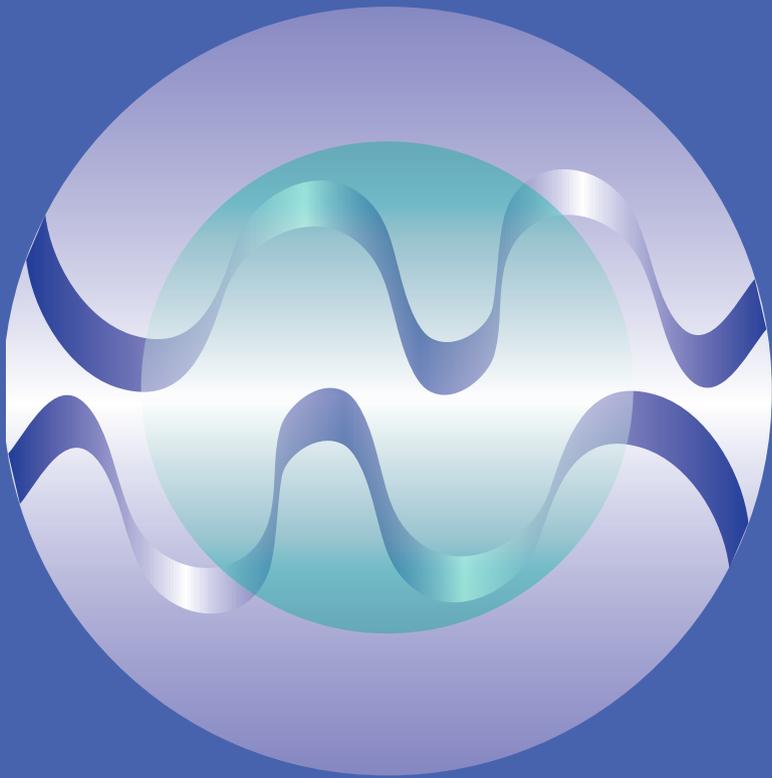




E c o n o m i c &

S o c i a l A f f a i r s

# Public Enterprises: Unresolved Challenges and New Opportunities



United Nations

**Department of Economic and Social Affairs**  
Division for Public Administration and Development  
Management

# **Public Enterprises: Unresolved Challenges and New Opportunities**

Publication based on the Expert Group Meeting on  
Re-inventing Public Enterprise and their Management  
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## FOREWORD

In recent times, globalization, liberalization and marketization and ongoing structural transformations of national economies contributed to an expansion of the private sector, on the one hand, and downsizing of the public sector including dismantling or divestment of public enterprises, on the other. These initiatives seemed to have been undertaken to accomplish two main objectives – giving more space to the private sector to function as the main engine of growth and at the same time, by downsizing and divesting inefficient public enterprise operations, save costs and generate revenue.

However despite being divested or dismantled, PEs continue to occupy significant roles in many countries, both developed as well as developing. Additionally, PEs remain in many developing countries, especially in the Sub-Sahara Africa, the principal suppliers of social services, some relevant to the attainment of the Millennium Development Goals (MDGs). For example, due to the slow growth of the private sector PEs remain the main sources of employment in many countries.

These varying conditions warrant a careful review of the role the PEs can play in socio-economic development of countries. However, what is also crucial is that new PEs must perform efficiently and effectively and where appropriate, under market conditions. The reform agenda of PEs includes, inter alia, the issues of management, structures, performance monitoring and feedback arrangements including exploring options of private/public partnerships etc. Currently, the debate on PEs do not seem to concern any more whether PEs have a role to play, but what that role should be and how it should be played.

By organizing the Expert Group Meeting (EGM) on “Re-inventing Public Enterprises and Their Management,” in New York during 27-28 October 2005, the Division for Public Administration and Development Management (DPADM) of the United Nations Department of Economic and Social Affairs (UN-DESA) attempted to advance the debate on the subject further and articulate more clearly the needs and options of Public Enterprises so that the Member States are in a better position to determine the institutional options of development more suitably. More specifically, the EGM discussed two inter-linked issues: (i) the role of Public Enterprises in today’s economy, especially within the context of the realization of MDGs; and (ii) the management and more particularly the performance monitoring issues of Public Enterprises.

This publication titled “Public Enterprises: Unresolved Challenges and New Opportunities” is based on the papers presented and views expressed during the EGM.

I take the opportunity to thank the experts, discussants and organizers for their contributions, especially the concerned staff of the Socio-economic Governance and Management Branch (SGMB) of DPADM who contributed more directly to the publication of this report.

A handwritten signature in black ink that reads "Guido Bertucci". The signature is written in a cursive style with a large initial 'G'.

Guido Bertucci  
Director, Division for Public Administration  
and Development Management  
Department of Economic and Social Affairs

## PREFACE AND ACKNOWLEDGMENTS

The Expert Group Meeting on Re-Inventing Public Enterprises and Their Management and the resulting publication on Public Enterprises: Unresolved Challenges and New Opportunities were undertaken as part of the United Nations Programme on Public Administration managed by Mr. Guido Bertucci, Director, Division for Public Administration and Development (DPADM) of DESA.

DPADM/DESA is grateful for the invaluable insights and expertise contributed by public enterprise experts namely Professor Prahlad Kumar Basu, Mr. Marc Dandelot, Professor Aristide Police, Professor Ismael José Gómez Gordillo, Mr. John-Mary Kauzya, Professor Dennis Rondinelli, Mr. Prajapati Trivedi and Mr. Jomo Kwame Sundaram, Assistant Secretary-General of DESA. In particular, DESA acknowledges the notable contribution of Prof. Basu who served as the Lead Consultant for this EGM and was responsible for the preparation of the initial background paper for the meeting. The following UN staff members acted as respondents to the sponsored papers: Mr. Shabbir Cheema, Mr. Jean Le Nay, Ms. Elida Reci, Mr. Ejeviome Otobo, Mr. Julio D'arcy and Mr. Olympios Katsiaouni.

*With a heavy heart, DESA also wishes to pay special tribute to Professor Dennis Rondinelli, one of the experts and a long-time member of the Committee of Experts on Public Administration, who passed away in the early part of 2007.*

The Socio-Economic Governance and Management (SGMB) of DPADM, headed by Mr. Adil Khan, Chief of Branch, implemented the activities. Mr. Khan provided the over-all guidance to the content of the EGM and of the publication. Mr. Jacinto de Vera, Chief, Policy Analysis and Coordination Unit (PACU) of SGMB and Portfolio Manager of the EGM steered the entire process and supervised the production of the final output, this publication of the EGM. Mr. De Vera was assisted in the finalization and editing of the publication by Ms. Mary Christine Ong-Reyes, Research Assistant. Mr. Numayr Chowdhury, consultant to PACU, provided useful inputs in the initial draft of the publication including its preliminary editing. Additional research inputs were also provided by Mr. Erasto Almeida, former intern from Columbia University.

The inputs of all other SGMB staff members during the EGM are also duly acknowledged.

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## Abbreviations and Acronyms

ASEAN	Association of Southeast Asian Nations
BOO	Build-Operate-Own
BOOT	Build-Operate-Own-Transfer
BOT	Build-Operate-Transfer
CEO	Chief Executive Officer
CFE	Federal Electricity Commission
CMA	Capital Markets Authority
CNOOC	China National Offshore Oil Corporation
DPADM	Division for Public Administration and Development Management
DPI	Directly Productive Investments
ECOWAS	Economic Community of West African States
EIU	Economic Intelligence Unit
EU	European Union
FGSA	French Government Shareholding Agency
GATS	General Agreement on Trade in Services
GCE	Government Controlled Enterprise
GDP	Gross Domestic Product
ICPE	International Centre of Public Enterprises
LDCs	Least Developed Countries
LMB	Lint Marketing Board
MDGs	Millennium Development Goals
MERCOSUR	Southern Common Market
MOU	Memorandum of Understanding
NAFTA	North American Free Trade Agreement
NEMA	National Environment Management Authority
NEPAD	New Partnerships for Development
NDA	National Drug Authority
NGO	Nongovernmental Organization
NNPC	Nigerian National Petroleum Corporation
NPM	New Public Management
OECD	Organization for Economic Co-operation and Development
PA	Performance Agreement
PE	Public Enterprise
PEMEX	Mexican Petroleum
PICKO	Private Infrastructure Investment of Korea

PO	Parastatal Organization
PPP	Public Private Partnership
SAP	Structural Adjustment Program
SGMB	Socio-Economic Governance and Management Branch
SOC	Social Overhead Capital
SOE	State Owned Enterprise
SRT	State Railway Authority of Thailand
TELMEX	Mexican Telecom
UDC	Uganda Development Commission
UEB	Uganda Electricity Board
UN	United Nations
UNDESA	United Nations Department of Economic and Social Affairs
UK	United Kingdom
URA	Uganda Revenue Authority
UWA	Uganda Wildlife Authority
SASAC	State Asset Supervision and Administration Commission

# Part 1

# Reinventing Public Enterprises

M. Adil Khan

## Introduction: Setting the Scene

Since the 1930s and particularly after World War II, numerous State Owned Enterprises (SOEs), also called Public Enterprises (PEs), were created in both developed and developing countries to address market deficits & capital short-falls, promote economic development, reduce mass unemployment and/or ensure national control over the overall direction of the economy, especially in developing countries. By providing capital and technology to strategic areas where the private sector either shied away from or lacked the capacity to invest (such as heavy industries, infrastructure etc), most governments resorted to PEs to increase capital formation, produce essential goods at lower costs, create employment and generally contribute to the economic development of the nation state. This trend continued till the early eighties.

However, rising corruption, management inefficiencies, overstaffing (without due regard to their economic viability, many governments treated PEs as easy conduits for job creation and a convenient vehicle for patronage distribution), inflation and rising current account deficits of the 1980s, exposed serious “government failures” and the limits of PEs as major players in economic development. In addition to management deficits many PEs also suffered from technological shortcomings. Imported through either foreign aid or soft loans from abroad, many of the PEs were either equipped with low or second grade machineries contributing to low capital/output ratio, or were established without due regard to their economic and financial sustainability<sup>1</sup>.

### *Divestments*

As a result of these failures, large-scale privatization of PEs were undertaken in the 80s and 90s, with the vital support (if not inducement) of multilateral financial institutions. The collapse of the Soviet Union also removed ideological and political barriers that hindered capitalist/market-oriented reforms, triggering a movement towards divestitures, marketization and privatization.

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<sup>1</sup> In the Philippines, a nuclear power plant constructed at a cost of approximately \$2 billion during the mid-eighties did not produce a single KW of power, mainly due to sub-standard technological infrastructure acquired at inflated prices – a clear effect of corruption.

Privatization activities peaked in developing countries in 1997 and began to drop off in the late 1990s; though it still remains at a low level overall, the level of privatization is once again slowly creeping up. As a result of two decades of divestiture, states have significantly reduced their direct participation in vital sectors of the economy. These disinvestments incorporated thousands of PEs worldwide with a net worth of US \$850 billion. In developing countries, revenues earned through divestiture totaled US \$250 billion, of which 49% came from the infrastructure sector, 19% from the primary sector, 16% from manufacturing and 12% from financial services. These sectoral distributions of divestitures also reveal the relative preferences of private sector investments.

About 55% of the proceeds were generated in Latin America and the Caribbean, 21% in Eastern Europe and Central Asia, 14% in East-Asia, 4% in South Asia, 3% in the Middle East and North Africa and 3% in Sub-Saharan Africa. Again this distribution highlighted the comparative order of privatizations among nations – Latin America and the Caribbean being the most privatized, Sub-Sahara being the least. Overall, PE's share of value added on GDP decreased by 15%<sup>2</sup>.

