaboration, credibility and trust, have all but disappeared in Zimbabwe. This suggests that even in nascent cases of business-state co-operation, as in Zimbabwe *circa* 1988, growth coalitions (no matter their potential development value) may be sacrificed for political ends” (p. 538).

This intrinsic uncertainty of PPD is not confined to the most institutionally fragile countries. Mason *et al.* (1980) point out that even in the highly developmentalist South Korea of the late 1970s, the private sector believed that whatever the government authorised, it was also liable suddenly to renege on it. “Policy implementation required close co-operation between government agencies and business enterprises, but there was never any question as to who held the whip hand” (p. 293), i.e. the state. This problem also occurs in democracies because of electoral pressures. The discrepancy between the duration of the state’s commitments to the private sector and political and electoral cycles weakens the credibility of the authorities, especially as regards their macroeconomic policies⁴.

From a more general point of view, the inherent fragility of PPD can be related to the shortcomings of the politician/bureaucrat system, as evidenced by the theoretical literature on public choice. We should naturally beware of such a reductionist approach, especially as regards its systematic assumption of the maximisation of utility of economic agents, but it is clearly useful for a heuristic understanding of the limits of PPD. Three main kinds of government failures have been identified: legislative failures, reflected in the over-supply of public goods (prompted by politicians wishing to be re-elected); bureaucratic failures, that reveal the lack of sufficient incentives for bureaucrats to implement policies correctly, no matter how appropriate these policies might be⁵; and lastly, failures linked to economic rents and rent-seeking: rents are created by government intervention, thus diverting scarce resources from more effective uses (in production, for example). The first two causes of government failure show the difficulty of setting up productive and sustainable dialogue with a party (the state) that has such contradictory motivations.

PPD and the emergence of a “developmentalist” bureaucracy

The risks of abuses that may arise in the course of co-operation between the public sector and the business community have usually led, in the literature, to recommendations that bureaucracy and government should become more insulated from society, especially special-interest groups, so as to abolish potential sources of rent and facilitate economic reforms⁶. The need to insulate the state has also been an argument in favour of policies (at their height in the 1980s) to minimise state intervention in many DC economies through privatisation programmes and economic liberalisation on a large scale.

Is this insulation of the state from private interests feasible? Is it even desirable, in view of the possible advantages of PPD already mentioned? Haggard (1997) stresses the illusory nature of possibilities of reform without the major support of interest groups: “Independence from interest-group pressures may be a prerequisite for initiating reform, but reforms can only be consolidated under representative government if there are bases of electoral, legislative, and – ultimately – interest-group support” (p. 126). He also notes that “successful reform may be facilitated by developing political relationships with losers” (p. 126) in order to convince them that immediate sacrifices will be compensated for by longer-term gains.

It may also be less important to insulate the state than to work out how sustainable, balanced, transparent and ultimately productive PPD can be established. A normative analysis of the conditions for fruitful interaction between state and private sector suggests that the characteristics of the stakeholders play a crucial part: it is the quality of bureaucracy and the configuration of the business sector that determine the feasibility of dialogue and influence its success. However, an analysis of past successes and failures does not permit any clear-cut decision as to the type of political system (authoritarian or democratic) that is most likely to enable the establishment of fruitful PPD.

The uncertain nature of PPD arises in part, as we have seen, from contradictions in the very apparatus of state: the state is the guarantor of the social contract and the embodiment of the common interest (and as such, holds the monopoly on lawful violence); but the state is also an institution that runs according to its own vested interests, and it faces the permanent risk of its public authority being turned towards private ends.

The possibility of implementing PPD depends therefore on the characteristics of the state and the bureaucracy. As Evans (1997) says: "Government-business relations cannot be interpreted without first specifying the internal structure of the state" (p. 66). More precisely, the emergence of balanced and transparent PPD depends on a "developmentalist" state resting on two pillars: first, a bureaucracy that displays *integrity* and *autonomy* in the face of pressure groups; and second (in apparent contradiction with what has been said before), *proximity* between bureaucrats and the business community.

A bureaucracy possessing "integrity" and "autonomy"...

The main pillar of a developmentalist state is its bureaucracy: this must possess integrity and be concerned about the public interest. Integrity means autonomy: bureaucrats must be independent of the pressures of society, and their incentives must first and foremost be linked to the goals and interests of the institution they work for. Since it would be impossible totally to insulate bureaucratic decision making from the pressures of civil society (in the broad sense), autonomy signifies rather that there should be independence of judgement on the part of officials and political leaders during decision making, and that the decisions taken should not be over-influenced by any previous consultations with stakeholders. This is the ideal of Weberian bureaucracy that Max Weber (1947) defined as follows:

- √ There is a sophisticated division of labour based on a hierarchy with clear and explicit rules applied routinely and impersonally.
- √ Officials are full-time professionals who are likely to make their career in the institution.
- √ Bureaucrats do not own the instruments of the administrative power that they possess, nor their jobs (so they cannot pass them on to others in a corrupt manner), nor the money that they handle.
- √ They are paid salary-workers, and their income is completely separate from any income generated as part of their work.

By extension, a Weberian bureaucracy is one with merit-based hiring and promotion, with the possibility of making a career in the institution, as well as adequate pay, skills-linked prestige and a strong sense of public service.

Fields (1997) states that South Korea's and Chinese Taipei's bureaucracies have approached this ideal of Weberian bureaucracy. President Park Chung Hee built a bureaucracy that was close to this ideal in South Korea after he came to power in 1961, relying particularly on an ancient Confucian tradition of public service based on merit. Chang (1994) and Meisel (2004) stress that the strong bureaucracy in Gaullist France in the 1960s and 1970s largely protected the state from special-interest pressure groups. More generally, the World Bank (1993 and 1997) emphasises the importance of training, promotion by merit and pay in promoting integrity within bureaucracies in DCs. This is also discussed by Van Rieckeghem and Weder (1997).

Evans and Rauch (1999) describe the many ways in which a Weberian bureaucracy can boost growth and promote economic development. Specifically, its integrity and autonomy help to lay the basis for a balanced, sound and trusting relationship between the public sector and the business community. A public service that displays integrity and competence can demand the same qualities from the private sector, and can monitor it while at the same time guaranteeing predictability and stability. The private sector will realise that when dealing with public officials of integrity who are little vulnerable to pressures, the estimated gains from rent-seeking will be less than yields on productive investment⁷. A bureaucracy that establishes a reputation over time for integrity and predictability will have less difficulty in convincing the private sector of its credibility and sincerity: it will hence be in a position to prevent non-co-operative equilibria scenarios in which the state and the private sector end up behaving in ways that undermine socially optimal goals (Box 2.1).

... but remaining close to the business sector

However, a bureaucracy's integrity is not alone enough to create sustained, in-depth dialogue with the private sector. The emergence of a developmentalist state is a delicate process (Evans, 1997) and requires an administration that is an apparently contradictory combination of Weberian bureaucratic insulation and thorough integration into the social fabric⁸. Hence, the state must remain autonomous concomitantly with the development of close relations with business leaders, as the Kuomintang managed to do in Chinese Taipei. In Japan, councils and roundtable meetings regularly bring together government officials and private-sector leaders, resulting in what the World Bank (1993) calls an "administrative web". Okimoto (1989) points to the important role of factory visits by officials of the MITI (Ministry of International Trade and Industry) in Japan and of the IDB (Industrial Development Bureau) in Chinese Taipei.

Professional associations also provide an effective means for dialogue between bureaucrats and the private sector. South Korea and Chinese Taipei were extreme examples of this: Korean business associations hired retired government officials, while the Chinese Taipei authorities appointed very loyal former top civil servants to head national business associations with obligatory-membership. In other words, professional associations were used as instruments for the near-capture of the private sector by the state (Maxfield and Schneider [1997]). Lastly, the proximity – and even alliances – of political, administrative and economic elites encourage (often informal) dialogue between the public sector and firms (cf. below.)

The Japanese state apparatus was long seen as a classic Weberian state, since it was at the same time embedded in the economy and in society, and independent of vested interests. Although the crisis of the Japanese model in the 1990s challenged this vision (particularly in exposing the influence of lobbies on the state apparatus), close ties between government and the private sector have long been a key to the country's economic success. Taira and Wada (1987) describe the "Todai-Yakkai-Zaikai" complex (Tokyo University/bureaucracy/private sector). The shared education of the Japanese elite at Tokyo University (and a few other prestigious institutions) ensures close-knit ties between the different sections of this elite. The professional stability of bureaucratic staff and private-sector representatives ensures that dialogue continues afterwards, and then, through a process called *Amakudari*, some members of this bureaucracy enter parliament or the private sector. (In France, this is known as "*pantouflage*".) The formal distinction between private and public sectors therefore becomes very blurred.

Yet an efficient and accountable bureaucracy may be unable to influence the economic development of the private sector if this bureaucracy is little involved in the economy. For example, India has an efficient federal bureaucracy, but it has not created the close links with business that are found in Southeast Asian bureaucracies. Partly as a result, Indian public-sector industrial experts have not been as successful as their MITI and IDE colleagues in setting up mechanisms for information-sharing, in creating an administrative framework for the private sector and in creating consensus on economic development strategy (Evans, 1997).

The distance between the business community and the bureaucracy (however good the latter) may be very wide when it is based on a country's ethnic divisions. Strict compartmentalisation of political, administrative and economic elites on ethnic grounds can seriously obstruct in-depth PPD. The division in Thailand between Chinese (10 per cent of the population), who dominate the economy, and Thais, who control the political system and administration, has blocked substantive PPD (Doner and Ramsay, 1997). Chinese-community business associations have had very little political influence. Doner and Ramsay (1997) state that "...relations between state and private sector have exhibited little systematic exchange. Rather than being dense and institutionalized, public-private sector ties have been diffuse, particularistic, personalized, and hence, clientelist" (p. 238).

A rigid state apparatus may also prevent the government from communicating with the business community. The Weberian model has been strongly criticised, especially for its rigid procedural rules and hierarchical management structures: these may blunt a bureaucracy's capacity to adapt to change, to foster policy dialogue, and to be responsive to demands, starting with those of the private sector. These shortcomings have prompted a paradigm switch (see Chapter 1) towards more decentralised bureaucracies, more participatory government structures and the privatisation of public services. The main thinking about the state's organisation and its capacity to respond to demands from a fast and greatly changing environment has moved on from a Progressive-Era Public Administration (PPA) paradigm (Hood, 1994) corresponding to the Weberian model of public administration, to a Generic Managerialism (GM) model. The latter is an offshoot of post-Ford industrial organisation methods, and is based on flexibility, externalisation, performance assessment, participation and a managerial vision geared to satisfying the customer of public services. These changes have themselves been controversial⁹ but they do highlight some limitations of the Weberian ideal of public administration. They at least point out that

the normative model of integrity, competence and merit-based pay remains the bedrock of fertile interaction with the private sector, but that other aspects of the Weberian model, such as the importance of procedures and hierarchical management, have gradually proved to be incompatible with management by the state of three important dynamic issues identified by Yeatman (1997): growing cultural and social complexity; increasing uncertainty (and thus unpredictability); and growing demands and expectations from citizens regarding the quality of public services.