### *Current State of Public Enterprises*

Although reduced significantly, PEs continue to have a major presence in many national economies. In high-income countries, PE's share of GDP and investment constitute 8%, and 13% respectively. For middle-income countries the corresponding shares are 9% and 17%, while in the so-called Least Developed Countries (LDCs)<sup>3</sup> they are 14% and 28%<sup>4</sup>. PE's also constitute an important source of government revenue in many developing countries (China: 7%, Thailand: 7%, Turkey: 6%) and regions such as North Africa (Algeria: 60%, Egypt: 12%, Morocco: 4%, Tunisia: 7%), the Middle East (Jordan: 14%, Lebanon: 17%, Syria: 24%) and Eastern Europe (Czech Republic: 2%, Hungary: 3%, Poland: 4%, Slovakia: 5%, Slovenia: 3%).<sup>5</sup> In terms of employment, PEs employ 34.3% of the total workforce in Ghana, 25.1% in Gabon, 12.2% in Sri Lanka, 8.1% in India, 7.7% in Kenya and 7.4% in China<sup>6</sup>.

<sup>2</sup> Global Development Finance 2001, The World Bank.

<sup>3</sup> Sheram, K. and Soubotina, T., Public and Public Enterprise: Finding the Right Mix, in Beyond Economic Growth, The World Bank, 2000.

<sup>4</sup> While in high-income countries SOE shares are smaller, when it comes to central government expenditure the situation changes significantly: the share of GDP reached 46.6% in France, 32.9% in Germany and 21.1% in the US, compared to 14.4% in India, 8.1% in China, 29.9% in Turkey and 21.6% in Chile.

<sup>5</sup> ANIMA – Euro-Mediterranean Network of Investment Promotion Agencies; Data refer to the most recent year available during the period specified. Share of government revenues from public enterprises includes mostly revenues from property and tax payments as a percentage of total revenue.

<sup>6</sup> Note about the data: most of it from World Bank's database organized for the research report "Bureaucrats in Business" and included in the 1999 edition of the World Development Indicators. Data missing for many countries and not up to date.

The question arises with regards to what role, if any, PEs (given their significant economic presence) can play in achieving the Millennium Development Goals (MDGs), particularly in LDCs. Should PEs incorporate commercially-oriented enterprises or should they be limited to producing public goods requisite for the satisfaction of societal needs? An answer to this question calls for an assessment of general outlook on trends in private investments, particularly in FDI:

- (i) Between 1990-2003, apart from Brazil and China, most countries experienced a reduction in Foreign Direct Investment (FDI) as a share of GDP
- (ii) FDI tends to lean towards affluent nations that are considered to be stable, both politically and economically
- (iii) FDI tends to shy away from the social sector
- (iv) Countries that receive more FDI also tend to have higher GDP per capita; however, some countries with high FDI also have high Gini Indices (Brazil: 59; China: 45; Malaysia: 49; Nigeria: 51), underscoring in some way, a correlation between increased FDI and inequality.
- (v) Conversely (though not conclusively) it can also be inferred that countries where SOE's play a relatively minor role, tend to have greater inequality given higher Gini Indices (Brazil, Nigeria, Malaysia, South Africa etc.)
- (vi) With regards to capital formation, intense privatization & private sector development from 1999-2003 resulted in mixed outcomes. Countries where PEs played a prominent role achieved higher capital formation (Bangladesh, China & India) compared to countries where PEs played a comparatively smaller role (Brazil and Kenya).
- (vii) During the same period, Industry Sector Value Added (ISVA) as a percentage of GDP experienced mixed results; most countries recorded gains (China, Malaysia and Nigeria gained significantly) with the notable exception of Brazil where ISVA was low.
- (viii) Furthermore, countries with increased FDI as a share of GDP also experienced gains in Service Sector Value Added, which lead to the benefits of foreign investment being shared unequally.

A number of lessons emerge from this scenario: countries that pursued privatization within a strategic policy framework for investment gained more from privatization compared to countries that approached it haphazardly and consequently only had partial or no gains. Secondly, countries that retained a significant proportion of their SOEs gained in a more balanced manner. Finally, with regards to infrastructure development, countries gained positively when they combined privatization with appropriate market structures, regulatory frameworks and sound contract design.

### **Public Enterprise and the Millennium Development Goals (MDGs)**

Measured in the medium term by the MDGs, poverty reduction as well as timely, quality public service delivery are essential to the United Nations development agenda. Suitable strategies accompanied by appropriate institutional options are vital to the achievement of MDGs. While the intent of this publication is not to establish a hard and fast definition for Public Enterprise, for the purpose of facilitating an understanding of the concept, Public Enterprise can be considered as an organization established by the government under public or private law, as a legal personality which is autonomous or semi-autonomous, produces/provides goods and services on a full or partial self-financing basis, and in which the government or a public body/agency participates by way of having shares or representation in its decision-making structure.<sup>7</sup>

Although there is no acceptable definition of the role of PE in the governmental agenda, there is support for the view that PEs have an important role to play in achieving socio-economic growth. While governments have adopted numerous strategies to promote the transfer of activities from the public to the private sector, there is a widely held belief that essential basic services like health, education, water, electricity and transportation should remain as public enterprises. Rondinelli<sup>8</sup> states that the distinction between “public enterprise” and “public service” is being blurred and gives the example of the state providing services and then recovering the cost and often making profits through user charges – something that can also be done by the private sector. However, Dandelot<sup>9</sup> makes the important distinction that the social benefit of having the state provide a particular service is that the state theoretically reinvests profits for the benefits of the citizenry while the private sector distributes the profits for the benefits of its shareholders. Additionally, there is a prevailing argument that retaining vital services as public entities guarantees the masses equitable and efficient provision of social services. Given that seven of the MDGs address social issues, this argument bodes well for the role of public enterprises in their implementation.

However, efficient and effective management of public enterprise remains one of the key concerns of development management. Public enterprises that tend to function either in monopolistic or in near monopolistic conditions are often not subjected to the market signals to enable assessment of the quality and relevancy of the goods and services produced, requiring a very different set of management tools and feedback mechanism for

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<sup>7</sup> Kauzya John-Mary, *The Question of the Public Enterprise and Africa's Development Challenge: a Governance and Leadership Perspective*

<sup>8</sup> Rondinelli, Dennis. *Discussions from EGM on “Re-inventing Public Enterprise and its Management”*

<sup>9</sup> Dandelot, M. *Discussions from EGM on “Re-inventing Public Enterprise and Their Management”*

performance monitoring. Geopolitics also places PE in a category of its own given that its domain of influence extends well beyond the national economy to preservation of the nation state itself. For example, PE played a pivotal role in the unification of post-colonial African and Asian states and in the reconstruction of war-torn European states in the post World War II period. Additionally, PEs are entrusted with governing strategic national resources, whose control by private vested interests, particularly foreign, can greatly jeopardize the sovereignty of the nation state. Consequently the aforementioned circumstances necessitates that PE cannot be judged by its commercial viability alone - i.e. PE has a purpose that precedes simple profit maximization – the bottom line in measuring the performance of private enterprises. Hence, the challenge is to look for non-market tools that can provide for a semblance of cost efficiency and guarantee transparency and accountability in the management of PEs.

In situations where the public sector acts less as the provider and more as a partner in the provision of services, challenges unique to public/private partnerships arise at three levels: (i) the choice regarding types of partnerships (joint ventures; ‘purchaser/ producer’ equation etc.); (ii) the regulatory arrangements for private sector development; and (iii) impact based partnerships,<sup>10</sup>etc. Regardless of whether these partnerships are seen as public enterprises or as quasi public sector initiatives, the key elements that must guide all partnerships are cost efficiency, sustainability and equity in the delivery of the services. However it is also argued that public enterprise (given its nature and role) is intrinsically a part of the governmental agenda and cannot be seen as a partner.

In summary, the integration of the national economy in the global market has led to the privatization of public operations, leading to a reduction in direct state participation in traditional commercial and public service activities. Nevertheless, despite more than 15 years of privatization, government ownership is still prevalent in a number of regions and countries, particularly in certain basic sectors in virtually every country, given that neither the private sector nor the market can respond fully to the challenges of development, especially equitable development. Furthermore, resource conditions, the operating environment and the size of the market all have important bearings on the size of the private sector. Consequently there is a heavy reliance on the public enterprise in countries where the aforementioned factors are lacking. Even in countries where the contribution of public enterprise is relatively lower than the private sector, the strategic importance of PEs to the national economy is still quite significant.

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<sup>10</sup> Impact based partnerships refer to those partnering arrangements that contribute directly to social development accomplishments.

# Reinventing Public Enterprises and Their Management as the Engine of Development and Growth

Prahlad K. Basu

## Introduction

The role of State on the lives of people is a universal phenomena in both capitalist as well as socialist economies of the world. The subject of State intervention has thus been an issue of continuous debate over the years in different socio-economic milieu. The State assumed greater economic role in certain periods of time, followed by the doctrine of “Laissez-faire”. The Industrial Revolutions in the 18<sup>th</sup> and 19<sup>th</sup> centuries in the West and the colonial rule in a number of Asian and African countries led to massive societal imbalances in the world. Concentration of economic power and intense poverty among the vast millions of people compelled the State to step in a big way in the first half of the 20<sup>th</sup> century.

Two world wars – 1914 – 18 and 1939 – 45 led to intensification of the role of State over the economic processes. Europe, especially UK turned to Socialist ideas, which advocated the philosophy of Welfare State in health, education and infrastructure sectors with State-ownership of the means of production in the public utilities during the first half of the 20<sup>th</sup> century. Even in USA, Tennessee Valley Authority in the last century and the role of NASA and ARPA with the creation of information highway in the 21<sup>st</sup> century are also examples of the role of the State. The recent initiative in USA to convert the several thousand employees in the airports within the ambit of the State is a recent example of this trend. Similarly in the UK the total public sector employment during 2004 increased by over 200,000 as stated by Prime Minister Tony Blair with pride on the floor of the British Parliament not so long ago.

A wide and vast application of the instrumentality of State was designed to correct the economic and social imbalance through investment, production, trade, distribution and consumption. Further, the role of State underwent change in the second half of the 20<sup>th</sup> century led by the UK and followed by other nations. Dismantling of the State’s role in industrial activity in the erstwhile Soviet Union and East-European nations brought about on the other hand a sea change in the concept of Public Sector i.e. State ownership.

The prevailing opinion in early 1980’s in many countries was that the State-owned Enterprises had become a drain on national economy.

Privatization emerged as a significant element of the economic reform process. The major objective was reduction of fiscal deficits, subsidies and costs of debt servicing. At the same time, the interest of workers was sought to be protected through safety nets.

Another development which emerged over the last two decades or so, is the Public-Private Partnership in the economic developmental process. Even in India, the policy is under active consideration with proposed Public-Private partnership projects in Roads, Ports, Airports and Railways. Indian Government's ambitious plans to fund infrastructure projects is expected to take shape in the coming weeks with Prime Minister's Committee on Infrastructure – deciding to lend \$ 2 billion special purpose vehicle to focus on Public-private partnership projects <sup>11</sup>. With this backdrop, a new definition of the Public Sector with its various models adopted in different countries and a vast gamut of issues thrown up by the philosophy and practice once again need to be considered and discussed.

### CONCEPTUAL ISSUES

The term "Public Sector" is understood to mean different things to different people in different countries. In its widest interpretation the Public Sector encompasses all activities of Government. An understanding of the distinction between "Public Sector" which is a very compendious term and Public Enterprise (PE) which is otherwise called Government Controlled Enterprise (GCE) <sup>12</sup> or "State Owned Enterprise (SOE)" <sup>13</sup> would be instructive.

With a vast range of activities extending to diverse fields, a working definition is desirable for a meaningful interpretation. In this endeavor, the definition adopted by one of the ICPE<sup>14</sup> Expert Groups provides some guidance. It covers "Any commercial, financial, industrial, agricultural or promotional undertaking – owned by public authority, either wholly or through majority share holding – which is engaged in the sale of goods and services and whose affairs are capable of being recorded in balance sheets and profit and loss accounts. Such undertakings may have diverse legal and corporate forms, such as departmental undertakings, public corporations, statutory agencies, established by Acts of Parliament or Joint Stock Companies registered under the Company Law". Basic to the adoption of this definition is the concept of an expected economic or social return on investment.

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<sup>11</sup> Reported in the Economics Times, New Delhi, 6 October 2995

<sup>12</sup> Renalto Mazzoline, "Government Controlled Enterprises" in International Strategic and Policy Decision," John Wiley & Sons.

<sup>13</sup> Mary M. Shirley "Managing State-Owned Enterprises" World Bank Staff Paper No. 577.

<sup>14</sup> International Centre of Public Enterprises at Ljubljana set up under the guidance of UN with participating Member Governments which included India.

In the evolutionary process, Public Sector has taken distinct forms, each with its own status and varying degrees of autonomy. There are three distinct forms:

- (i) Departmental undertaking
- (ii) Statutory Corporation, and
- (iii) Joint Stock Company with shares owned by State

The departmental form is the oldest and traditionally used for undertaking certain activities, e.g. the Post Offices, the Ordnance Factories, the Railways including its workshops as well as establishments under Atomic Energy, Space, etc. in the Indian context. Government control is total in respect of this category of PSUs and they form an integral part of budgetary process of the department concerned. The managers of these Departmental undertaking like the Railways in India are run by civil servants with high professional reputation.

Statutory form of undertaking does have more operating flexibility required for a commercial venture, but as a creature of an act of Parliament, any amendment or modification to the provisions contained in the Act require approval of Parliament, which is time consuming. This form in the Indian context included Damodar Valley Corporation, Food Corporation of India, Life Insurance Corporation of India, Central Warehousing Corporation, etc. One could say that organizationally this form holds a middle stage.

The third type is the Joint Stock Company form which provides greater flexibility and is created by an executive decision of Government which owns the shares issued without any specific approval of Parliament. The largest number of PEs belongs to this category in India.

In the formative years of Public Enterprises system in India, distinctions between “Corporation” and “Companies”, executive Ministries (such as Railways), “Commissions” and “Valley Authorities” had been belaboured and strained. The distinction between statutory Corporation and Company has validity in Indian law, but the distinction is a technical one and not fundamentally significant <sup>15</sup>.

## THE THEORY OF PUBLIC ENTERPRISES (PEs)

In any economy, there are four types of economic activity: first, those which are privately remunerative – provided by market through Directly Productive Investments (DPI); secondly, those which are socially profitable but not privately remunerative – provided by State, like road building, irrigation, through Social Overhead Capital (SOC); and third, those which are privately

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<sup>15</sup> Paul Appleby Consultant of Government’s Industrial and Commercial Enterprises, Government of India, Cabinet Secretariat, O&M Division, 1956

remunerative but not capable of private execution, like heavy industry, high technology involving capital intensive investments like power, transportation, etc – also provided by the State with/without the help of the market; and fourth, those which are natural monopolies. PEs are set up to undertake the second, third and fourth category of activity. The third category of activity can be transferred to the private sector when the capitalist development in these countries attain sufficient maturity to enable them to handle capital intensive investment where private sector development takes place along with financial sector restructuring. That State intervention through economic planning and PEs can help countries to catch up decades of poor growth and slow development is also borne out by experiences in India, Mexico, South Korea, Brazil and China. Ideological and strategic economic and social considerations provided the genesis of growth and development of Public Sector in several of these countries.

In the Indian context the forms of PEs included (1) Statutory Corporation where PEs are formed under Acts of Parliament like (2) Holding Companies (a set of companies in one type of activity bound together e.g. Coal India, Bharat Bhari Udyog Nigam etc.), (3) Departmental Enterprises like the massive Indian Railways as well as ISSRO in the Department of Space, the Atomic Energy Department establishments – not forgetting the huge Indian Posts & Telegraphs Department (4) other forms like Public Limited Companies. That this is a critical pre-condition for PE management success is also evident from the Japanese experience where PEs are formed in several different categories like Kosha, Gengo, YO, Kokyo Hojin, Kodan, Jigyodan, Kinko, Koko, Eidan, Tokushu, Kaisha & Koshi Kongo Kigyo.

### **WHY PUBLIC ENTERPRISES?**

That the role of the State has increased manifold<sup>16</sup> in the advanced countries is also evident from (i) the percentage of government expenditure in the GDP in those countries as well as (ii) increasing levels of tax collection by their governments as percentage of their GDP. Thus government's expenditure exceeded 40% of GDP in Austria, Belgium, Canada, France, Germany, Italy, Netherlands, Norway, Spain, Sweden and Britain in 1996. Similarly the ratio of the tax revenue to GDP exceeded 40% in several OECD countries including Sweden, Denmark, Finland, Belgium, France, Austria, Italy, Norway, Greece, Germany, Britain and Canada in 2000. There is an overall realization on Galbraith's conclusion<sup>17</sup> that affluent societies must strike a social balance between the production of private goods and the provision of public amenities. That such a balance is difficult if not impossible to achieve in a country like India is evident from the extremely low level of tax to

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<sup>16</sup> IMF reproduced in the Economist 17 September 1997.

<sup>17</sup> Galbraith, "The Affluent Society" 1968

GDP ratio which still ranges below 10%. The link between public finance and public enterprise is therefore extremely important. The short-sighted approaches of several developing countries including India to reduce fiscal deficit by selling public enterprises- which follow from inadequacies of public finance management – could be disastrous in the long run.

### Issues of Governance and Management in Public Enterprises

The composition of boards of PEs is an important issue. In China's CNOOC, Chief Executive Officer (CEO) Fu Chengyu has two foreigners in his Board from Shell and Goldman Sachs who recently last July 2005 played an important role in preparing CNOOC's bid for US Company Unocol against Chevron. In Indian PEs like ONGC (which is the counterpart of CNOOC), the question of inducting foreigners in the Board has so far been unheard of.

The French system of "contrat du programme" combined with "a posteriori" control replacing "a priori" control prevalent in most developing countries is also an important institution. In the Indian context the system of MOU has not made much impact owing to continued "a priori" control of the Government over PEs. The option of preparing Department-wise "Performance Aims and Financial Targets" documents attempted in the Ministry of Steel & Mines in late 1980 with its impact on PE performance should be looked at again. Clear guidelines for investment policy and price policy of PEs<sup>18</sup> can also clarify the PEs role. Wrong investment decisions taken by Government led to enormous delays in project management. In 1987, a Committee under the Chairmanship of Ratan Tata recommended that Public Investment Board, Project Appraisal Division, Plan Finance Division and associated agencies should be merged in a Financial Institution so that there is appropriate accountability for implementation of their decision. This recommendation is yet to be considered by the Indian Government. This needs urgent consideration.

Whether some selected PEs should be placed under Management Contract or Lease or Joint Venture should also be examined – as options of non-divestiture led privatization is also an important issue. The need to institutionalize the "partnership" between the Government and the PE without diluting their accountability in the running of PEs is an equally important issue in efficient running of PEs. China's SASAC and Singapore's Temasak and Malaysia's Khazana are interesting institutions which could throw new light against the increasingly dysfunctional Indian system of a whole lot of

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<sup>18</sup> Basu P. K. and Nove, Alec "Public Enterprise Policy on Investment, Pricing and Return": City Press Kuala Lumpur, 1979 and Basu P. K. "Performance Evaluation for Performance Improvement: An Essay on Strategic Management 'Of PEs in India" Allied Publisher 1991, Boycko, Shleifer and Vishny:" A Theory of Privatization" Economic Journal, March 1996

supervising Ministries numbering 38 today – which oversee 240 PEs under Central Government without accountability for their under performance.

### *Synergy between the State and the Market*

It should also be emphasized that Public Enterprises are generally established with two distinct strategies – take over or nationalization of the existing activity in the private sector as well as creation of new activity in the public sector through investments which are entrepreneurial in nature. Public Enterprises created by the newly independent countries as the visible hand of the State through the post-independence “planning” machinery in the “mixed” economy like the PEs in India belong to the second category. Unfortunately, the setting up of these Public Enterprises in these economies in order to ameliorate the problem of “market failure” brought in “government failure” in many countries with its impact on the “managerial failure” and deficiencies in PE management. This “vicious circle” which has since been broken in several countries with improved “management”, as well as “control” of the State replaced by “partnership” between the State and the PEs - once again needs urgent attention. The issue today is no longer “Rivalry” between the State and the Market but how to achieve “Synergy” which eluded the grasp of several developing countries. The assumption that State has no role in economic activity and the Markets do not fail - have both proved to be incorrect.

Several PEs today continue to run efficiently in France, Japan, Germany, Italy, Australia, South Korea, China, Malaysia, Philippines, Indonesia, Sri Lanka, India as well as in Africa and Latin America. The paradigm of “Synergy” between State and Market achieved by China where they have opened up their economy for the private enterprises without privatizing their PEs – can even be revolutionized if we can consciously bring in the new regime of Government – Industry (both PE and private enterprise) partnerships as well as introduce Public – Private Competition to ensure (i) not only the PEs run well with the active involvement and leadership of their governments (ii) but also that Private Enterprises run well with the new norms of corporate governance. Both PEs and private enterprises could thereby achieve “Efficiency” and “Welfare”. It is pertinent to mention that the US Congress not only passed the legislation of “Government Performance and Results Act, 1993” applicable to all civil servants of the State but also “Sarbanes Oxley Act of 2002” applicable to all private enterprises in the country. It is equally pertinent to mention that China’s “State Asset Supervision & Administration Commission” (SASAC) has replaced the dysfunctional role of several scores of Administrative Ministries/ Departments in the Chinese Government, even though the Administrative Ministries continue to play their dysfunctional role of control and fiefdom without sharing either accountability or responsibility for PE performance in several countries, including India.

## STATE OWNED ENTERPRISE MODELS

Temasek, Singapore<sup>19</sup> – one of the largest State investment agency owned by the State of Singapore; Baosteel, China<sup>20</sup> – one of the largest steel producing company in the world owned by the State of China (PRC); EdF, France<sup>21</sup> – one of the largest power generating- cum-distributing company in France owned by the State – which is also one of the largest power generating companies in the world; NTT<sup>22</sup> NTT Do Como and NTT Data – one of the largest group in communication industry owned by the State of Japan – NTT alone had until recently occupied fourth position in the League table of global companies; ENI Italy<sup>23</sup> – one of the largest energy groups in the world, owned by the State of Italy; also Oil & Natural Gas Corporation of India<sup>24</sup> which figures as the largest Indian company in FT 500, which is also owned by the State. These are not the only examples of State Owned Enterprises (SOEs) which are also called the Public Enterprises – which are managing huge operations with great efficiency in various developed and developing countries of the world. Volkswagen in Germany, Pohang Steel in South Korea, Pertamina in Indonesia, Khazana in Malaysia – we can go on adding similar PEs in other countries to the list. Indeed, we should not be misled into thinking that it will be a retrograde step to once again have a close look at the PEs of the world and ensure that they follow the guiding light of “excellence” still burning bright in countries like Japan, France, Italy, China, Singapore. Even in India where several PEs are rightly under attack for their less than satisfactory performance – some of the largest and best run corporate enterprises like ONGC, Indian Oil, National Aluminum, Steel Authority of India, etc. are SOEs.