What kind of private sector is required for high-quality dialogue?

The risks and possible abuses of PPD also depend on the characteristics of the business community, and especially on how representative and legitimate the private-sector organisations engaged in dialogue with the state are.

One must therefore ask what factors in a given national context lead to the emergence of a powerful private sector that is structured into representative professional associations and that sees dialogue with the government not mainly as a rent-seeking device, but as a way of building a transparent and positive business environment.

In most DCs, the size and the level of organisation of the private sector depend on the emergence of a business class, which usually occurred along with the development of a post-colonial national capitalist bourgeoisie. There is an extensive literature on this complex issue, particularly on the question of why many Asian countries underwent rapid development while most African countries failed to achieve similar economic take-off. This is beyond the scope of this study though (see Boxes 3.1 and 3.2); however, we will examine two issues that ensue: is there room for PPD that is not mainly about rent-seeking and what are the factors that persuade national private sectors to opt for constructive dialogue with the state, instead of rent-seeking?

The private sector torn between lack of organisation and rent-seeking

Collective action paradoxes and the private sector's (dis)organisation

The private sector's capacity to organise itself into professional associations is an essential prerequisite for dialogue with the authorities. To ensure coherent and effective dialogue when defining economic or sectoral policy, the state must have opposite it a small number of representative stakeholders. The authorities are less interested in holding discussions with a private sector that is weak, fragmented, disorganised and lacking in analytical capacity¹⁰.

However, the collective action required is far from certain even when the interests within an economic sector are convergent. This is partly because of the paradoxes of collective action described particularly by Olson (1965, 1982).

Olson's main argument is that collective action and the benefits that stakeholders expect from it can be seen as public goods. Individual participation in the collective action would seem to be logical but is unlikely, because each person would be tempted to become a free rider, thus benefiting from the action without taking part in it and without helping to pay for it. The consequences of this paradox are greater as the number of stakeholders increases and the benefits of the collective action are spread over a larger number of beneficiaries.

Individual or company stakeholders are therefore unlikely to succeed in organising themselves so as to promote collective action (public goods) "making the pie the society produces larger, so that its members would get larger slices even with the same share as before" (Olson, 1982, p. 42).

Advisory and participatory mechanisms for designing public policy may hence run into the indifference of private-sector stakeholders if the stakes involved and the benefits produced are too great and are seen as public goods. If no serious political or social emergency demands dialogue and co-operation between state and private sector, this difficulty may become insurmountable. "In times of crisis, the private benefits to a resolution may motivate participants [in the dialogue], even though their work brings substantial benefits to others¹¹. In absence of crisis, 'free rider' problems may limit participation or sustainability [of the advisory mechanism]" (World Bank, 2001, p. 3)¹².

Olson draws conclusions from this paradox and explains that the commonest forms of collective action do not seek public goods, but rather the selective incentives that can alone incite social stakeholders to act. A selective incentive is one "... that applies selectively to the individuals depending on whether they do or do not contribute to the provision of the collective good" (*idem*, p. 21). In other words, a selective incentive only goes to individuals who have participated in the collective action.

Olson links selective benefits mainly to economic rent. The idea of selective benefits explains why professional associations and, more generally, interest groups, have usually been regarded with suspicion by economists.

Rent means advantages and privileges that some social and economic groups have due to their position in the country's economy (for example, monopolies) and/or their proximity to political decision-making centres. It may be linked to access to scarce resources (for example, import and export quotas, foreign exchange quotas), or privileges such as tax relief, government subsidies, and prices set above marginal production cost, etc. Some sections of the private sector seek rents from the government by forming pressure groups, and the harmful effects of this have been the subject of an extensive literature. Tullock (1967), Krueger (1974) and Baghwati (1982) were among the first to measure the economic costs of such behaviour; these costs have also been stressed by Olson (1982). Rents are often closely tied to corruption (which seeking them encourages)¹³.

The private sector versus the state: dialogue or rent extraction?

The key importance of these selective benefits in mobilising firms for collective action explains the duality of the private sector in many DCs, where much of the economy is very fragmented, poorly organised, often informal and without influence on the government, while the formal sector consists of merely a few powerful sub-sectors organised in very influential pressure groups, sometimes even directly controlling the state administrative apparatus.

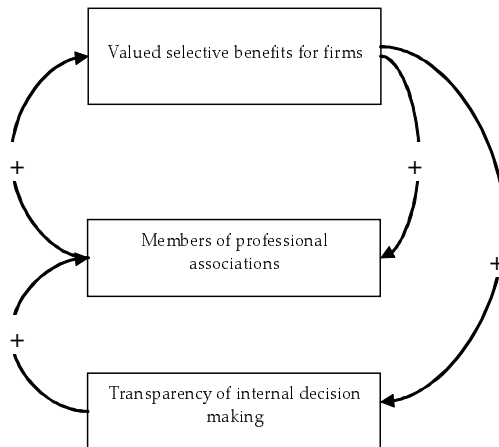
The first group is caught in a disorganisation trap that means they have little influence on the government (Box 2.2), but the second is highly organised and able to keep its professional associations united opposite the government. Moreover, in line with Olson's collective action paradoxes, this strong cohesion is supported by the distribution of selective benefits (usually rents) to the members of representative professional associations. Olson (1982) emphasises

Box 2.2. Why is the private sector so poorly organised in DCs?

An analysis of this problem with the tools supplied by Olson leads to some answers. Doner *et al.* (2001) take Olson's collective action paradoxes further, and suggest an interaction between three factors that explain why the private sector's level of organisation varies from country to country and from sector to sector: *i*) how representative an organisation is of a sector *ii*) the transparency of the organisation's decision-making mechanisms and *iii*) its ability to provide selective benefits for its members.

The interaction among these three factors demonstrates the multiple equilibria that may occur in the organisation (and disorganisation) of the private sector (cf. Diagram 2.1). The more representative professional organisations are, the more influence they will have within that profession, enabling the provision of high-value selective benefits to members. Similarly, an organisation's ability to provide major services to its members tends to make it more costly for them to leave or to become free riders (threat of penalties or expulsion); the organisation is therefore a strong agent of cohesion. The provision of high-value benefits is also an incentive for members to set up strict, transparent decision-making procedures, and this transparency is likely to attract new members. The voluntary nature of membership is a guarantee of genuine representativeness and also a guarantee that the association accurately reflects the quantity of resources that members are prepared to invest in collective action.

Diagram 2.1



However, an economic sector can be trapped in a negative equilibrium. A high degree of fragmentation especially makes it costly to bring firms together, and so any associations that do exist are not very representative, and have little influence and limited ability to provide valued selective benefits to firms. They are therefore not very attractive (even though such fragmentation is harmful to each firm individually). Except for a few dominant sectors of national economies, this disorganisation trap sums up the situation quite well in most DC economies that have a large informal sector.

that oligopolies and other small groups are more able to organise themselves for collective action and can do so more quickly than more extensive groups. If benefits from collective action go to a small number of firms, they become selective benefits (and not public goods). Benefits of this kind therefore provide a strong motive for collective organisation – and, moreover, collective organisation on the basis of shared interests is easier for very concentrated economic sectors. In such circumstances, PPD very much risks being monopolised by an extremely small group of powerful lobbies that are often in control of key national resources and have a crucial influence on government policy. Dialogue will then amount to little more than a means of extracting rents, blocking reform, and maintaining the *status quo*. Then, far from strengthening democratic decision making, PPD is likely to increase the power of existing elites and of groups and individuals that already exercise a strong influence on government policy making.

Beyond simple rent-seeking: how professional associations can contribute to sound and productive dialogue

At first sight, collective action paradoxes seem to challenge the very idea that PPD can have a goal other than rent-seeking. If the best-organised professional associations – that is, those most able to influence the government and engage it in dialogue – are also those that provide their members with selective benefits (rents, according to Olson), what possibility is there of PPD without collusion and corruption?

On closer examination, however, one sees that the factors involved in the creation of professional associations are more complex than Olson says. For example, transaction costs or co-ordination difficulties (free riders, negative externalities attributable to certain firms, etc.) are strong incentives for the firms within a sector to form associations and take steps to solve these problems, by monitoring members, penalising free riders, and so on: therefore, collective action paradoxes do not consign PPD merely to a role of acting as a screen for rent-seeking.

Hence, Doner *et al.* (2001) expand the definition of the selective benefits provided to their members by professional associations beyond simple rent extraction, by including:

- i) *Reduction of sector-level transaction costs*, e.g. seeking new outlets and suppliers for association members; guaranteeing compliance with contracts, by gathering information about the quality of association members' trade and industrial partners and reporting unreliable partners; and establishing private dispute-resolution mechanisms. Schneider (2004) stresses that Colombia's powerful association of coffee producers, Federacafé (Federación Nacional de Cafeteros de Colombia), with 3 500 members, "had firmly established Colombian coffees in the high-quality, high-price segments of the world market" (p. 3). When the association was founded in 1928, the government had in fact given it responsibility for marketing in the coffee sector and for the sector's infrastructure and credit management, as well as powers of taxation.
- ii) *Resolution of collective-action problems*, e.g. establishing and ensuring compliance with sector quality standards, banning and penalising unfair competition, harmonising producer interests in a sector upstream and downstream of the production chain, and so on.

Doner and Schneider (2000) stress also that dialogue with the government can be one of the selective benefits that the best-organised associations can give their members: "Another major benefit that states grant associations is institutionalised access to government policy makers and policy forums. The access sometimes comes through arrangements like consultative councils in Asia This access is a valuable conduit for information and a conduit that can be construed as a selective benefit for the most active members of an association". (p. 16).

Associations can therefore aim to provide non-rival and non-exclusive public goods: this generally requires extensive dialogue with the government – for example, in order to obtain control and regulation of the profession, along with powers of sanction.

What determines the type of benefits that a professional association can give its members and, hence, the quality of dialogue with the government? Bräutigam (2000) points to the role of historical heritage, including the type of "productive sectors in which accumulation of significant capital began", and to the need to analyse the transaction costs in these sectors. In order to understand why and to what extent rent-seeking exists, one must therefore examine the *political economy* of sectoral interests in the country in question.