The “drama” of Development in the last few decades after the end of the Second World War, unfolded powerful scenes of both “rivalry”, “synergy” as well as “control-cum-freedom” syndrome in the role of State and Market in different parts of both capitalist and socialist economies. Adam Smith’s “Invisible Hand of the Market Forces” was clearly flawed in several of its invalid assumptions like perfect competition on the demand as well as on

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<sup>19</sup> The Economist, 14 August 2004

<sup>20</sup> Like Temasek’s CEO, Ms Ho Ching – Baosteel’s CEO is also an impressive woman of China

<sup>21</sup> French PEs are classified into Listed and Unlisted Stakes. EdF is unlisted stake as not a single share has been sold by the State, like SNCF, GDF, Snecma etc. See P. K. Basu’s “Disinvestment: Recent Experience in Britain, France, India” London, October 2003.

<sup>22</sup> FT Global 500, Financial Times Special Report, London 27 May 200 Government holding of shares in NTT was 65.5% in 2000.

<sup>23</sup> Interview with ENI’s Franco Barnabe in Harvard Business Review, July-August 1998

<sup>24</sup> Op.cit FTGlobal 500 27/5/2004

the supply side with perfect market information and absence of indivisible factors of production and economies of scale; In post-Marxian, post-Soviet and post-Keynesian decades, therefore, the “State” intervened to correct the “market failures”. The “market failure” syndrome including absence of markets was also written largely in developing countries even before they gained their independence from the colonial “State” as the so-called free markets did not provide any engine for growth or development in these countries.

### **HOW TO PRIVATISE PUBLIC ENTERPRISES EFFICIENTLY WHEN CONSIDERED NECESSARY?**

A balanced agenda of PE reform as well as privatization or Divestiture <sup>25</sup> can be presented in the flow diagram in the following page. Backward and forward linkages are critical to any successful privatization.

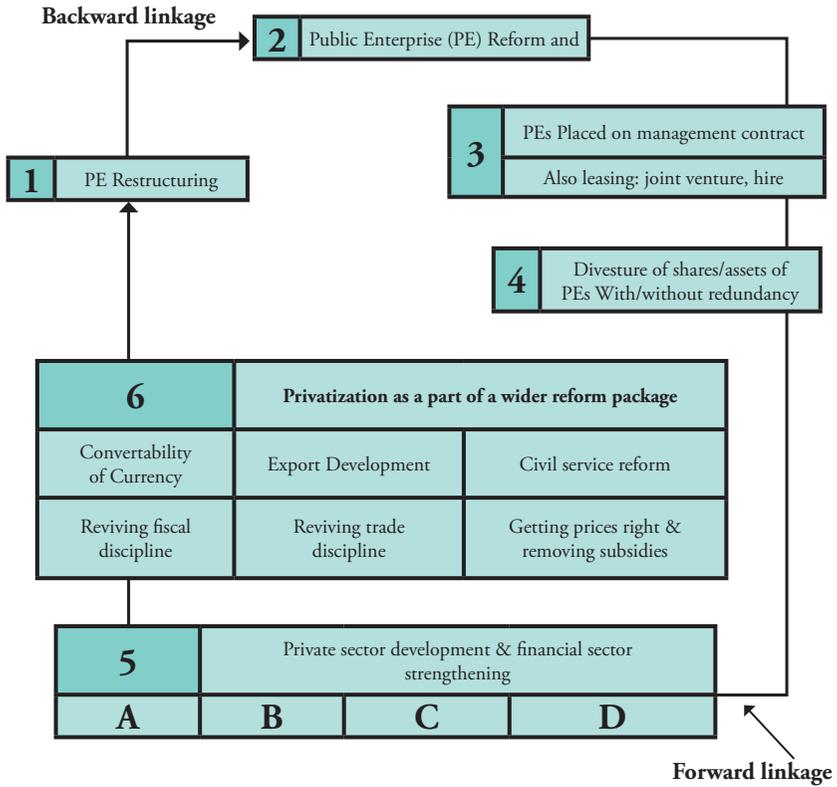
Inability to undertake investment for renewal and repair of rail track by the privatized British Rail led to their re-nationalization in UK during the last one and half years (2004-05). This is a reminder of what can go wrong despite the overall success of British privatization. The experience of France <sup>26</sup> though quite different from that in Britain also had its own lessons. While cash may be welcome to be raised through privatization, the French will not exchange the cash for “control” which must continue with the government. The French always maintained this attitude towards the role of government which can be expressed in their saying - it is better to be “French and inefficient” rather than “foreign and efficient”. This goes back to the influence of Colbertism in France. Similarly, the paradigm of Government-Industry partnership in Japan cannot be easily traded for privatization of ownership of Japanese PEs. In Japan, “privatization often conveys commercialization of departmental PEs into joint stock companies with shares owned by the State. There are other models which have their own lessons. Big bang hasty and wrong privatization and divestiture led to destruction of the economy of Russia where the economy suffered from negative growth rate throughout the decade of 1990-2000. Slow and steady opening up of the economy in China introducing competition and tremendous vigor without divestiture of PEs is another equally impressive model.

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<sup>25</sup> Basu, P.K :Demystifying Privatization in Developing Countries, International Journal on Public Sector Management, Bradford, U.K. 1994.

<sup>26</sup> Op-cit. “Disinvestment Experience in U.K, France and India: London, October 2003

**Figure 1 Linkages: Privatization Agenda with Backward/Forward Linkages**



## HOW TO RUN PUBLIC ENTERPRISES WELL?

In order to attack “market failure” - Public Enterprises must after they set up, avoid “government failures” as well as consequent “managerial failure” in their operation. Managerial failure invariably follows from inability of governments to adopt sound policies on investment, prices, financing, as well as on new projects which are invariably delayed and several other areas affecting the management of PEs. Inability of governments to build effective and efficient managerial cadres for the PEs and provide the managerial cadres with necessary autonomy to run PEs with efficiency and welfare also result in managerial failures. In earlier stages of PE development it was felt necessary to delink the impact of managerial decision making by governments as policy-makers – but governments continue to enjoy over-riding strategic powers of appointing the PE Board, fixing their terms and remuneration, deciding on all new investments and expansion, fixing prices, approving contracts and purchases – besides policy on location, employment etc. without co-sharing either the corporate risk of managing the PEs or being accountable for PE performance. The experience of countries like Japan and France shows that the governments and PEs can and do operate as “partners” in development and not as “adversaries” unable to share both “success” and “failure”. The checklist of issues to ensure <sup>27</sup> that PEs run efficiently with its accountability to the public as well as to the governments which are their owners would also include several issues, like:

- (i) The pattern of ownership and management of Public Enterprises which vary from country to country. Management is an extension of the ownership pattern. Given a corporate form, Public Enterprises is managed by a Board of Directors. Ownership provides the authority to Government.
- (ii) Building Managerial Cadres for the PEs which could be inside the Civil Services, like the Central Administrative Pool and the Industrial Management Pool of India as successor to the Commerce Finance Pool in the ICS as well as professional civil services in the Indian Railways, Ordnance Factories, Atomic Energy and Space Organizations, etc as well as Career Executive Service in Philippines/Iran and related institutions like the ENA of France which throws up some of the brightest leaders of French PEs. Alternatively, PE based management cadres can also be established like Tata Administrative Service in the Tata Group of Companies in India. Induction of appropriate managerial remuneration which should relate to remuneration in the private sector is also an urgent issue that needs to be addressed.

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<sup>27</sup> Op-cit. Basu and Nove.

The Government – PE relationship should not be either “Control” or “Fiefdom” but “Partnership,” “Involvement” and “Accountability for results” with efficiency and welfare. PEs must implement and deliver the physical and financial results with growth, efficiency and welfare. In searching for new innovation for strengthening the efficiency and effectiveness of PE management – we can emphasize a “global partnership for development” which is also a Millennium Development Goal. The essential approach would be to ask three fundamental questions on this issue and to try and find an answer to each one of these questions, namely, (i) Why Public Enterprises even in capitalist economy? (ii) How to run Public Enterprises well by appropriately empowering the managers so that the enterprises achieve both efficiency and welfare? (iii) If it is decided to privatize selected Public Enterprises, how do we privatize them, and again with efficiency?

# Can Public Enterprises Contribute to Development? A Critical Assessment and Alternatives for Management Improvement

Dennis A. Rondinelli

## Introduction

Public enterprises were created in most countries to accelerate economic and social development. Yet, increasing evidence indicates that most public enterprises either do not contribute strongly to development or perform their public service functions ineffectively or inefficiently. Policy makers engage in continuing debates over whether or not state-owned corporations contribute to economic and social development, why so many have failed to deliver effectively the services for which they were created, and how their management can be improved. These issues will become more crucial as governments in developing and emerging market countries consider how best to achieve economic and social development in an age of globalization, how to spread more widely the benefits and mitigate the potential negative impacts of international economic interaction, and how to alleviate poverty so that larger numbers of people can participate effectively in productive activities and gain access to social services essential for human development.

In this paper, I define state enterprises much as the World Bank does: as government-owned or controlled commercial entities that generate all or most of their revenues from the sale of goods and services.<sup>28</sup> As does the World Bank, I exclude from discussion those government organizations that provide goods and services through general revenues. The distinction between those goods and services provided by what are essentially commercial enterprises owned or controlled by government and those provided by ministries and agencies through general revenues is important in focusing the discussion on the appropriateness and efficacy of one specific type of organization -- a legally created commercial entity generally known as a public enterprise, state-owned enterprise, or parastatal organization. The distinction also highlights the option that all governments have in seeking to achieve the Millennium Development Goals: whether to provide goods and services essential to people's social and economic well-being through conventional ministries and agencies, through state-owned enterprises, or through other types of organizations.

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<sup>28</sup> World Bank, *Bureaucrats in Business: The Economics and Politics of Government Ownership*, New York: Oxford University Press, 1995

Over the past 50 years governments around the world established large numbers of public enterprises to accomplish development objectives, among the most important of which were to provide services and infrastructure that could not easily be extended by conventional departments and agencies of the State or by a weak or fledgling private sector. In many countries, however, state-owned enterprises took on a life of their own. Many pursued their objectives independently of government development policy or failed to perform efficiently and effectively functions for which they were created. In other countries, political intervention and strenuous government control inhibited public enterprises from fulfilling their intended missions. Although public enterprises in some countries are managed effectively and do provide services that are needed for development, too many merely become another bureaucracy plagued by inefficiency, ineffectiveness, corruption, and incompetence, draining resources from the public treasury.

Recognizing their ineffectiveness, governments have been restructuring or liquidating public enterprises since the early 1980s. Many state-owned enterprises have been commercialized, corporatized, or privatized. Some governments require them to compete with private providers, forge partnerships with private businesses and non-government organizations, or outsource functions to the private sector.

Although many enterprises remain in public ownership, their rationale, purposes, and effectiveness continue to be questioned. Governments seeking to meet the Millennium Development Goals (MDGs) should be asking if there is a role for public enterprises in countries where the private sector has grown stronger, where market economies are established or emerging, and where development depends at least in part on providing services and infrastructure to larger numbers of people.

I will argue that in many developing countries, serious questions need to be asked about whether or not state-owned enterprises are the most effective instruments for economic and social development. SOEs are often perceived to be ineffective as instruments for development for a variety of reasons: because governments never infused them with strong developmental missions, because they used them for purposes that were not directly related to economic and social development, or because the inherent limitations of state ownership render public enterprises ineffective. I will also argue that governments should use as the primary justification for creating public enterprises, or for attempting to reform those that have a past history of poor performance, whether or not they have a strong probability in the future of achieving development objectives that are not and cannot be achieved more effectively by the private sector or by non-government organizations.

Moreover I contend, as much of the literature on public enterprises now shows, that the organization and structure of state-owned enterprises inherently create difficulties in providing developmentally-oriented services and facilities in many countries whether or not they have strong private business

or civil society sectors. Public enterprises face continuing risks of political interference, of cronyism and corruption in their governance and operation, and of an inability to generate adequate financial returns to either cover their costs or return a surplus to the government, all of which can divert them from fulfilling development objectives.

In an era of increasing globalization, emerging markets, and expanding private sectors, governments seeking to achieve the Millennium Development Goals must have a clear strategy for deciding which enterprises remain in public ownership and how they will contribute to achieving social and economic progress. The record of experience with public enterprise failures is now so strong that governments cannot merely assume that they will necessarily contribute to development. Although none of the alternatives to state ownership is a panacea for the problems of weak public enterprise management, under appropriate conditions they can sometimes overcome the continuing difficulties that plague many SOEs. When governments decide to keep them in state ownership, serious consideration must be given to the need for reforming their internal structures, governance, and operations in ways that assure that they can pursue clear development objectives.

## **THE PERFORMANCE PROBLEMS OF PUBLIC ENTERPRISES AS INSTRUMENTS OF DEVELOPMENT**

Any assessment of public enterprises as instruments of economic and social development must begin with a frank recognition of the problems encountered in their performance over the past of half century. In both economically advanced and developing countries, governments created public enterprises as revenue-generating ventures, to support an import-substitution development strategy, or to provide services or infrastructure that were considered to be essential to national, regional, or local development. In reality, however, many governments created public enterprises for reasons that were only tangential to development or that ineffectively contributed to it.

After the Second World War, governments in Europe and North America used public enterprises to develop economically lagging regions, to provide specialized services that were beyond the expertise or resources of traditional government agencies, or to protect industries that were considered essential to future economic growth. But a significant expansion of public enterprises also took place both in Western Europe and in the former Soviet Union and its satellite countries for political or ideological reasons. Many countries with socialist governments nationalized industrial and service enterprises and collectivized agriculture in order to centrally plan their economies and minimize or eliminate market influences.

In the post-colonial period of the 1950s and 1960s, governments in Africa, Asia, and Latin America sought rapid economic growth through industrialization strategies that required heavy investment in physical

infrastructure and production facilities. In many of the post-colonial developing countries the government expropriated foreign-owned companies and centralized control over natural resources, mining, mineral, and some manufacturing industries. And in their push to accelerate economic growth and consolidate political control, governments in many developing countries created new public enterprises rather than looking to the private sector for investment. The number of public enterprises also grew rapidly because the private sector was often viewed with suspicion by both political leaders and the public, especially in countries where colonial regimes previously ruled, or where major industries were owned by foreign companies, or where commercial activities were dominated by foreign or ethnic minorities. By the late 1970s, however, the contribution of public enterprises to economic and social development came into question when military or authoritarian civilian governments in some Latin American countries nationalized nearly all major industries in order to consolidate their political power and control over the economy and sometimes to extract public resources for private gain.<sup>29</sup> Moreover, the developmental orientation of public enterprises became more ambiguous as many African governments, pursuing the concept of “African Socialism,” took control of agricultural and agribusiness sectors as well as mining and natural resources industries that they lacked the expertise or financial capacity to manage effectively. Nationalization of production and service enterprises increased the already growing number of public employees in many developing countries and the public wage bill grew rapidly.<sup>30</sup>

Although not all of the growth in government employment took place in public enterprises, SOEs were often convenient organizations for locating surplus labor and providing a wide array of social benefits for workers. Directorships and senior managerial positions in public enterprises were often viewed as political patronage positions for retired military and high level civil servants or for relatives and friends of powerful political leaders. In Eastern Europe, the former Soviet Union, and many Asian countries, public enterprises hired large numbers of redundant employees to reduce social disaffection and to build political support. In Eastern Europe and in China, governments imposed strong social burdens on state industrial enterprises to hire redundant labor and provide social services while at the same time allowing them to operate with soft budget constraints, leading to inefficiency, low levels of productivity, and financial losses.<sup>31</sup>

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<sup>29</sup> See P.H. Boeker, “Latin America’s Economic Opening and the Rediscovery of Foreign Investment,” in P.H. Boeker (ed.), *Latin America’s Turnaround* (San Francisco, California, ICS Press, 1993), 3-12.

<sup>30</sup> World Bank, *World Development Report 1988*, Washington: World Bank, 1988

<sup>31</sup> X.Y. Dong and L. Putterman, “Soft Budget Constraints, Social Burdens and Labor Redundancy in China’s State Industry,” *Journal of Comparative Economics*, 31, 1 (2003): 110-133.

The developmental orientation of public enterprises was more seriously questioned with the growing economic and financial problems that accompanied worldwide recession in the late 1970s, the debt crises faced by many African and Latin American countries in its aftermath, the succession of politically conservative governments in North America and Europe during the 1980s, and the shift to market economies in Asia, Latin America, and Eastern Europe during the early 1990s, all of which focused attention on the failures of public enterprises to deliver services effectively, contribute financially to the national economy, or to promote social progress. These trends were reinforced in the 1980s and early 1990s by growing dissatisfaction with the way governments provided goods and services, especially to the poor; by political interference in the operation of public enterprises; by continuing charges of cronyism and corruption in some state-owned corporations; by the imposition of surplus employment requirements; and by their inefficient operation.<sup>32</sup>

By the end of the 1980s, widespread criticism of the performance of both national government ministries and public enterprises in providing goods and services and of the rising costs and ineffectiveness of government control of economic activities in general led political leaders in both Western and developing countries to reconsider their efficacy. Their inefficiencies were seen clearly in their limited abilities to satisfy the rapidly growing needs for commercial and social services that were becoming crucial for economic growth and for widespread participation in a globalizing economy. The investment decisions of government agencies were constrained by special laws and by central government planning criteria and procedures; they rarely considered the needs of communities or the preferences of consumers.<sup>33</sup>

Almost everywhere, government-owned telephone and telecommunications companies, for example, were notoriously ineffective in meeting demand for services that had become crucial to the participation of both small and large enterprises' in global trade and investment and for creating jobs that would help alleviate poverty and raise people's standards of living. During the 1980s and early 1990s, the average waiting period for telephone installation in Indonesia was nearly 8 years, in the Philippines 7 years, and in the former Soviet Union and in Pakistan 10 years. Call completion rates were extremely low in many developing countries because of the inability of public enterprises to invest in even basic telecommunications equipment and switching capacity. Completion rates for trunk calls were as low as 12 per -

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<sup>32</sup> Richard M. Kennedy and Leroy P. Jones, "Reforming State-Owned Enterprises: Lessons of International Experience, Especially for the Least Developed Countries," Working Paper 11, Vienna, Austria: United Nations Industrial Development Organization, 2003.

<sup>33</sup> Jin Ho Choi, "Republic of Korea Country Paper," in *Asian Development Bank, Urban Policy Issues*, (Manila: ADB, 1987): 477-527.

cent in Pakistan and for local calls as low as 31 per cent in Indonesia. Many of the state-owned telecommunications companies in developing countries lacked investment capital and financial resources for maintenance and line expansion, and were seriously over-staffed. The World Bank reports that state-owned telephone companies in developing countries had 50 to 100 employees per 1,000 telephone lines in service compared to 0.2 employees or fewer in the United States and Europe.<sup>34</sup>

The ineffectiveness of public enterprises to deliver basic services extended to other sectors as well. In Nigeria, for example, state ownership and the monopoly position of the National Electric Power Authority, an organization plagued by corruption, inefficiency, and mismanagement (conditions that characterized many of Nigeria's public enterprises) compounded rather than solved that country's continuing energy service delivery problems.<sup>35</sup>

Doubts about their ability to contribute to development increased with growing evidence that many public enterprises were loss-makers rather than revenue generators. Studies by the World Bank indicate that by the beginning of the 1980s, public enterprises in developing countries accounted for one-quarter to one-half of all outstanding domestic debt and for a substantial portion of foreign borrowing.<sup>36</sup> In Thailand, 61 public enterprises accounted for more than 60 per cent of the government's foreign debt in 1988.<sup>37</sup> About 40 per cent of Malaysia's external debt service payments in the late 1980s were made by non-financial public enterprises.<sup>38</sup> The heavy demands of many public enterprises for capital squeezed private investors out of capital markets in some countries, and in others limited the private sector's access to borrowing for investments that could generate jobs, income, and public revenues.

These limitations on the capacity of public enterprises to contribute to development continued into the 21<sup>st</sup> century. In Romania, for instance, the survival of loss-making public enterprises through direct and indirect state subsidies led in the late 1990s to pervasive networks of arrears throughout the economy and to negative impacts on the national budget and on overall economic efficiency.<sup>39</sup> In Turkey, the government's manipulation of the

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<sup>34</sup> W. Ambrose, P. Hennemeyer and J. Chapon, *Privatizing Telecommunications Systems*, Washington: World Bank, 1990.

<sup>35</sup> A. Alukoju, "Never Expect Power Always: Electricity consumers' Response to Monopoly, Corruption and Inefficient Services in Nigeria," *African Affairs* 103 (2004): 51-71.

<sup>36</sup> Mary M. Shirley, "Managing State-Owned Enterprises," *World Bank Staff Working Papers* No. 577, Washington: World Bank, 1983.

<sup>37</sup> Matthew Montagu-Pollack, "Privatization: What Went Wrong" *Asian Business*, (August 1990): 32-39.

<sup>38</sup> United Nations Economic Commission for Asia and the Pacific, "Issues in Privatization," *Development Planning Newsletter*, No. 9 (June 1989): 10-15.

<sup>39</sup> R. Ahrend and J.O. Martins "Creative Destruction or Destructive Perpetuation: The Role of Large State-Owned Enterprises and SMEs in Romania During Transition," *Post-Communist Economies*, 15, 3 (2003): 331-356.

prices of goods and services produced by public enterprises during periods prior to elections to reduce inflation and potential political backlash, placed both public and private service suppliers in unstable financial positions.<sup>40</sup>

The inability of public enterprises to contribute to development arose not only from their inefficiencies due to their monopoly or protected status but also because of lax governance and oversight. The checks-and-balances that come with private ownership -- that is, the pressures that shareholders and external directors can exert on managers to improve efficiency, that capital markets can exert on companies to allocate scarce resources economically and to operate within "hard budget" constraints, and that managers who are responsible to shareholders and outside directors can exert on workers to improve productivity -- are all usually missing from public enterprises. Where SOEs were too strongly controlled by the state they often became inflexible bureaucracies.<sup>41</sup> In the former Soviet Union, former socialist regimes in Poland, Hungary, and Czechoslovakia, authoritarian regimes in many Latin American countries, and in China and Vietnam most of large state enterprises were over-staffed and had obsolete technology and deteriorating facilities that made it difficult for them to compete effectively with Western multinational firms in global markets or to provide goods and services in adequate amounts and at reasonable prices in domestic markets.

In many countries ineffective public enterprises not only failed to contribute to development but siphoned-off resources that could have gone to development activities, thus creating significant opportunity costs in resource-scarce economies. The costs of continuing to subsidize unprofitable state enterprises took a heavy toll on the treasuries of even the largest countries. The government of China, for example, had to commit \$11 billion (17 per cent of the national budget) in direct subsidies and \$20 billion in loans to inefficient state enterprises in 1990. Despite these high subsidies the state-enterprise sector's industrial production grew by less than 3 per cent.<sup>42</sup> The highest rates of growth in the value of industrial output were in private enterprises (about 21 per cent) and joint ventures and foreign firms (56 per cent).<sup>43</sup> Recent studies of public enterprises in China found that, controlling for a variety of other factors, those provinces with a larger

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<sup>40</sup> H. Berument, "Public Sector Pricing Behavior and Inflation Risk Premium in Turkey," *Eastern European Economics*, 41, 1(2003): 68-78.

<sup>41</sup> Organization for Economic Cooperation and Development, *Reforming the Economies of Central and Eastern Europe*, Paris: OECD, 1992.

<sup>42</sup> David Shambaugh, "China in 1991: Living Cautiously," *Asian Survey*, Vol. XXXII, No. 1 (1992): 19-31.