“Good” and “bad” private sectors: the political economy of public-private relations

The nature of public-private interaction depends on the characteristics of the domestic economy: type of firms, sectoral structure of the economy, degree to which the economy is opened up to the outside world, and so on. These characteristics determine how well the private sector can organise itself as well as the nature of its interaction with the state (co-operation, distancing, conflict); they also determine the purpose of this interaction (rent-seeking, improving the business environment). Three factors are of particular importance:

- *The size of firms and their degree of diversification.* An economy built around large groups is one where business is likely to capture the state. Yet Leff (1978) states that a conglomerate structure tends to encourage movements of capital and factors of production between the activities of a firm and make its activities less concentrated and specific: then, however, conflicting interests will make rent-seeking more difficult. A conglomerate will also be more open to changes in economic policy. The weight of multinational firms in the national economy is also an important factor. In countries where the business sector is largely organised around multinationals, dialogue with the government can be distorted. Locally implanted groups may produce only a narrow range of goods inside the country; they sometimes have few ties with local elites (especially when the companies are run by foreign managers); and they tend to keep quiet on the question of the collective organisation of the private sector.
- An analysis of the *structure of the economy and sectoral interests* is also vital to understanding the political economy of reforms, especially where the opening-up of trade is concerned¹⁴. The factor endowment of each sector and the sectoral structure of the economy determine the nature of public-private interaction – dialogue, support, co-operation, or lobbying to speed up or block a policy of reform. A sector producing equipment and consumer goods emerged in Brazil, Mexico and Venezuela in the 1970s with the help of protectionist measures; manufacturers in this sector then went on strongly to oppose reform and liberalisation policies in the 1980s. However, the opposite can also be true: economic sectors hampered by tight regulations that create situation rents will press for their elimination.

- *The characteristics of professional associations.* These are key to explaining their behaviour and their ability to engage in a dialogue with the government that does not take the form of rent-seeking. Despite his scepticism about the action of professional associations, Olson (1982) stresses that *inclusive multisectoral associations* (federative associations, for example) are likely to press for policies to boost overall economic growth: they do not defend the interests of any particular economic sector, but strive towards the general improvement of the business environment. In Mexico, professional federations helped to promote a policy of price restraint in the late 1980s and early 1990s while preventing free-rider behaviour between sectors owing to the fact that the federations were multisectoral bodies (Schneider, 1997).

Between bribes and the round table: what framework for public-private interaction?

PPD, taken in the broad sense of interaction, can assume countless forms, from very informal (such as secret contacts involving the exchange of favours), to very formal (structured negotiations between government and professional associations, and even the adoption of a policy of entryism towards government and administration on the part of members of the business community). These different forms of interaction can also be complementary.

The adoption of one interaction framework rather than another is, of course, dependent both on the motivations of each party for becoming involved in PPD and on the relative effectiveness of the various interaction frameworks. The portfolio choice approach developed by Schneider (2005), in his analysis of public-private relations in Latin America, describes a portfolio of *five* options and strategies that private stakeholders have for influencing policy making:

- i) corruption;
- ii) political funding (legal or secret) and lobbying;
- iii) networking;
- iv) forming professional associations and dialogue (in the strict sense) with the authorities;
- v) involvement in government.

Corruption is patently a very informal type of interaction with specific discreditable purposes, starting with rent extraction. Legal or secret political funding is, by and large, also a kind of rent-seeking. It can be legal, but where there are very strict laws in force, it becomes mostly secret and informal.

Informal knowledge and social networking constitute another important channel of influence between the public and private sectors by means of which policy makers, bureaucrats and business elites can communicate and develop a shared view of the economy and of the country's future (see the example of Japan, cited earlier).

Economists and policy makers have long been suspicious of these networks as being havens of collusion, rent-seeking and the expression of private interests to the detriment of public good. The political analysis of networks in DCs has tended to be treated as an analysis of clientelism, i.e. personal relationships extending over very many fields whose existence depends on an unequal exchange of services and favours – all of which, in the end, affects the democratic functioning of institutions, distorts the economy and absorbs public money earmarked for other purposes.

However, analyses of such networks have gradually come to more qualified conclusions: institutions and formal hierarchies have, always and everywhere (including in countries with the best economic performances), been closely involved in informal networking. Naturally, the state itself has to be included among the formal institutions that are closely linked to such networks. Evans (1995) places the state at the centre of network analyses, and shows that networks can increase the state's effectiveness: networks can be platforms for dialogue, forums for consultation, and think-tanks where future government policies and compromises between state and private sector can be worked out. Whether these networks are collusive and clientelist, or else promote the growth of these networks, depends on the nature of the elites (state structures, characteristics of the private sector, past history and traditions, etc.).

The involvement of private-sector representatives in government is perhaps the most striking form of public-private interaction. The private sector's participation movement in governance has been quite spectacular in Latin America, especially in Colombia, Mexico and Peru, during the recent presidencies of Uribe, Fox and Toledo, respectively. Schneider nonetheless emphasises that the private sector's role in designing government policy in these three countries under these governments has remained limited (Schneider, 2005).

Table 2.1

		Strength of inclusive professional associations (IPA)*						Public-private interaction models						
	Level of organisation of IPAs	Association	Date	Coverage	Number of Employees		Lobbying & Elections	Associations	Networks	Corruption				
Mexico	High													
		Coparmex	1929-	Inclusive	30									
Mexico, 1990s	High	CMFN	1962-	Inclusive	0									
		CCE	1975-	Inclusive	80									
Chile	High													
		CPC	1935-	Inclusive	8									
		Sofoda	1883-	Industry	50									
Colombia	High													
		Federacafé	1927-	Coffee sector	3500									
		ANDI	1944-	Industry	150									
Argentina	Weak													
		ACIEL	1958-73	Inclusive	0									
		APEGE	1975-6	Inclusive	0									
		CGE	1952	Inclusive	10									
		UIA	1886	Industry	50									
Brazil	Weak													
		UIBE	1967-88	Inclusive	5									
		IEFI	1989*	Industry	8									

* Voluntary-membership associations
 Source: Schneider (2005).

In the end, structured and organised dialogue between professional associations and the government remains the most propitious environment for sound and productive dialogue. The main goal of professional associations may well be to extract situation rents – and they may even negotiate openly for these during formal official negotiations with the government (and not just use bribery): yet the example of Latin America shows that formal PPD with the participation of professional associations has taken place essentially in countries with powerful, inclusive, multisectoral professional associations with voluntary membership (as in Chile, Mexico, and Colombia), and that the dialogue can concern matters of general interest, such as “concerted inflation reduction, collaborative implementation of major economic reforms, consultative negotiation of trade agreements, and sectoral governance” (Schneider, 2004, p. 211). Professional associations that have been widely involved in PPD have therefore not necessarily been strictly sectoral or rent-seeking. In Brazil and Argentina, where inclusive, multisectoral professional associations have always been weak, public-private interaction has been based more on corruption and political funding (and to a lesser extent, on networking) than on open, organised and transparent dialogue. Table 2.1 shows the importance of each factor in public-private interaction in five Latin American countries and the strength of inclusive voluntary-membership associations in each.

One must not forget, however, that PPD can come up against highly compartmentalised political and economic elites. It then becomes essential that formal public-private interaction in the form of an official and organised dialogue is underpinned by more informal interaction, such as informal networks in which senior civil servants, political decision makers and business people can meet and seek partnership solutions and compromises for the future.

Especially in DCs, PPD therefore runs the risk of being merely a façade, either by being reduced to becoming a screen for collusion, corruption, and government capture by vested interests, or else by serving to disguise the theft of private-sector wealth by state officials who are using official power for their own purposes. Establishing PPD therefore demands the existence of certain structural preconditions in both public and private sectors. Another issue to be considered is the influence exerted by the type of political regime on the forms that PPD may take.

Is democracy necessary for PPD?

The characteristics of the bureaucracy and the private sector are decisive for the quality of PPD, but its politico-institutional context must also be taken into account. Considering specifically the political regime, the role of democracy in creating a transparent and balanced dialogue between government and business appears ambivalent, since democracy is intrinsically pluralistic. Two connotations of the word are relevant here: electoral democracy means free and transparent elections with universal suffrage, multipartyism, and (in principle) freedom of expression and freedom of the press; while institutional democracy implies the separation of powers, the rule of law (respect for the rights of individuals and legal entities) and the responsibility of state institutions¹⁵.

Multipartyism, free elections and PPD

Multipartyism, free and transparent elections and freedom of expression do not in themselves guarantee productive dialogue between the state and the private sector, nor are they essential prerequisites for it.

One might well expect this type of institutional environment to favour the development of PPD, even if only because it encourages the expression of civil society, including the business community. When the private sector can create associations and communicate through the media, then it can enter the public debate and make the government take more notice of business interests. Business can also become a political force in its own right. Conaghan (1992) says that democratisation in Latin America allows business and the political opposition to form “growth coalitions” which can in turn challenge the political and economic *status quo* supported by the current authoritarian regime. Conversely, weak democratic mechanisms can obstruct the influence of the business class. For example, in Lebanon, the sectarian and religious structure of political life leaves little room for horizontal and multid denominational groups such as professional associations, and so these associations have little influence on members of parliament (Atallah, 2000). In more extreme cases, an authoritarian and repressive regime that rules over civil society by

intimidation and a “culture of silence” may make it difficult for business to express its interests, as happened in Ghana under the authoritarian presidency of Rawlings in the 1980s (Kraus, 2002).

Furthermore, democratic political activity protects PPD by guaranteeing in theory that public policy making is not monopolised by business but is the product of a dialogue between government and society as a whole. Counterbalancing elements, whether strong and well-structured civil society or powerful and independent media¹⁶, tend to preserve transparent interaction between government and business and ensure its integrity. Changes of government and of political parties in power also curb collusion between business and political and administrative officials. Bräutigam *et al.* (2002) see well-established democratic institutions as having been key to the success of PPD in Mauritius, whereas Woo-Cummings (1999) denounces the incestuous ties that developed between politicians and leaders of the *chaebol* business conglomerates in South Korea between the 1960s and 1990s. The fact that the regime was politically authoritarian and economically interventionist (and used bank loans as its main negotiating tool) encouraged the *chaebol* to bribe politicians.

In fact, however, electoral democracy is not only no guarantee of successful PPD, it can actually hinder it. Democratisation in DCs can have destabilising effects. On the one hand, they can make bureaucratisation (in the Weberian sense) of the national administration difficult: in creating a bureaucrats/politicians/private sector triangle, democratic institutions tend to reduce the insularity of the state. Geddes (1990) states that, historically, Weberian bureaucracies have mainly been created under authoritarian regimes. On the other hand, democratisation can create short-term and medium-term political and social instability. The short life of governments then hampers the emergence of a credible developmentalist state: faced with a private sector that is sceptical and distrustful from the start about the reliability of government promises, the authorities need to have enough time to demonstrate the sincerity of their developmentalist creed. The political stability in the 1970s in South Korea which was achieved through use of repression by the Park regime enabled the state to show its “sincerity” and extend the private sector’s timeframe (Mason *et al.*, 1980).

Lastly, where political leaders are democratically chosen, the private sector is only one of several elements among heterogeneous electoral pressures (Przworski, 1985), and so its influence on government may be very small.

The separation of powers: a guarantee of property rights and the creation of private-sector trust

In practice, the quality of PPD perhaps depends more on the capacity of the institutional environment to provide the private sector with predictability and security. The government can possess no credibility, and dialogue cannot be productive, unless the private sector feels that property rights are guaranteed, that the state's arbitrary power is limited, and that its promises can be relied upon. Here the rule of law and the separation of powers can play a key part: democracy, which is essentially a system of checks and balances, can therefore provide the right framework for PPD¹⁷.

The separation of powers must be real and not simply formal. Even backed up by institutions and rules of constitution, the separation of powers cannot by itself limit the state's use of arbitrary powers: for it to be effective, respect for the rule of law must underpin the social fabric, the political parties and the state. The genuine entrenchment of the rule of law and its institutionalisation (more than simply institutional structures) are the keys to a successful dialogue and the creation of a climate of trust between state and business sector.

Democratisation in Zambia from 1991 is a good example of this. Despite the existence of institutions embodying the principles of the separation of powers and the monitoring of government activity, Bräutigam *et al.* (2002) note that: "Since 1994, the Zambian executive has proven its autonomy from all potential restraining forces, including the international donor community, the parliament and its auditor general, the Bank of Zambia, the courts, and the private sector, permitting the Zambian government to place concerns of political office above macroeconomic stability and economic development" (p. 541).

PPD and authoritarian regimes

If productive and confident PPD is dependent on a government's credibility and on its record of keeping its promises and respecting property rights, it is easy to see that productive dialogue between government and business can occur under an authoritarian regime. For example, Silva (1997) and MacIntyre (1994) describe productive PPD in authoritarian political contexts in, respectively, Chile and Southeast Asia. Government respect for

private property and its commitments to business are not the monopoly of regimes endowed with separation of powers. It can also be provided, informally, by authoritarian albeit developmentalist leaders¹⁸.

However, the guarantee of this depends on the personal inclination of a dictator or an enlightened oligarchy, and not on an institutional arrangement that is independent of the country's rulers. An authoritarian regime can create the right climate for PPD at a given time, but PPD will remain essentially vulnerable and precarious. It is therefore a second-best solution compared with a situation in which dialogue with the private sector takes place within a democratic institutional framework with separation of powers, legally guaranteed property rights, and a broadly and nationally supported rule of law and respect for institutions.

Normative analysis of the conditions for balanced, transparent, lasting and ultimately productive PPD shows how difficult and complicated setting it up can be:

- ◆ Identifying a point of equilibrium where the bureaucracy is adequately integrated into the economy while the mutual independence of public and private stakeholders is maintained requires finding an extremely delicate, and often precarious, balance: this point must be as far from a kleptocratic state as it is from the capture of government authority by special interest groups;
- ◆ Creating a political and institutional climate of trust between state and private sector depends either on democratic traditions and institutions that the countries most advanced in this respect have painstakingly built up over the past 200 years, or else on enlightened authoritarian regimes that may emerge under particular historical conditions.

Following this analysis of the risks and conditions associated with establishing PPD, the next chapter will look at the possibilities of effective interaction between public and private stakeholders in LDCs.

Notes

1. For example, many sub-Saharan African countries that Chabal and Daloz (1999) highlight as being bloated, predatory and, at the same time, very weak and inefficient at performing their administrative tasks.
2. The Weberian notion of the state is contradictory, in that, if the state has a monopoly on lawful compulsion, how can an institution with a monopoly on the use of violence restrict itself to using it lawfully? How can one ensure that the state does not use its privileges abusively and seize complete power? This question of "*Quis custodiet ipsos custodes?*" (Who will guard the guards?) is as old as politics and the state itself, and at least as old as thinking about the social contract, from Hobbes to Montesquieu. It is hard to ensure that authority, and especially its secular arm, the state, is not hijacked by the leaders of the very apparatus set up as part of the social contract.
3. The dialogue resulted in the government dropping its import-substitution policy for a policy of trade liberalisation (which was unfortunately badly designed, as later revealed by economic problems in the 1990s).
4. For a theoretical and empirical review of work on political business cycles, see Drazen (2000).
5. Niskanen (1971) maintains that the main goal of bureaucrats is to obtain control of the largest budget possible, since that is what they depend on for their salaries, power and prestige.
6. See also Haggard and Webb (1994), and Williamson (1994).
7. Tollison and Congleton (1995) describe rent-seeking as economic activity that business expects to get return on and whose profitability depends on the characteristics of local officialdom. (The more bureaucracy displays integrity, the less rent-seeking becomes profitable.)
8. Evans calls this requirement of autonomy and proximity "embedded autonomy".
9. For a review of the limitations and risks of "Generic Managerialism," see Dollery and Wallis (1999, pp. 155-166), who say that implementing its value system (performance, a largely managerial vision of the fulfilment of public-sector tasks,

and so on) is at some point likely to erode the advantages of the PPA-Weberian model of independent and ethical public officials. It can also lead to fragmented administrative management that is incompatible with the state's usual task of co-ordinating and identifying socially optimal solutions.

10. These are characteristics of economies that have a large informal sector.
11. In the already-cited case of Mexico, the mid-1980s crisis (hyperinflation and risk of social and economic crisis) was key to establishing a dialogue between government, private sector and trade unions. The ensuing co-operation led to the introduction of "Economic Solidarity Pacts" (1987-94).
12. Nevertheless, economic and social crises should not be overestimated as spurs to dialogue between government, private sector and trade unions. "War of attrition" models (Alesina and Drazen, 1991) that try to explain why the implementation of structural adjustment programmes in crisis countries is often so slow, demonstrate that each social group tries to avoid the costs of reform and stabilisation plans. This produces non-co-operative crisis exit strategies, after which only one social group (the first one for which the crisis becomes more costly than the reform) pays the entire cost of the adjustment. By prolonging economic and social disruption, these strategies are probably sub-optimal in Pigouvian terms (that is, collectively).
13. For a review of what feeds corruption and its effects on economic performance, see UNDP (1997).
14. For a review of issues linked to the political economy of the opening-up of trade, see Rodrik (1995). On the political economy of trade policy in Africa, see Ogbu and Soludo (2004).
15. This would include: monitoring the constitutionality of laws, ensuring the defence of citizens against the state (administrative judicature) and overseeing government accounts to see that public money is properly used.
16. See for example Brunetti and Weder (2003).
17. The principle of the separation of powers should be taken in a broad sense. It not only refers to the separation of executive, legislative and judicial powers, but also to the setting-up of independent regulatory administrative bodies and of other independent bodies with, for example, the right to issue currency (a central bank). What is important is to reduce the state's ability to use its power arbitrarily. How, for example, can a common incomes policy exist between government, trade unions and employers if the government practises a monetary policy that is based on seigniorage? One solution is to hand over monetary policy to an independent central bank (cf. Cukierman, 1994) whose duties are laid down in the national constitution.
18. For a discussion of the respective merits of democracy and authoritarian regimes concerning respect for property rights, see Borner *et al.* (2004), and Clague *et al.* (1997).

Chapter 3

Is Encouraging Public-Private Dialogue in Sub-Saharan Africa a False Solution?

Given the requirements for setting up PPD and the risks of abuse involved, what room is there in LDCs for establishing collaboration between the state and the business sector on the design of government policy? This chapter shows how in most LDCs, especially in Africa, the institutional, political and ideological environment – and the legacies of history – work against productive PPD. It is therefore necessary to make a pragmatic analysis of the means and instruments that local private and public stakeholders have at their disposal, as well as what foreign donors can do, in order to promote co-operation between the state and the business sector in the poorest countries.

What works against PPD

Most LDCs seem to meet hardly any of the requirements for balanced, transparent and long-term PPD. Their state structures are a very long way from the ideal Weberian bureaucracy, the private sector is weak and poorly organised, the line between public-sector action and private-sector interests is hard to establish, and institutions (in the broad sense) are weak: the separation of powers is often only formally true, and the rule of law often merely a matter of posturing.

But where are developmentalist governments to be found?

Corruption, predation, weak bureaucracy and even “criminalisation of the state” (Bayart *et al.*, 1997): some institutional realities of LDCs fall very short of the ideal of Weberian bureaucracy. The late development of the

nation-state and the lack of a universalist and bureaucratic notion of the state are some of the many explanations for this very complex phenomenon. Weak states are particularly characteristic of sub-Saharan African countries. Africanists talk of relations between government and the governed in Africa in terms of a “neopatrimonial” state – a state that is a source of personal enrichment, power, and political and social legitimacy (Box 3.1). Public resources privatised in this way are partially redistributed to tentacular networks of political and social supporters of these political entrepreneurs throughout society. The line between state and society becomes largely fictitious, and, in many ways, the notion of civil society (in its usual meaning of the autonomous organisation of society separately from the state) is absent in Africa.

Civil society’s lack of autonomy equally affects the business sector, given its multiple links with the state apparatus. Political entrepreneurs (government leaders and top officials) can sometimes at the same time be important economic entrepreneurs and use the state apparatus to serve their industrial and commercial interests – and of course, this situation of collusion somewhat destroys the meaning of PPD.

Nevertheless, some analysts consider the involvement of political leaders and bureaucratic elites in economic activities as being likely to produce pro-business policies. Berman and Leys (1994) point to the case of Côte d’Ivoire, where policies favouring commercial agriculture arose from President Houphouët-Boigny’s own private farming interests. This argument nevertheless supposes that there will be convergence between the overall interests of the business sector and those of the politico-bureaucratic elite – which is largely fortuitous. Moreover, when political leaders and top officials are involved in economic activities, the risk that conflicts of interest will arise obviously cannot be ruled out.