<sup>43</sup> Erin McGuire Endean, "China's Foreign Commercial Relations," in U.S. Congress, Joint Economic Committee, *China's Economic Dilemmas in the 1990s*, (Washington, D.C.: U.S. Government Printing Office, 1991): 741-757.

proportion of state-owned enterprise industrial production have lower provincial economic growth rates.<sup>44</sup>

With the increasing globalization of economic interaction across national borders, many countries with large numbers of public enterprises found that they inhibited both national development and international integration. By the early 2000s, the government of Vietnam, for example, explicitly recognized that most state-owned enterprises no longer met development needs due to their small scale and irrational structure and their failure to focus on key areas of the economy.<sup>45</sup> The government reported that Vietnam's SOEs have "backward technology and weak management capacity with low levels of autonomy and accountability in business and production," weak management capacity, unclear objectives, weak accounting systems, and low levels of efficiency, rising overdue debts, and large numbers of underemployed and redundant employees.

An assessment of public enterprises in South Africa in 2000 pointed out that the establishment of SOEs skewed development aims and infrastructure and service delivery and that many of them have "unsustainable debt burdens, underinvestment in infrastructure and technology and unmanageable corporate structures." The report pointed out that by continued public ownership of these enterprises, South Africa "... risks not only failure to achieve its broader policy objectives, but also a severe depreciation in the value of these assets as the market discounts them owing to their present difficulties." The study emphasized that the "total effect would be continued failure to ensure rigorous and directed interventions for ensuring that socio-economic development takes root both in those areas most sorely affected by the past and in the areas of the new economy."<sup>46</sup>

## **POLICY ALTERNATIVES FOR IMPROVING THE MANAGEMENT OF PUBLIC ENTERPRISES**

For all of these reasons, governments should clearly determine the development contributions of public enterprises and rationalize their structure. Figure 1 suggests one approach to public enterprise reinvention in developing countries.

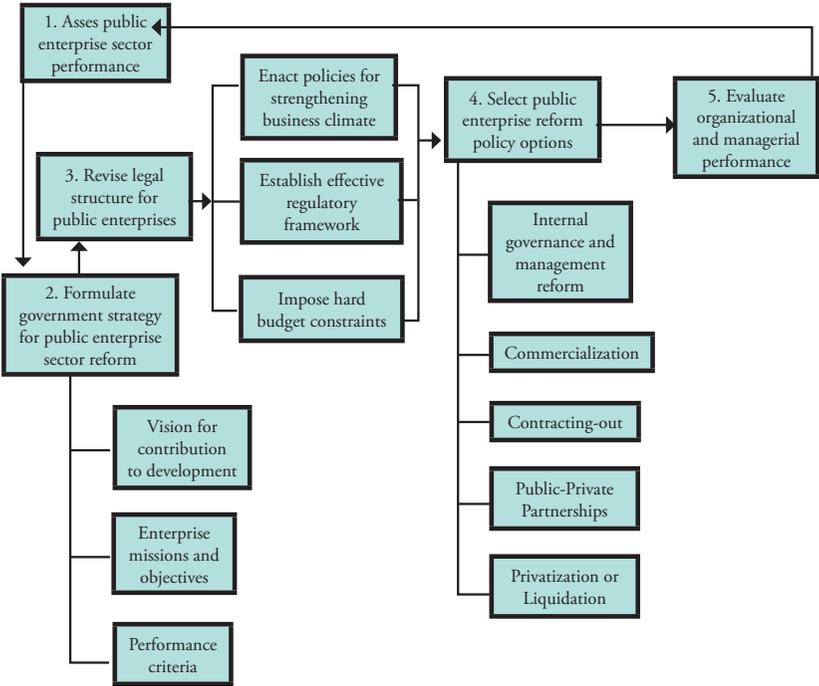
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<sup>44</sup> Kerk L. Phillips and Shen Kunrong, "What Effect does the Size of the State-Owned Sector Have on Regional Growth in China?" *Journal of Asian Economics*, 15, 6 (2005) 1079-1102.

<sup>45</sup> Tran Ngoc Phuong, "Reform of State Owned Enterprises in the Context of Vietnam's WTO Accession," paper presented at conference on Vietnam: Readiness for WTO Accession, Ho Chi Minh City, VN, June 2003.

<sup>46</sup> Republic of South Africa, Ministry of Public Enterprises, "An Accelerated Agenda towards the Restructuring of State Owned Enterprises: Policy Framework," (Hatfield, South Africa: Department of Public Enterprises, 2000): quote at p. 15.

**Figure 1: Framework for Assessing Public Enterprise Reform**



**Public Enterprise Reinvention Process**

Reinventing public enterprises in any country should begin with a comprehensive performance review and the formulation of a government strategy for reform. Governments are unlikely to be successful in restructuring public enterprises unless they develop a strategy that sets out a clear vision for how SOEs are expected to contribute to development and defines clear missions and performance criteria for each public enterprise.

In South Africa, for example, the government declared the goal of public enterprises would be to “contribute to sustainable economic and social development,” an objective that was “more likely to occur where there is a mixed economy, that is an economy that is responsive to market incentives within a framework of socially integrative institutional mechanisms.”<sup>47</sup> The

<sup>47</sup> Sivi Gounden, “Restructuring of State Owned Enterprises – A Critical Element of Economic Restructuring in South Africa,” speech delivered at Leadership Center, University of Kwazulu-Natal, South Africa, March 7, 2001.

vision for reform of South African public enterprises at the macro-economic level was to attract foreign direct investment, contribute to the reduction in public borrowing, and assist the development of an economy that promoting industrial competitiveness and growth and increased domestic savings. The South African government set social imperatives on public sector reform that included the need to increase employment and rationalize or develop new skills in the labor force as well as promote wider ownership and participation in the South African economy.

In any country seeking to reform public enterprises, strategy formulation should be preceded by an assessment of the performance of the public enterprise sector carried out by a government commission or agency that can identify SOE objectives, assets, and resources; assess their financial assets and liabilities; evaluate their performance in meeting their objectives; and demonstrate their contribution to economic and social development.

Governments undertaking public enterprise reform must often revise the legal framework to clarify the ownership relationships between the state and SOEs, impose internationally accepted accounting and financial reporting standards, and outline governance options. Public enterprise reform should proceed in conjunction with the enactment of policies that strengthen the business climate and competitiveness within the economy; the creation of effective regulatory frameworks and corporate laws that protect the rights of businesses, consumers, workers, and citizens; and that impose hard budget constraints on those enterprises that remain in state ownership. Whether public enterprises remain in state ownership, or are commercialized or privatized, governments must create a balanced regulatory framework to ensure that neither public nor private enterprises abuse their power. At the same time, however, governments should not make regulations so overly restrictive that they prevent enterprises from achieving their objectives efficiently.

Any reform strategy should assess the strengths, weaknesses and appropriateness of options for restructuring public enterprises. Among the potential policy alternatives open to governments are 1) internal management and governance reform; 2) commercialization or marketization; 3) outsourcing or contracting out; 4) public-private partnerships between SOEs and private companies or civil society organizations; and 5) privatization or liquidation. In pursuing any of these alternatives, governments retain important roles in creating conditions and adequate oversight to ensure that reforms work effectively and that they achieve development objectives.

#### *Internal Governance and Management Reforms*

Governments decide to keep poorly performing public enterprises in state ownership for a variety of reasons, including a strong belief that the goods or services they provide cannot be offered effectively by the private sector, because of strong political opposition to privatization, in order to protect what is considered a strategic industry or sector for economic development

purposes, because of the fear of potential social or political backlash from the reduction or elimination of jobs, as a means of publicly subsidizing the provision of services to poor or low income people, or because of political inertia. Whether or not these reasons are deemed valid and legitimate, if governments decide to maintain state ownership, they should undertake internal governance and management reforms that increase the capacity of public enterprises to attain development goals effectively.

Governance reforms are among the most important ways to improve public enterprise performance. In order to operate effectively, public enterprises should be adequately supervised by a state agency or an independent board of governors. Enterprise governance includes those structures and procedures that ensure that the enterprise operates effectively, efficiently, accountably, and responsively in the public interest and that it is contributing to national development. Government's role is to establish the policies, procedures, and organizational structures that guide public enterprise operations to achieving those goals.<sup>48</sup> The most appropriate structure for governance differs among countries, but three options include 1) a politically objective and qualified Board of Directors composed of representatives of government and outside members who do not have a conflict of interest or potential for illegal personal gain from serving on the board; 2) a responsible government body such as a Public Enterprise Commission or Agency with the responsibility for supervising the enterprises' activities, auditing its finances, and ensuring compliance with laws and regulations, and 3) a state enterprise holding company to which several state-owned enterprises report.

Whichever option is chosen, the governance structure should not mix operating, regulatory, and public enterprise supervisory responsibilities within government ministries. Governments should take measures to ensure that the operations and procedures of the public enterprise governance body are transparent and open to inspection. Adequate checks and balances should be created to limit inappropriate political interference in the governance body's decisions and to protect it from cronyism, conflict of interest, corruption, and nepotism in the hiring of executives and workers.

Little change is likely to come about in poorly performing public enterprises unless the governance authority establishes procedures for ensuring the recruitment of professional and competent management and trained and skilled workers and support staff, and assists managers to set or clarify clear objectives for the organization. The government's role is to establish effective and appropriate legal and regulatory frameworks that simplify and streamline legal structures for public enterprises' operations, specify obliga-

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<sup>48</sup> Richard M. Kennedy and Leroy P. Jones, "Reforming State-Owned Enterprises: Lessons of International Experience, Especially for the Least Developed Countries," Working Paper No. 11, Vienna, Austria: United Nations Industrial Development Organization, 2003.

tions, protect the rights of stakeholders, and create standards and procedures for effective internal and external audit, transparent and accurate accounting, and public financial disclosure.<sup>49</sup>

The governance body and senior management, together, can improve the operation of public enterprises by developing and applying performance criteria related to a clear mission and set of development objectives. This requires public enterprises to formulate short-term operating and medium-term strategic plans and programs, evaluate organizational performance and the performance of executive officers or senior managers. The governance body should provide appropriate compensation standards and incentives needed to attract experienced, qualified, and professionally trained managers and staff. Where restructuring involves streamlining operations or downsizing or “right-sizing” the workforce, adequate provisions need to be developed for assisting laid-off workers or for retraining them for new functions within or outside the organization.

### *Commercialization*

In many developing countries internal governance and management reforms of public enterprises alone, while necessary, may not be sufficient to achieve development objectives. Once the governance body and senior management have been strengthened, governments may have to deregulate relevant sectors of the economy to allow for greater market competition in providing what had previously been considered purely “public goods.” Deregulation to allow market competition is often followed by “corporatization,” that is, legally making public enterprises independent corporate entities and requiring them to cover their costs and to generate revenues under hard budget constraints. A third stage of commercialization involves “marketization” -- that is, opening goods, services, and infrastructure provision to the private sector and requiring public enterprises to compete in the market with private or civil society providers. Governments can marketize service through franchising, the use of vouchers, or leaving service provision to voluntary organizations or to individuals.<sup>50</sup>

Government’s responsibility in the this aspect of public enterprise reform is not only to create a legal framework for deregulation, corporatization, and commercialization, but also to help make national markets competitive, allow prices to reflect true relative scarcities in the economy, and encourage public and private enterprises to behave according to fair and equitable market rules. In most countries this means finding effective

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<sup>49</sup> Organization for Economic Cooperation and Development, “Guidelines on Corporate Governance of State-Owned Enterprises,” Draft Text, Paris: OECD, 2004.

<sup>50</sup> E.S. Savas, *Privatization and Public-Private Partnerships*, New York: Chatham House Publishers, 2000.

ways of implementing structural adjustment policies, liberalizing trade and investment, creating or strengthening property rights, and developing a legal framework for business activities.