A heterogeneous, poorly organised and virtually silent private sector

A dual, heterogeneous private sector

The private sector in LDCs is weak and largely informal. More exactly, the production sector in these countries is often divided into two, with a few large foreign firms (and occasionally local firms as well) exploiting the country’s principal resources and co-existing with a weak and fragmented local private sector that remains confined to the informal sector, partly because these firms absorb material and human capital. These large groups, especially those

Box 3.1. The state and “patrimonialism” in Africa

Most Africanists would agree that the state in Africa has not managed to separate itself from society or move away from a patrimonial relationship with it (patrimonialism). Basically, there are no Weberian bureaucracies in Africa. Relations between government and governed are still based on patronage, and for government employees (of whatever level), the line between public and private is often very thin. In this sense, the state in Africa is little institutionalised and remains closely interwoven with society. Nepotism often plays an overriding role in government appointments. Interpersonal loyalties within the state apparatus, and between bureaucracy and political authorities, often take precedence over the application of legislation and the official rules of bureaucratic machinery (which, in the Weberian sense, therefore exists only in theory). Besides this agreement among analysts, Chabal and Daloz (1999) list three theoretical paradigms that, in different ways, describe the nature and workings of the state in Africa:

- 1) **The *neopatrimonial state*.** This approach was developed especially by Médard (1991) and holds that the state in Africa has retained the *apparent structure* of the modern Western state from the colonial period, but that its workings and machinery (i.e. its *effective functioning*) are based on ancestral and patrimonial standards; political legitimacy results from the interaction between the two. Elites have to fight for control of the state, which has become an instrument of vested interests. The political system is therefore no longer entirely *traditional*, but *neotraditional*: elites have to gain control of the apparently Western-style state apparatus in order to make the patrimonial system function within it. However, the state is illusory also in that it largely operates in an informal manner, and the rule of law is weak.
- 2) **The *hybrid state*** approach considers that the state in Africa is a combination of Western standards inherited from the colonial period and values derived from the African social system. This approach has been described by Bayart (1989), who talks of the emergence of an indigenous state that is an instrument of primitive accumulation for political elites. This is a rhizome state theory: the state’s institutional forms hide a mass of relationships, power struggles and ancestral rivalries.
- 3) **The *transplanted state*.** This approach, described by Badie (1992), claims that the transfer of Western state structures to Africa has failed mainly for cultural reasons: aspects of the Western state began operating differently as soon as they were transplanted to Africa, and most modern state functions stopped working. So the African state no longer resembles the Western state in any way, and is not a hybrid state, but a model in itself, albeit a dysfunctional model unable to “master” internal violence.

working in extractive industries, benefit from close ties with local officials and governments. When governance is weak, with arbitrary decision making, a predatory bureaucracy and weak institutions, there is a great risk that the interaction between these groups and local governments will become corrupt, collusive and involve the exchange of favours.

The relations between governments and large oil companies in Africa are classic examples of this. The oil windfall "... reorients economic incentives toward competition for access to oil revenues and away from productive activities, especially in non-transparent environments characterised by political discretion and unclear property rights" (Eifert *et al.*, 2003, p. 41). Extractive industries (unlike manufacturing) are only possible in a few countries where raw materials can be extracted profitably, and so companies cannot play on competition between oil-producing countries and rob them of their sovereignty, even when governance is very opaque and unstable. Copinschi and Favennec (2003) point out that "African countries have great leverage in their relations with the oil companies – their sovereignty over access to the oil" (p. 143). On the other hand, large oil firms can put very strong pressure on governments, and so the negotiating power of countries "... tends to diminish these days with the advance of economic liberalism and its development priority of opening borders. African oil states are also heavily in debt and, in many cases, access to world capital markets – necessary to pay for oil development – can only come through the oil companies with their solid credit rating"¹ (p. 143, *ibid.*). When political and bureaucratic decision making is opaque, the oil companies establish "special" ties with local decision makers and, in exchange for favours, obtain very attractive commercial terms. This kind of collusion between local elites and oil company chiefs encourages a lack of transparency, routine corruption and theft of oil revenues².

A weak and fragmented local private sector

There is an extensive literature on weak formal private sectors in LDCs (especially Africa) which we will not discuss in detail here; however, one point worth recalling in particular is that, alongside a *large state sector* inherited from colonial and post-colonial times, there is a *broad informal private sector* (Box 3.2). The ideological and political hostility of governments (especially in Africa) to the emergence of a class of private entrepreneurs independent of the state has in fact restricted the growth of the formal sector and encouraged informal activities (sometimes dominated by foreign diasporas).

Box 3.2. The weakness of the private sector in Africa³

In Africa, the absence of a large, dynamic and sufficiently structured and organised private sector can rightly be thought of as an obstacle to creating balanced and productive PPD on the continent. In most African countries, the private sector is largely informal, and the formal sector represents a very small share of national income in many African countries, as the table below shows (allowing for problems of measurement).

Table 3.1. Share of informal sector in non-agricultural employment, non-agricultural income, total employment and total income, in selected sub-Saharan African countries

Country (year of census)	% of non- agricultural employment	% of non- agricultural GDP	% of total employment	% of total GDP
Benin (1993)	92.8	42.7	41.0	27.3
Burkina Faso (1992)	77.0	36.2	8.6	24.5
Burundi (1996)		43.7		25.7
Chad (1993)	74.2	44.7	11.5	31.0
Ghana (1988)		58.3		31.4
Kenya (1999)	71.6	25.0	28.8	18.4
Mali (1989)	78.6	41.7	13.3	23.0
Mauritania (1989)	75.3	14.4		10.2
Mozambique (1994)	73.5	44.8	7.6	38.9
Niger (1995)		58.5	27.2	37.6
Senegal (1991)	76.0	40.9		33.0
Tanzania (1991)		43.1	19.6	21.5
South Africa (1995)	18.9	7.2	16.6	6.9
Zambia (1998)	58.3	20.2		14.7
Sub-Saharan Africa	77.4	39.6	19.7	25.9

Source: Charmes (2000).

The private sector in most African countries is hampered by lack of capital, skilled labour and technological expertise, by weak infrastructures, and by too-small domestic markets (Gibbon and Schulpen [2002], p. 4). The state sector remains substantial or even dominant, despite structural adjustment programmes.

Several factors explain the weakness of formal private sectors on the African continent:

- *The legacy of the colonial period, aggravated further by post-independence economic development strategies in the 1960s and 1970s.*
 - Development of the colonies was mainly undertaken by large firms from the “mother” country that were mainly involved in extracting raw materials.
 - The absence of a local business class was prolonged after independence by the priority given by most African governments to building a strong public sector. This choice was in line with the ideological thinking of the time in DCs (strategy of import substitution, planning, hostility to a market economy), met the need to begin industrialisation in the absence of a local business class and was a refusal to allow the emergence of a dynamic bourgeoisie that might eventually undermine the political monopoly of post-independence parties (McCormick and Pedersen, 1999).

Box 3.2. (continued and end)

Growth of a local business class was therefore difficult, and the local private sector developed mostly in the informal sector as a multitude of micro-enterprises more concerned with subsistence than with accumulating capital. Only the Lebanese and Indian diasporas continued to develop industrial and, especially, commercial activities (Himbara, 1994) as part of investment and growth efforts. Attempts to Africanise local economies in the 1960s and 1970s mostly resulted in a strengthening of local public sectors.

- *The structural adjustment programmes of the 1980s and 1990s did not reverse this trend.* Analyses suggest that dismantling public sectors led to further informalisation of the economies, with public employees handling their loss of purchasing power, and in some cases their jobs, by developing informal economic activities (Azam, 1994). The opening-up strategies that structural adjustment programmes entailed were not very successful in a situation of very low competitiveness and technology lag inherited from the import-substitution period. These strategies in fact resulted in the destruction of a large part (albeit the least competitive part) of the formal sector (for example, 20 to 30 per cent of Nigeria's manufacturing sector, according to Lubeck and Watts, 1994). The low competitiveness of manufacturing also led foreign direct investment to focus further on raw materials, so increasing the specialisation of many African countries in these sectors (Cantwell, 1991) and usually contributing little to the growth of the local private sector. We can therefore confidently talk of a de-industrialisation of African countries in the 1980s, along with growing informalisation of their economies.

Hence, the legacies of colonialism and the historical context since independence both help to explain why policies and institutional, economic, political and social environments were, and still are, largely unfavourable to the growth of the private sector (Hadjimichael and Klein, 2003). This analysis enables aid donors to design practical strategies for changing the environment in which the private sector operates (starting with infrastructures and business conditions) and for upgrading firms (training, technological expertise, financing, competitiveness, etc.). The results of such efforts have often been disappointing, and faster growth in other regions of the world perhaps suggests that there may be incompatibility between a market-based development model (involving the emergence of a dynamic bourgeoisie engaged in capital accumulation, investment and capitalist growth) and the characteristics of African societies. This extremely complex question, which requires contributions from fields ranging from economics, sociology, history and even anthropology, is beyond the scope of this study. However, it is relevant to issues as fundamental as the role and status of the individual in society and versus the state, the relationship between state and private sector, the role of the state, and the notion of public service (cf. Box 3.1): more understanding of this question may finally help to explain the reasons for the development and structure of the private sector on the continent, and so it cannot be ignored when considering what can be expected from PPD in Africa.

Bräutigam *et al.* (2002) note that “few governments [in Africa] rely on local manufacturing as their political and social support base, many were founded on statist and/or socialist beliefs, and some remain suspicious of domestic capital as a possible base for opposition” (p. 523). Kraus (2002) describes in detail the hostility of the Rawlings regime and its political supporters in Ghana in the 1980s towards the local business sector, and the hounding of its members (routine accusations of fraud and arbitrary arrests, seizures, tax harassment, lack of communication between government and private sector, and so on). An opaque and unstable business environment also encouraged the growth of economic activities outside the legal economic framework.

The weight of the public sector, along with the size of the informal sector, indicates that the formal sector is small and not very influential, especially when the country’s comparative advantages are in the raw materials extraction industry, often in the hands of foreign companies under government supervision. The formal private sector is therefore the missing link in the poorest economies, especially in sub-Saharan Africa: it only contributes an estimated 22 per cent of Africa’s GDP, while the informal sector accounts for 52 per cent of the wealth produced by the continent (IFC – International Finance Corporation, 1999). A dynamic bourgeoisie has only rarely emerged in Africa, but “the formation of a politically influential and productive capitalist class, with a solid and mature bourgeois culture to support and focus its economic and political projects, has never been the work of a generation or two” (Leys, 1994, p. 12).

A poorly organised and virtually silent business class

Because local private sectors are weak and mainly informal, they are poorly organised and carry little weight with governments. Most informal-sector stakeholders, especially those in rural areas, are in practice excluded from any structured dialogue with the state⁴. Moreover, the weakness of the formal private sector makes its regrouping into influential professional associations difficult. For example, Moore and Hamalai (1993), point to the divisions in Nigeria’s business community and its inability to influence the structural adjustment programmes implemented by military governments in the 1980s and early 1990s. Kraus (2002) describes the lack of resources and organisation of Ghana’s economic stakeholders and their inability to make themselves heard by President Jerry Rawlings’ authoritarian regime⁵. More generally, Doner and Schneider (2000) state that: “Indeed, developing countries are full of associations that consist of little more than a telephone listing, a

president, an office, a secretary, and a small annual meeting. ... Lacking not only staff and funds, but also information about their own members, they are unable to broker binding agreements among their members ..." (p. 14).

These poorly organised business communities are therefore rarely able to develop their analytical capacity or to become influential negotiators with the state or aid donors. There are exceptions (as in Uganda, cf. Devarajan *et al.*, 2001), but only in a very few countries did the business community, including sectors that stood to benefit (such as exporters), make any moves to back liberalisation and structural adjustment policies in the 1980s and 1990s. Local private sectors generally have limited capacity for analysing current government policies and proposing alternatives – and so they are far from becoming credible partners in the eyes of the government in LDCs and being able to further the emergence of growth coalitions. Democratisation processes in many DCs in the 1990s *momentarily* increased the visibility of business communities and their influence on government decisions, but these processes mostly did not last. Especially in Africa, democratisation was not accompanied by advances in the rule of law, or even by a reform of bureaucracy and a break with the mechanisms of the patrimonial state. Democratisation was more a question of a “mirror-image policy” (Chabal, 1996) in order to satisfy Western aid donors.

In the case of Zambia, the return to multipartyism at the 1991 elections saw the victory of a coalition that included representatives of the business community, but the private sector’s weakness from the start prevented it from becoming a vital element of support for the new government or a stimulus for economic reform. The Zambian economy remained dominated by the public sector and by the interests of an anti-reform bureaucracy. Democratisation did not lead to a break with the machinery of the Zambian patrimonial state (Chabal and Daloz, 1999). Dialogue between government and business deteriorated into mutual distrust at official level, and the relationship was reduced to personal ties and networks of influence.

Seizing opportunities

The discrepancies noted between the political, economic and institutional situation in most LDCs and the conditions theoretically required for transparent, balanced and effective PPD might lead to scepticism regarding the possibility of establishing a relationship between the state and the private sector that will have a positive effect on economic and social development.

Nonetheless, opportunities do exist, even in an unfavourable institutional environment. Seizing such opportunities requires positive action on the part of the government in its relations with the local private sector, and cautious and pragmatic support by aid donors in order to bring government and business closer together.

Forging links with the private sector: a task for the government

“Transforming” the private sector for better dialogue

The quality of PPD depends partly on the characteristics of the state and the business sector, but it would be wrong to think of the private sector as intangible and immobile. Interaction affects both parties, and in particular, “the character of the business community can be reshaped by state policy” (Evans, 1997, p. 66). The state can not only change the private sector’s economic orientation and influence its choices in matters of production specialisation, but it can also *influence the private sector’s organisational methods and its representation in professional associations*. The state can be a kind of midwife for the private sector (*idem.*, p.78). Bates and Krueger (1993) say that governments, before embarking on reform, often try (with varying success) to reconfigure the representativeness of interest groups by giving them more formal structures.

A good number of analysts describe how Japanese governments have encouraged the growth of a strong domestic computer industry since the 1960s by linking dialogue with the private sector with proactive policies (R&D, funding, strategic protectionism)⁶. By fostering this industry, the government thoroughly transformed the shape of the national private sector – and in pushing the business community towards high value-added activities, it also made it more inclined to engage in dialogue with the state. The same process in South Korea is described by Evans (*idem.*).

A proactive state policy can therefore create the conditions for PPD that encourage economic development. Existing economic structures do not unequivocally and permanently determine the form of PPD. However, the state’s ability to create favourable conditions for PPD is partly linked to a wider and more complex issue, i.e. what government policies encourage the emergence and growth of the private sector in LDCs. Here, the legacy of history and current events both play a role. The state cannot simply *decide* on its own to reorganise the private sector: its efforts are always subject to economic, political and institutional constraints.

Evans (*idem.*) points out that in countries of Southeast Asia, the combined pressure of the United States and the communist threat freed governments from the grip of traditional agrarian elites. These states also possessed a legacy of strong bureaucratic traditions, but they were faced with an under-funded capitalist sector disorganised by war⁷. Conditions were therefore favourable for PPD based on proactive government action. This can be compared with the situation in Brazil where, ever since the colonial era, bureaucratic elites and landed oligarchy have been closely linked, leading to clientelism and corruption, and slowing down the transformation of the economy (Hagopian, 1994).

Dispelling distrust between the dialogue partners

The difficulty of establishing effective PPD can, as we have seen, also be due to mutual distrust between public and private dialogue partners. Distrust between political and administrative elites and the business community may arise for ideological or ethnic reasons, and it risks making public-private interaction superficial and ineffective. Initial distrust on both sides, along with information asymmetry about promise-keeping by each partner, may lead to the “Prisoner’s Dilemma”; resulting in socially sub-optimal private and public investment. Huff *et al.* (2001) stress that without any credibility at the outset, a government may not be able to convince the private sector that its developmentalist choices are sincere, and so the dialogue may be merely a façade – it cannot, by itself, change the attitudes of those taking part in it.

How can this initial distrust be dispelled and a virtuous circle of trust, dialogue and improved policies be created? Here, the state’s commitment and determination to maintain a dialogue play a key role. The government must send strong political signals and then back these up with guarantees, that is, economic policy changes that give substance to dialogue. In other words, dialogue is not an end in itself: it may help to improve the quality of government policy making, but its continuance depends on the real changes brought about by the policies adopted. The government can act:

- ◆ *At the procedural level:* a commitment by top government leaders sends a strong positive signal to the private sector; this can make a decisive contribution to reducing the gap between economic and political/bureaucratic elites.

In the early 1980s, Malaysia's "Look East" development programme – destined to transform the country into a newly industrialised country – was based on the idea of a country as a company (Malaysia Inc.), i.e. on the will to create a new interdependency between private and public sectors. Setting up public-private consultation mechanisms became a priority based on a commitment made by top Malaysian government leaders. Prime Minister Mahathir Mohamad took part in national public-private consultations (such as the Malaysian Business Council), and his ministers personally attended ministerial meetings with private-sector partners (World Bank, 2001). Professional exchange programmes and informal meetings between top officials and business leaders were also organised from 1983 in order to narrow the ideological and cultural gap between business and government. In Ghana, on the other hand, the open hostility of President Rawlings to the consultation mechanisms set up by the World Bank in the late 1980s and early 1990s destroyed the credibility of this initiative (*ibid.*).

- ◆ *Through economic policy choices:* the best way for government to persuade the private sector of the utility of dialogue and the sincerity of the consultation process is to show its effectiveness. In other words, the authorities must take substantive policy decisions that have clearly taken into account suggestions made by the business sector.

Botswana is an interesting example. Despite efforts by the country's main professional organisation (the Botswana Confederation of Commerce, Industry and Manpower, BOCCIM) to set up a dialogue with the government (formalised through twice-yearly public-private conferences from 1988), interaction between government and business remained limited until the mid-1990s (Land, 2002). It was only then, when the government really began to regard in-depth co-operation with the private sector as indispensable, that PPD took off. This new approach took concrete form at procedural level with the creation of the *High Level Consultative Council*. Probably more significantly, Land points out that "the fact that most recommendations raised at the National Business Conference have been followed up and implemented is indicative of the private sector's being treated as a serious and legitimate partner in the policy process. Interviewees further suggested that engagement through dialogue has helped cement relationships between the government and the private sector and encouraged the move towards a climate of 'smart' partnership" (p. 11).

Government determination to push substantive PPD and to implement measures for facilitating communication between companies, government and bureaucracy – or even for entirely reshaping the private sector – tends to create a virtuous circle of consultation and better policies. There is a place for efforts by local authorities, but in the most fragile countries (where there are corrupt bureaucracies, patrimonial states, weak institutions, and so on), such efforts are difficult. So what can foreign donors do to help bring public and private sectors closer together and to provide “positive incentives” for dialogue?

The role of donors: catalysing and supporting the dialogue process, and making it credible

What can donors do if a government is not interested in constructive PPD, if bureaucracy is dysfunctional, and if the rule of law is ineffective? Should they wait patiently for local stakeholders to evolve towards the conditions necessary for productive dialogue? Should they count on the gradual emergence of a domestic private sector that will oblige the state to engage in dialogue, reform itself, and improve the business climate? This approach takes the risk of ignoring the length of time that this might take. The emergence of a developmentalist and Weberian state could take several generations, and perhaps forever, if the political legitimacy of the country’s leaders continues to rely on the looting of public resources and use of the bureaucracy for personal, corrupt and patrimonial ends⁸.

The existence of unfavourable political, economic and social conditions for PPD should not prevent donors from acting, but they must do so with a pragmatism that takes account of local institutional constraints. Donor action in encouraging the development of the local private sector and bureaucratic reform may be preparatory and long-term, but donors can also have a direct and immediate impact on the quality of the relations between state and private sector by initiating the process of PPD, identifying stakeholders and supporting the process over time.

Initiating the process and providing suitable incentives

Bräutigam (2000) stresses that “the state and business need opportunities to allow repeated interactions to occur and mutual trust to build.” This is where multilateral and bilateral donors can be catalysts, by providing participants in the future dialogue with suitable incentives, and by acting:

- i) *on the locally dominant ideology.* Macroeconomic stabilisation and structural adjustment reforms in the 1980s and 1990s helped change the ideological framework of economic policy in many LDCs. In sub-Saharan Africa, the promotion of the private sector, of the market, of growth strategies through export promotion, and the liberalisation of trade and exchange controls became accepted, and “these reforms increased the space and ideological legitimacy for BAs [business associations] to operate” (Kraus, 2002, p. 428). Apart from the complex question of the economic success of these strategies, Kraus says that “a private sector ideology has displaced statism and socialism as the dominant strategy among politicians and intellectuals in Africa more thoroughly than one would have imagined in 1980” (p. 428).
- ii) *through publicising the advantages and potential knock-on effects of a dialogue with the private sector.* Highlighting successful past and present PPD in poor (but emerging) countries and pointing to good practices are ways of showing the feasibility and relevance of PPD. This approach nevertheless implies an in-depth discussion about whether solutions that were successful elsewhere can be replicated and transposed.
- iii) *on policy design.* Some donors insist on private-sector involvement as a condition for financial and technical support. The World Bank played a crucial role in setting up consultation mechanisms in Ghana in the late 1980s and early 1990s, when the government was extremely hostile towards the business community. Without the Bank’s insistence and the financial conditions laid down, the Ghanaian government would probably not have taken the necessary steps to improve its relations with the private sector (Ayee *et al.*, 1999). Donors can also persuade governments to take some initial steps to send a strong signal to the private sector that they are seeking constructive dialogue.