By encouraging interaction through market competition governments establish a process in which firms are free to enter and leave the market based on their profitability. Policies promoting commercialization should end public enterprises' monopoly status but also prevent -- through anti-trust laws -- excessive collusion among private businesses that would constrain competition or fix prices artificially for socially-beneficial services. Marketization policies aimed at commercializing public enterprises seek to reduce barriers to entry and eliminate marketplace impediments to competition.

One of the most important institutions for market development is a reliable system of property rights that facilitates property ownership and its transfer. Establishing and enforcing a "rule of law" -- that is, providing a reliable legal framework for business transactions -- gives participants in market economies the guidelines to operate efficiently and effectively and a framework for protecting natural resources and ecological systems. Without a transparent system of business laws, owners and managers of enterprises waste time and money negotiating each transaction with government officials -- a process that opens the way for bribery and corruption. In addition, effective commercialization depends on legal institutions to establish and enforce product and pricing standards, and securities and exchange regulations, rights of access to credit and capital, regulation of bank operations, and guidelines for viable contracts and adjudication of disputes are all essential market institutions.<sup>51</sup>

#### *Outsourcing or Contracting-Out*

In some circumstances governments choose to maintain enterprises in public ownership but outsource or contract-out the provision of some services, the construction or operation of infrastructure, or the management of some or all of a public enterprise's functions. Contracting for infrastructure and services allows public enterprises to arrange with private companies to provide services or facilities that meet government specifications. Generally, public enterprises outsource to private organizations through three mechanisms: service, management and leasing contracts.

Service contracts allow a public enterprise to purchase services on a long-term basis from the private sector. Public enterprises have used outsourcing to modernize government housing projects, obtain defense equipment, and expand schools, prisons and hospitals. Contracting has become

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<sup>51</sup> Dennis A. Rondinelli and Jack N. Behrman, "The Institutional Imperatives of Globalization," *Global Focus: International Journal of Business, Economics and Social Policy*, 12, 1 (2000): 65-78.

one of the most important methods of privatizing water and wastewater treatment services in many countries. In South America, the public utility enterprises in Chile and Guatemala offered territorial concessions in large cities to private firms that procure, purify, distribute, meter, and charge for water. In both countries, tariffs were approved by the national government, which also monitored water quality. In Peru, the public utilities contracted out to private companies many of the activities involved in water supply, such as meter reading, computer services and billing and collection.<sup>52</sup>

Public enterprises also use management contracts to arrange for private companies to provide services or produce goods more efficiently. They have contracted with international firms to privatize state-owned hotels in Africa and Asia, agro-industries in Senegal, Cote d'Ivoire and Cameroon, and mining operations in Latin America and Africa. Management contracts allow a private firm to take over responsibility for operation and maintenance of public service facilities for a specified period of time with the freedom to make routine management decisions.

The Persian Gulf state of Abu Dhabi sought to bring commercial discipline and efficient management to its public utilities by contracting with the private sector to manage electricity generation. It competitively tendered long-term management contracts with a private firm while maintaining its majority stake in the partnership. Several francophone African countries began in the 1980s using the "affermage system" through which municipal utilities construct a facility and contract with a private firm to operate and maintain it. The government established rules for price setting and surcharges on water fees that the private company pays to the municipal utility to amortize the construction costs of the water system.

Lease contracts are also used extensively for both public services and commercial operations. In Latin America and Africa, state-owned industries have been leased to private companies for long-term operation. The government has leased electricity and water supply enterprises in Cote d'Ivoire; steel mills and refineries in Togo; and hotels and farm holdings in Jamaica. Companies leasing facilities assume responsibility for operation, maintenance and replacement of non-fixed capital assets. The State Railway Authority of Thailand (SRT) successfully experimented during the 1980s and 1990s with contracts with private firms to provide service on three intercity rail routes that were incurring substantial losses. The private companies leased passenger rail-cars and railway lines from SRT and paid it a fee every 15 days. The private contractors covered the costs of rail-car maintenance and cleaning and optional concession services. SRT provided the use of railway stations and the personnel to manage them, as well as train drivers and guards.

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<sup>52</sup> Dennis A. Rondinelli, "Privatization, Governance, and Public Management: The Challenges Ahead," *Business & the Contemporary World*, Vol. 10, No 2 (1998), pp. 149-170.

All three forms of contracting -- service, management and lease arrangements -- allow the government to maintain ownership of public facilities and control over public services but also to benefit from private sector management and operation and derive revenues from leases, management fees, or service concessions. Under appropriate conditions, contracting with the private sector has increased efficiency, decreased vulnerability to employee actions and contractor failures, ensured protection against monopolistic behavior of contractors or government agencies, provided dual yardsticks for measuring and comparing performance, and provided more substantive knowledge and understanding of service delivery.

### *Public-Private Partnerships*

Another potential means of improving the management of public enterprises is through public-private partnerships (PPPs) – collaborations with corporations, small businesses, non-government organizations and civil society organizations to provide socially-beneficial goods and services. Public enterprises and the private sector cooperate in providing services and infrastructure through a variety of mechanisms including concessions, build-operate-and-transfer (BOTs) arrangements, joint ventures, and informal and voluntary cooperation. Public-private partnerships allow or encourage domestic- and foreign-owned businesses, community groups, cooperatives, private voluntary associations, small enterprises, and other non-governmental organizations (NGOs) to offer social services. In some countries PPPs are an intermediate phase in privatizing SOEs or an alternative to privatization.<sup>53</sup>

Joint ventures are one means by which public enterprises work with the private sector through mergers, partial acquisitions of SOEs (retaining some share of the stock in profitable or politically strategic enterprises) or joint ownership by government and private investors. In Oman, for example, the government developed a joint venture between Omani public and private enterprises and Sealand to expand and maintain its Salalah container shipping port. In 2002, the municipality of Ajman in the United Arab Emirates formed a equal ownership joint venture -- the Ajman Sewerage Company-- with a consortium of Black & Veatch, Thames Water, and other companies, to invest \$100 million in a wastewater network that will deliver services to 300,000 people in the emirate. The government granted the joint venture a 27- year concession in which the company will recover its costs by levying tariffs for service to be paid by customers.

China has used joint ventures between foreign investors and state enterprises to obtain foreign technology and capital, learn foreign management and marketing techniques, increase foreign exchange-generating capacity,

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<sup>53</sup> Gabriel Roth, *The Private Provision of Public Services in Developing Countries*, New York: Oxford University Press, 1987.

and promote joint research and development projects. The Chinese government also used joint ventures between SOEs and private foreign companies to make new investments in infrastructure and manufacturing facilities. The expansion of telecommunications equipment facilities in the Shanghai area, for example, was financed through joint ventures. Shanghai Bell Telephone Equipment and Manufacturing Company was taken over by a joint venture among China's Ministry of Posts and Telecommunications, Alcatel Bell, and the Belgian government to produce switches for telephone companies in China.

Governments around the world use turnkey projects with consortia of private companies to build telecommunications, transport, shipping, airport, utility, and water and sewerage infrastructure. Governments in countries with both advanced and developing economies use build-operate-transfer (BOT) agreements in which they buy or lease completed facilities constructed by private investors after the companies have recouped their investment and a reasonable return by operating the facilities for an agreed-upon period of time.

The government of South Korea, for example, used a BOT arrangement to develop and operate the Seoul Beltway and Daegu-Pusan highway as toll roads. It gave the Pusan NewPort Company sponsored by the Samsung corporation, CSX World Terminals, and local Korean contracting companies a 50-year secured concession to develop a \$900 million Pusan port expansion project using the PPP approach. The Private Infrastructure Investment of Korea (PICKO) organization sought financing and participation from private firms around the world in constructing, financing and operating infrastructure in Korea.

BOT or build-operate-own (BOO) arrangements have also been used extensively in Malaysia and Turkey to build telecommunications systems, highways, utilities, and water supply systems, and operate them under a concession from the government. Debt financing is usually highly leveraged and the private consortium takes a small equity position. The consortium usually seeks loans from international financing agencies and commercial banks using future revenues from the projects to repay them. Another approach, a build-operate-own-transfer (BOOT) arrangement, has been used to construct and operate independent power plants in China (Shajiao project) and Pakistan (Hab River project) as well as in the Dominican Republic and Costa Rica. These projects usually involve limited recourse financing in which capital is raised on the basis of cash flows and not on the collateral of project owners.

Although they offer governments in developing countries important means of expanding services and infrastructure and the private sector commercial opportunities to expand their businesses, public-private partnerships are complex arrangements and can create potential problems for both the public and the private sectors if they are not properly designed and admin-

istered.<sup>54</sup> They often displace public workers, thereby generating political opposition among public officials, labor unions, and public employee associations.

If PPPs are not well designed and supervised, their services can become more expensive than those provided by the government. Poorly designed and inadequately analyzed projects have failed in both rich and poor countries. Corruption can undermine public trust in PPPs if the contracting process is not transparent and carefully supervised. Lack of sufficient competition can turn PPPs into private monopolies that operate no more efficiently than SOEs. Overly restricting concessions or creating too many can deprive PPPs of economies of scale. If government regulation is too stringent it can lead to deficiencies in service provision and if it is too lax it may not hold private service providers sufficiently accountable.<sup>55</sup> The cost of contract management can be substantial. In all cases, governments must compare carefully the costs of contracting out with the costs of providing services directly. The involvement of the private sector in providing services that were formerly free or that were subsidized by the government can increase their price and place poor segments of the population at a significant disadvantage.

### *Privatization*

Increasingly, governments in developing countries have come to the conclusion that public enterprises cannot be reformed or restructured enough to ensure that they carry out their functions effectively, and have decided to liquidate or privatize them. Governments in some countries turned to privatization as a way of reallocating the expenditures on subsidies to SOEs to more productive investments in infrastructure and social programs; for increasing the size and dynamism of the emerging private sector; for distributing ownership of state-owned enterprises more widely; and for promoting both foreign and domestic private investment.<sup>56</sup> Moreover, privatization can generate the revenues needed to create new jobs for workers displaced by industrial restructuring, reduce the state's administrative responsibilities and the burdens of government intervention in enterprise management, and provide consumers with more-efficiently produced goods and services. As

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<sup>54</sup> Dennis A. Rondinelli, "Partnering for Development: Government-Private Sector Cooperation in Service Provision," in D.A. Rondinelli and G.S. Cheema (eds) *Reinventing Government for the 21<sup>st</sup> Century: State Capacity in a Globalizing Society*, Bloomfield CT; Kumarian Press, 2003): 219-239.

<sup>55</sup> Ruth H. DeHoog, *Contracting Out for Human Services*, Albany, New York: Stat University of New York Press, 1984; Harry P. Hatry, *A Review of Private Approaches for Delivery of Public Services*, Washington: Urban Institute Press, 1983; E.S. Savas, *Privatizing the Public Sector*, New York: Chatham House, 1982.

<sup>56</sup> International Finance Corporation, *Small scale Privatization in Russia: the Nizhny Novgorod Model -- Guiding Principles*, Washington, D.C.: IFC, 1992.

a result, governments around the world began, in the late 1970s and early 1980s, to intensively privatize their state enterprises and to elicit the participation of the private sector in providing services and infrastructure more vigorously. The World Bank reports that during the 1980s alone more than 70 countries experimented with some form of privatization and sold or liquidated more than 7,000 SOEs.<sup>57</sup>

A change in ownership of public enterprises theoretically leads to organizational restructuring and behavioral changes that allow the privatized SOEs to operate more competitively and generate profits. Under appropriate conditions, the transfer of ownership to the private sector should change organizational characteristics so that privatized SOEs begin to operate in ways that allow them to focus on clear and concise missions, be more innovative, manage human resources more effectively, and increase productivity through stronger work effort.<sup>58</sup> The organizational performance improvements can then lead to improvements in financial management and higher returns to investors, better production of goods and services, more efficient and effective service delivery, and creation of more employment opportunities. Table 1 summarizes the factors that often inhibit effective performance in state-owned enterprises and that can allow better management in private enterprises.<sup>59</sup>

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<sup>57</sup> World Bank, *Bureaucrats in Business*, New York: Oxford University Press, 1995. The performance benefits of privatization seem to depend not only on the transfer of ownership but also on the type of privatization used, on the degree of concentration of ownership, and on the ability of governments to enact and implement policies that promote competition and effective regulation. Increasing evidence suggests that the transfer of SOE ownership to the private sector through direct sales is more likely to bring organizational change and performance improvements than continued state control or mixed ownership. Partial privatization or privatization through means that simply transfer ownership to former SOE employees and managers, or to a dispersed set of small shareholders who cannot effectively exercise independent governance, may not lead to organizational restructuring or performance improvements.