Identifying the dialogue partners

Setting up credible PPD also requires the selection of participants who are *legitimate, representative, involved, and convinced* of its usefulness. Donors can here provide decisive help in launching dialogue by identifying suitable partners (within professional associations, government and public administration), especially where attempts to set up productive, transparent and balanced PPD might seem doomed to failure because of a weak private sector and a dysfunctional bureaucracy: situations of this kind must not be seen as insurmountable.

Where it is not possible to involve the entire bureaucracy in dialogue, by means of regular interaction with the authorities, donors can nevertheless identify decision makers in the government who favour reform and PPD (“policy champions” [USAID, 1994]), as well as pockets of efficiency (Evans, 1997) within the administration. Bureaucracies are rarely monolithic: even those most closely resembling the Weberian ideal cannot be considered to embody it completely (see Okimoto, 1989, about Japan). Conversely, in countries such as Thailand or in some Latin American countries where bureaucracies are very subject to clientelism, there exist pockets of efficiency that are very close to the Weberian ideal: they can be very influential in designing government policy, and can also play a dynamic role in development, reform and growth⁹. Powerful pro-reform officials in the government can be a focus for PPD, and they should be encouraged to meet the most energetic members of the private sector with a view to initiating change.

Dollery and Wallis (1999, p. 97) also point to the need to make a distinction in administrations between “technocrats” – defined by Williamson (1994, p. 1) as those who, from within monitoring bodies, “... advocate the organization and management of a country’s industrial resources by technical experts for the good of the whole community” – and “bureaucrats”, who are often located in ministries and departments that use public funds, and whose aim is to maximise their budgets. The departments most likely to be pockets of efficiency that can be involved in PPD from the start are those where the “technocrats” are to be found.

Lastly, donor support to the private sector (particularly in respect of its organisation and the development of its capacity of analysis) is also vital, especially where the local private sector is weak and fragmented. This effort can take the form of financial, analytical and technical support to professional associations in order to increase their understanding of the issues at stake and give them tools to analyse government policy and propose alternatives, but it must also help to make these associations credible partners in the eyes of the authorities.

Working with and supporting interaction between the state and the private sector

Donors can also act as supporters, intermediaries and guarantors throughout the dialogue process, thus ensuring its sustainability and credibility over time. They can intervene in the following areas in particular:

- ◆ *material, analytical and procedural support.* On the basis of their PPD experience and best practices, they can advise participants on procedural and organisational aspects of the consultation process (e.g. frequency, number of participants, defining the agenda, conduct of discussions and publication of minutes). They can also provide material and analytical support to the secretariat co-ordinating the dialogue process.
- ◆ *reduction of “transaction costs”.* Donors can be guarantors of the dialogue process, ensuring its transparency and, especially, its follow-up. Supporting the co-ordinating secretariat is a key role. “A secretariat may provide an objective information-collection and analytic capacity ... And the ability to collect information may help monitor the extent of compliance with CM [consultative mechanism] decisions by participants” (World Bank, 2001, p. 5). The follow-up and monitoring of commitments made during the dialogue is vital to its credibility, and so it is essential to have a secretariat that is financially and analytically independent – and this can be guaranteed by donors.

A pragmatic and cautious approach

Action by donors must be designed pragmatically and cautiously. A donor may take on the roles of intermediary, catalyst and guarantor, but cannot become the *deus ex machina* of PPD. The many pitfalls to be avoided include:

- ◆ *Lack of ownership* of the dialogue process by local stakeholders. When international funding institutions impose the condition on governments that they must consult the private sector, this consultation can sometimes remain a mere formality (see Soludo *et al.*, 2004, on several African countries). Donors can hardly demand more from governments than a pledge to commit resources to PPD. Inertia and passive resistance by public stakeholders, especially at the top level, are difficult to overcome. Donor pressure often turns out to be self-defeating, as witnessed by the failure of the 1993-94 Private Sector Roundtable (PSR) in Ghana, but this effort was premature, since the government was not ready to hold talks with the business sector. The key role of the World Bank in setting up the dialogue confirmed the private sector’s view that the government was dragging its feet and only taking part to satisfy its biggest funding source (Ayee *et al.*, 1999). The private sector’s trust in the government’s intention to implement the Roundtable recommendations therefore remained very limited.

- ◆ In a political, economic and social environment that is poorly conducive to PPD, finding influential reform-minded people and pockets of efficiency within a government apparatus can be very difficult. Even when these can be found, support for PPD within the government apparatus is limited because its survival depends on individuals and not on institutions, and this makes it precarious. USAID (1994) emphasises that “policy issues are usually so complex that no individual can pull off the remediation of those problems by him or herself.” It is therefore necessary to create support for reforms as widely as possible, both outside and inside the government apparatus.
- ◆ The private sector’s weakness, fragmentation and lack of organisation, along with its close links with the patrimonial state and with what is called (often misleadingly in poor countries) civil society (including business), help to make priorities difficult to define. What professional associations should be supported? How autonomous are they of the government, and how representative are they? How can one ensure that these professional associations are not merely more instruments for capturing and diverting donor aid?
- ◆ Any action of aid donors in this area risks encountering serious conflicts of interest, since donors may be, at the same time, advisers and direct or indirect representatives of their own commercial interests (Soludo *et al.*, 2004; Solignac Lecomte, 2003).

Taking these difficulties into account should help to guide donors into adopting an approach towards PPD that is pragmatic, cautious and devoid of illusions. It should also help them to identify the scope of possible actions for promoting dialogue and effective and constructive consultation processes between government and business.

Notes

1. However, oil production is vital for local economies. In Nigeria, oil revenue was about a third of GDP in 2004 and 81 per cent of government income (African Development Bank and OECD, 2005). Hence in sub-Saharan Africa, the arrangements for oil production (taxes, access to oilfields) tend to be very favourable to large firms.
2. Copinschi and Favennec (2003) note that in Nigeria, “Shell is older than independent Nigeria itself. It has been in the country since 1937 when, with BP, it was given exclusive exploration rights by the colonial authorities. It is no longer dominant but still accounts for 40 percent of national oil production” (p. 143).
3. This box draws extensively on Langhorst (2003).
4. However, there are cases of professional associations whose members consist mostly of entrepreneurs whom economists would regard as part of the “non-structured” sector, but that are nevertheless well-established, have an Internet website and sometimes adopt public positions on government economic policies. The National Union of Traders and Industrialists of Senegal (UNACOIS) is an example of this.
5. Racial divisions can also help to split the business sector. In Zimbabwe, for example, white and black professional associations failed to present a united front against the authoritarian and populist abuses of the Mugabe Government in the late 1990s. “The fissures in the business community – including both racial and sectoral cleavages – were ably exploited by the Zimbabwean state, creating a vicious circle of conflict” (Bräutigam *et al.*, 2002, p. 537). But racial divisions are not always an obstacle to productive PPD, as the example of Mauritius shows (*ibid.*, p. 540).
6. Cf. Flamm (1987 and 1988).
7. In Korea, funding of the economy was provided by an entirely state-controlled banking system, giving the government great influence over the *chaebol* (Woo-Cummings, 1999).
8. We should probably not adopt a teleological view of the development of the state in Africa, and should also avoid the notion of political development. The absence of a Weberian state in Africa is not necessarily the sign of a lack of political and institutional maturity that must inevitably disappear if an African state corresponding to the Western model is to emerge. Some Africanists maintain that arguments for a non-Weberian state in Africa make sense (see especially Chabal and Daloz, 1999).
9. See Doner and Ramsay (1997) for a discussion of the relatively diverse nature of Thai bureaucracy in terms of competence, integrity and cohesion.

Chapter 4

Conclusion

It is clear that setting up PPD that can lead to improved government policy design and implementation, and so in turn encourage economic growth and poverty reduction, is far from easy.

Starting to talk about PPD is already a major step forward. Interaction between the state and the private sector has been widely discussed by economic and political scientists in terms of rent-seeking, collusion and corruption. Hence PPD has been regarded with suspicion, and this view has long led to calls for drastically reducing the state's role in the economy and for insulating the bureaucracy from society as a whole, especially the business sector.

In the early 1990s, an analysis of the conditions and reasons for the success of some Southeast Asian economies helped to challenge this approach, by addressing preconceived ideas about the state's role in the economy and the benefits of increased (economically productive) interaction between political elites, bureaucracy and private sector.

The growing influence of civil-society stakeholders – not only in industrialised countries, but also in some emerging countries and LDCs – has confirmed this trend. Whether one advocates a large or small role for the state, it is increasingly clear that the government apparatus (bureaucracy and politicians) cannot design policies if it is cut off from the people it governs and from social stakeholders, starting (where economic policy is concerned) with the business sector. This issue is as much political (legitimacy of government policies) as economic and social, since the social and economic effectiveness of government policy depends in many ways on its legitimacy. How can a government, even a democratic government, have the right to impose its policies upon society? Society does not consist of a mass of isolated individual citizens/electors versus the state: it involves multiple allegiances

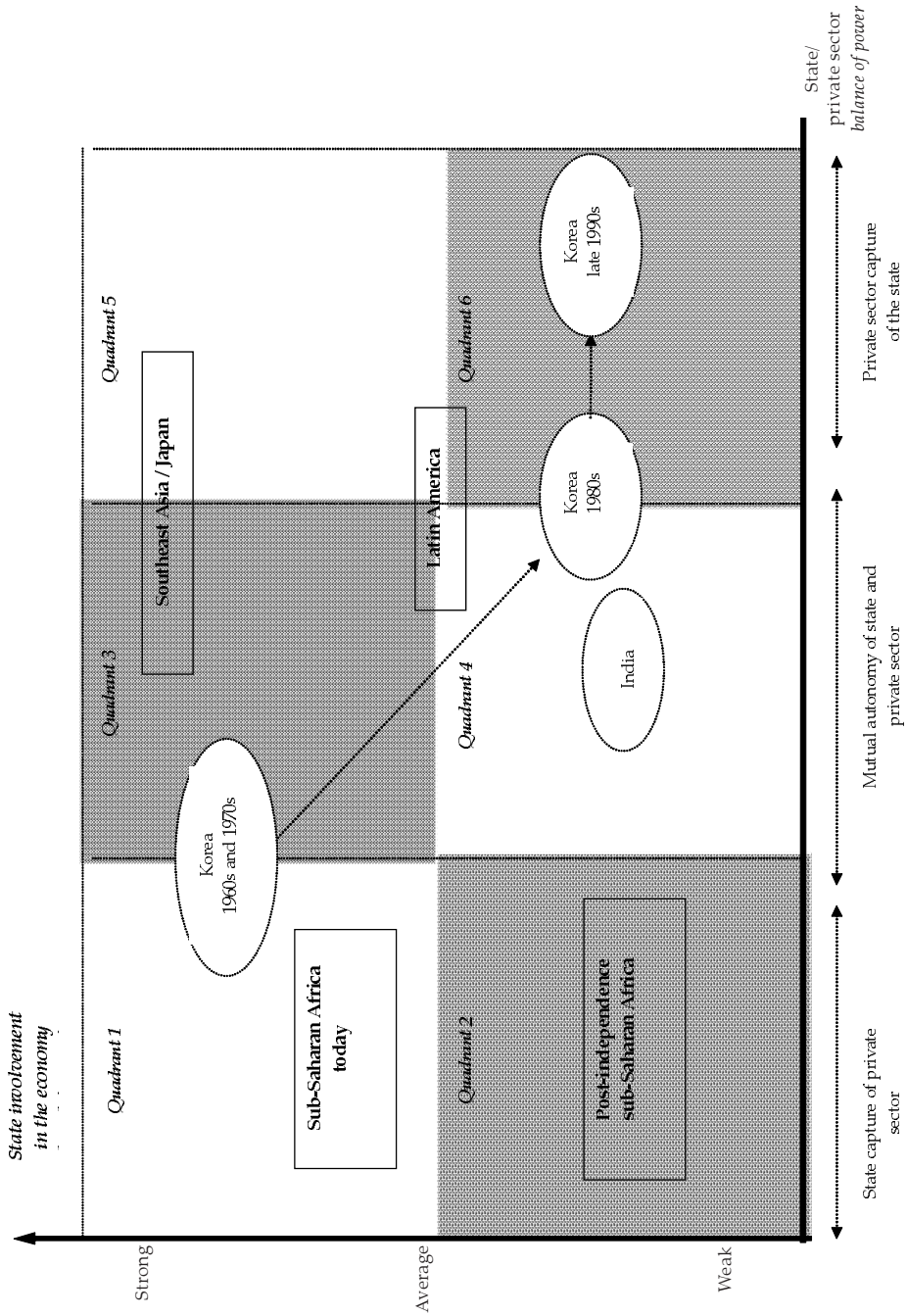
so complex that even representative democracy cannot reflect them. These questions are not new, but they have become increasingly significant in the past decade, pointing to a consultative approach to government-policy design, and especially the involvement of the private sector in the design and implementation of economic strategies.

This vision of PPD has gradually taken hold in industrialised countries, and few political forces in OECD countries would any longer advocate an authoritarian and hierarchical approach to political decision making. The call is now for consultation of opinion with social partners, economic stakeholders, and “citizen partners” in general (OECD, 2001), preferably before policies are designed – even if this consultation process is often more a matter of political posturing than of sincere commitment. It is interesting to note that, owing to the appearance of a consensus on this in OECD countries and to the lessons learned from the “Asian miracles”, bilateral and multilateral donors are now stressing the need for PPD in emerging countries and LDCs as a means of improving government policies, especially policies for promoting the development of a vigorous private sector (e.g. improvement of the business climate).

PPD should certainly not be seen as a new “miracle solution” for underdevelopment in LDCs: this study shows how over-ambitious that idea would be. The analyses made in the literature on the subject of rent-seeking in the political and economic systems of many DCs in fact remain relevant in many ways. The state sector in these countries is usually weak and bloated, while the private sector is fragmented and mostly unorganised, or else it only gives rise to powerful lobbies that obtain situation rents by putting strong pressure on the government. Where the rule of law and the separation and (often merely formal) monitoring of powers have only recently developed (if they exist at all), public-private interaction tends to become a process of collusion and mutual predation. This interaction, which may take the form of a dialogue, risks becoming nothing more than a screen for rent seeking – the very opposite of what might be expected from effective PPD, i.e. the production of public goods, such as economic policies to increase national wealth.

This study stresses how much the quality of dialogue depends on the structure of both the state and private-sector institutions involved, and why creating the conditions conducive to productive PPD is so complex. Figure 4.1 shows how difficult it is to reach the delicate balance required: the horizontal axis shows stakeholder integrity and illustrates the degree of autonomy retained by the state and/or the private sector, while the vertical axis indicates the extent of genuine dialogue, reflecting the private sector’s ability to gain

Figure 4.1. Interaction between state and private sector: state involvement in the local economy and mutual autonomy of stakeholders



access to the bureaucracy and/or the government/state's ability to involve itself in the national economy and develop networks. *Quadrant 3* shows the necessary balance, which requires an apparently paradoxical combination of involvement and autonomy (embedded autonomy, see Evans, 1997). Figure 4.1 also summarises the different possible scenarios for interaction at national level between state and private sector:

- ◆ *Quadrant 1* shows a situation where a (usually weak) private sector is captured by the state (corruption, bribes, secret pay-offs, etc.), while the distinction between public and private becomes very thin. The state is heavily involved in the national economy to the extent that politicians and bureaucrats use the government apparatus and their privileges to encroach on the economic sphere and become business entrepreneurs. There is high porosity between state and private sectors and, in this sense, heavy state involvement in the national economy. This situation is a fairly good description of public-private links in many countries of sub-Saharan Africa.
- ◆ *Quadrant 2* also shows a situation of government hounding of the private sector, but in this case, there is quite a sharp distinction between the two. This reflects quite well the situation in many sub-Saharan African countries after independence, with very corrupt local bureaucracies and governments, along with hostility towards private enterprise (as in Ghana), sometimes based on ideology.
- ◆ *Quadrant 4* shows a situation where the integrity and autonomy of private and public stakeholders are preserved, but interaction between them is limited by the separation of bureaucratic and political elites from economic elites. India has in some ways historically been like this.
- ◆ *Quadrant 5* shows a situation where the state is heavily involved in the local economy, engaging in dialogue with economic stakeholders and maintaining an influence over them, but where incestuous relations (clientelism, favouritism, corruption) have gradually developed between a powerful private sector (especially large national groups) and the bureaucracy and political elites. This situation somewhat describes the interaction that developed between the bureaucracy and large economic groups in Japan, as highlighted by the 1990s economic crisis.
- ◆ *Quadrant 6* shows a public-private interaction scenario in which the state cannot influence the economy, take the initiative of setting up PPD, or influence the choices of the private sector. The bureaucracy and local

political elites are vulnerable to temptations from the private sector (corruption, favouritism, powerful private lobbies interfering in political decision making, etc.).

The position of Latin America on the edges of quadrants 3, 4, 5 and 6 reflects extensive state corruption by powerful industrial groups (in Brazil and Argentina, for example), but it also reflects successful PPD in Chile and Mexico involving stakeholders who possess mutual autonomy. Latin America's position also reflects varying degrees of interaction between private and public sectors according to sector, issue at stake and country. The history of South Korea from the 1960s to the 1990s reveals the unstable nature of public-private interaction. At first the Korean government dominated PPD and had virtually captured the private sector (quadrants 1 and 3 of Figure 4.1), but incestuous public-private links gradually emerged, and the powerful *chaebol* regained the upper hand (quadrants 4 and 6 of Figure 4.1). As the government's prestige fell and it lost its ability to guide and be involved in the economy, the *chaebol's* influence on the government apparatus increased to an extent where the *chaebol* in many ways gained almost complete control over public administration and politicians (quadrant 6 of Figure 4.1).

As already mentioned, the risk that public-private interaction will degenerate into collusion highlights the need to expand PPD to include other civil-society stakeholders (starting with the trade unions), and to engage dialogue in an above-board institutional context – with democratically renewed personnel, balancing institutions, and freedom of the press.

The discrepancies noted in most LDCs between the local institutional and economic context and the optimal conditions for productive PPD should therefore not lead to scepticism about this tool for designing government policy, but rather to a well-informed, proactive and cautious attitude to its use. Bringing government, top officials and professional associations together around a table is obviously not enough to create a climate of trust and foster collaboration in designing orientations for economic policy. The stakeholders involved, especially donors supporting these efforts, should keep in mind a number of constraints that can affect the dialogue:

- It is important to make a prior analysis of the institutional and economic aspects of the dialogue, i.e. its political economy, to determine whether dialogue is feasible and timely. Starting a dialogue prematurely (as with the Private Sector Roundtable in Ghana in 1993-94, p. 65) may not only be fruitless in the short term but also increase distrust between

stakeholders in the long term. Donors must therefore be cautious and pragmatic: they should not take the place of local stakeholders in the dialogue but, rather, present themselves as intermediaries and honest brokers.

- The procedural and organisational aspect of PPD can be crucial. Although an apparently minor contribution, this can be decisive. As has been pointed out, dialogue is a complex transaction involving information asymmetry and transaction costs. There is the difficulty that mutual distrust, further reinforced by not having the ability to ensure that the other partner's promises will be kept (and even of checking whether they are being kept or not), may lead to a non-co-operative equilibrium – that is, a vicious circle of misunderstanding, distrust, and hostile and mutually disadvantageous decisions. Breaking this vicious circle of distrust and starting a dialogue process that might lead to a co-operative equilibrium between state and private sector may then well require external resources and the intervention of a third party.

Donors can assume this role of mediator, by providing analyses to assist the dialogue process, suggesting good practices of procedure, and acting as guarantors of the commitments made and the sincerity of stakeholders.

Whatever part they play, donors must act cautiously. In the short term, it is difficult to avoid and impossible to change some of the constraints on state and private-sector interaction, such as dysfunctional local bureaucracies or the absence of an organised private sector. These are institutional features that can only change over several generations (Jütting, 2003, p. 12). However, when that has been understood, then it does become possible to formulate realistic and pragmatic expectations from a dialogue between the state and the private sector.

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Public-Private Dialogue in Developing Countries

OPPORTUNITIES AND RISKS

Putting aside the euphoria of supporters of public-private dialogue (PPD) and the doom prophecies of its detractors, this analysis identifies the advantages that it can bring, while cautioning against the very real dangers it can present to fragile states and relatively recent democracies. The type of state involved, the level of organisation within the national private sector and the kind of support offered by donors all have an influence on the potential and real success of PPD.

“Nicolas Pinaud does a masterful job of surveying the state of our knowledge – both in theory and practice around the world – and offers a thorough and balanced review of the potential benefits as well as risks of closer relations between business and government.” Ben Ross Schneider, Professor of Political Science, Northwestern University.

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