Similarly, privatization through any means in countries that do not create competitive conditions may simply substitute private monopolies for state monopolies resulting in little or no performance improvement.

<sup>58</sup> R. Ramamurti, "A Multilevel Model of Privatization in Emerging Economies," *Academy of Management Review*, 25, 3 (2000): 525-550.

<sup>59</sup> Hugh O'Neill, Dennis A. Rondinelli and Tibordec Wattanakul, "Ownership and Its Impacts on Coping with Financial Crises: Differences in State-, Mixed- and Privately -Owned Enterprises in Thailand," *Asia Pacific Journal of Management*, Vol. 21 (2004): pp. 49-74.

Studies of privatization indicate that ownership transfer alone, however, does not always yield the expected results, either in terms of organizational restructuring or performance improvement. Performance improvements are less likely in countries that have not developed effective systems of business law and regulation and that fail to enforce rules by which privatized firms can fairly compete in domestic and international markets.

**Table 1. Organizational Factors Affecting Public- and Private-Enterprises' Ability to Act Innovatively, Manage Human Resources, and Increase Productivity**

	<b>State-Owned Enterprises</b>	<b>Private Enterprises</b>
<b>General Characteristics</b>	<ul style="list-style-type: none"> <li>-Embedded in government</li> <li>-Goals influenced by national politics</li> <li>-Objectives diverse or not well articulated</li> <li>-Boundaries vague</li> <li>-Accountable to state</li> </ul>	<ul style="list-style-type: none"> <li>-Embedded in market</li> <li>-Owned by private investors</li> <li>-Clear profit maximization goals</li> <li>-Accountable to shareholders or private owners</li> </ul>
<b>Innovative Orientation</b>	<ul style="list-style-type: none"> <li>-Political and bureaucratic restrictions on innovation</li> <li>-Weak incentives to deviate from standard operating procedures</li> <li>-Civil service protected managerial positions</li> <li>-Organizational and technological changes driven by state budget resources</li> <li>-Able to survive as "loss makers" because of soft budget constraints</li> <li>-Fixed pay salary ranges</li> <li>-Limited interaction with external environment</li> <li>-Low levels of technological change</li> </ul>	<ul style="list-style-type: none"> <li>-Market opportunities provide freedom to innovate</li> <li>-Financial incentives for managerial risk-taking</li> <li>-Managers' employment depends on profitability</li> <li>-Salaries supplemented by opportunities for ownership stake</li> <li>-Extensive interaction with external environment</li> <li>-Potentially high levels of technological change</li> </ul>
<b>Human Resource</b>	<ul style="list-style-type: none"> <li>-Formalization and standardization in hiring</li> </ul>	<ul style="list-style-type: none"> <li>-Firm determines rules of recruitment</li> </ul>

<p><b>Management</b></p>	<ul style="list-style-type: none"> <li>-System-wide rules for promotion and removal</li> <li>-Limited ability to reward unique roles or performers</li> <li>-Limited incentives to use technology to increase labor productivity</li> <li>-Managerial behavior driven by civil service rules</li> <li>-Difficult to remove or reassign employees</li> </ul>	<ul style="list-style-type: none"> <li>-Differentiated pay rates</li> <li>-Promotion and removal determined by performance</li> <li>-Strong ability to reward unique roles and performers</li> <li>-Strong incentives to enhance labor productivity with technology</li> <li>-Behavior driven by incentives and firm strategy</li> <li>-Easy to remove or reassign employees</li> </ul>
<p><b>Productivity and Work Effort</b></p>	<ul style="list-style-type: none"> <li>-Difficult to provide feedback on performance</li> <li>-Limited freedom to design jobs</li> <li>-Limited control over group norms</li> <li>-Standardized pay and limited opportunities for extra rewards for effort</li> </ul>	<ul style="list-style-type: none"> <li>-Freedom to set goals and provide employee feedback</li> <li>-Flexibility to design jobs</li> <li>-Strong control over group norms</li> <li>-Strong work motivation driven by uncertain job security and opportunity for financial rewards</li> </ul>

Analyses of privatized and state-owned enterprises in Romania, for example, show that privatized firms perform better than SOEs and pursue more aggressive or competitive strategies, but are not much more adaptable and flexible.<sup>60</sup> Tendon found many cases where privatization did not lead to efficiency improvements, mostly in situations where there were no changes in competition before or after privatization.<sup>61</sup>

Other studies indicate that improvements in the performance of privatized SOEs depends to a great degree on the ability of governments in their home countries to create an appropriate institutional structure for competitive market economies that support a viable private enterprise sector.<sup>62</sup> A review of experience in Russia concluded that to attain performance improvements

<sup>60</sup> P. Arens and K. Brouthers, “Key Stakeholder Theory and State-owned Versus Private Firms. *Management International Review*, 41,4 (2001): 377-394.

<sup>61</sup> P. Tendon, “Welfare Effects of Privatization: Some Evidence from Mexico,” *Boston University International Law Journal*, 13, 2 (1995): 329-350.

<sup>62</sup> Dennis A. Rondinelli, “Capacity Building in Emerging Market Economies: The Second Wave of Reform,” *Business & the Contemporary World*, 6, 3 (1994): 153-167; and D.A. Rondinelli, “Privatization, Governance, and Public Management: The Challenges Ahead,” *Business & the Contemporary World*, 10, 2, (1998): 149-170.

in privatized firms, especially those privatized by means other than public or private sale, requires the creation of formal “governance chains” – independent boards and multiple independent monitoring, auditing and accounting institutions – to constrain the “grabbing hands” of insiders.<sup>63</sup> Analyses of telecommunications firms privatized between 1984 and 1997 in 30 African and Latin American countries found that performance improvements (measured by per capita number of mainlines, payphones, and connection capacity, and by the price of local calls) correlated with privatization and effective independent regulation.<sup>64</sup> Without effective regulation, privatization alone led to few improvements and to lower connection capacity.

Experience suggests that in order to be effective, governments must take the following actions to manage privatization effectively: 1) clearly identify goals and objectives of privatization and embody them in an official set of privatization laws; 2) develop a strategic management plan for privatization; 3) create an effective privatization agency; 4) select appropriate methods of privatization; 5) develop clear and transparent privatization procedures; 6) apply appropriate assessment and valuation methods; 7) create effective financial structures for private sector participation; 8) establish an effective system of government supervision and regulation, especially for natural monopolies; 9) help strengthen private sector management capacity; and 10) create employment protection measures for current government employees in organizations that will be privatized.<sup>65</sup>

## CONCLUSION

More than a quarter of a century of experience with public enterprise reform suggests that, for a variety of reasons outlined earlier in this paper, many SOEs have been ineffective in promoting economic and social development. Some public enterprises may be well governed, efficiently managed, and financially sound, but governments seeking to achieve the Millennium Development Goals or other indicators of economic and social progress must carefully reassess the performance of public enterprises in achieving development. The performance of some can be improved through extensive governance and management reforms that give them a clearer and more focused development mission; strengthen the governance body; ensure the recruitment and retention of professional, competent, and well-trained

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<sup>63</sup> A. Dyck, “Privatization and Corporate Governance: Principles, Evidence and Future Challenges,” *The World Bank Research Observer*, 16, 1(2001): 59-84.

<sup>64</sup> S.J Wallsten, “An Econometric Analysis of Telecom Competition, Privatization and Regulation in Africa and Latin America” *The Journal of Industrial Economics*, 49, 1 (2001): 1-19.

<sup>65</sup> Dennis A. Rondinelli and Max Iacono, “Strategic Management of Privatization: A Framework for Planning and Implementation,” *Public Administration and Development*, 16, 3 (1996): 247-264.

senior managers and of highly skilled employees; require internationally recognized audit, accounting and financial reporting procedures; develop and implement clear and appropriate performance targets; and impose hard budget constraints.

In other cases, performance improvements require not only internal governance and management reforms but also commercialization or marketization. Public enterprises may need to be corporatized and given a legal business status to operate according to market criteria and to compete with private and civil society service providers. Government's responsibility is to create an effective regulatory environment for both public and private enterprises providing social services and infrastructure and the market institutions and policies that ensure open and fair competition.

The performance of public enterprises in meeting development objectives and providing socially-beneficial goods, services and infrastructure may also be improved in some developing countries by allowing them to outsource some or all of their functions. Contracting out can bring the benefits of private production and distribution while maintaining enterprises in public ownership. Similarly, public-private partnerships can help some SOEs overcome weaknesses of state ownership while taking advantage of the benefits of private management. In many cases, however, public enterprises cannot or will not provide social services and infrastructure effectively because of the limitations of state ownership. Government's responsibility in this case is to create the conditions that lead to effective privatization and to assume a facilitating and regulatory role rather than one of service provider.

Because of their history of poor performance in meeting development goals, governments need to verify the viability of state enterprises in achieving development targets. Public enterprises that can no longer demonstrate a strong record of achievement in countries where the private sector can provide services effectively may be liquidated or privatized. Where performance can be improved by strengthening some aspects of their operations, public-private partnerships or contracting may be acceptable means of leveraging the benefits of private management. When government decides that public enterprises must remain in state ownership, a comprehensive and objective performance assessment should be carried out to determine how to strengthen their governance, management, operation, and integrity and to ensure that SOEs achieve economic and social development goals.

# Designing and Implementing Mechanisms to Enhance Accountability for State Owned Enterprises

Prajapati Trivedi

## 1. Need for Enhanced Accountability of Public Enterprises

There is a widespread perception around the world that public enterprises<sup>66</sup> have not delivered what was expected from them—instead of pursuing public interests they are increasingly seen as pursuing private interests. This negative perception about public enterprises cuts across the developed and developing country boundaries. From Argentina to Zambia and from Australia to United States of America, governments are trying to improve public sector performance. Students of public enterprises appreciate the important role some of these public enterprises have played in the development process of many countries. Yet, the man on the street is clearly disappointed with their performance.

While the term “re-inventing the government” may have been coined in a developed country (United States of America), it is required more urgently in most developing countries. Statistics tell us that in spite of a tremendous wave of privatization in the nineties, public enterprises continue to play an important role in the economies of developing countries. It is not just the magnitude of the public sector that is at issue, the debilitating impact of inefficient and ineffective PEs have a huge multiplier effect due to the sectors in which they operate. The battle for commanding heights may have been won by the public sector; it is now seen sitting on these cliffs and preventing others from reaching the higher peaks.

In the global economic race, nations that succeed are the ones that have a competitive advantage and not necessarily those that just have a comparative advantage. The latter is determined by resource endowment, whereas the former is primarily determined by an efficient and effective public sector. That is, resource endowment is neither a necessary nor sufficient condition for economic success. On the other hand, public sector efficiency is a necessary (and often sufficient) condition for economic development. The inefficiency of public sector acts as a glass ceiling on the efficiency of the private sector. Former Malaysian Prime Minister Mahathir Mohamad once said “The quality of an effective government administration can not be lower than that of its

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<sup>66</sup> State-Owned Enterprises (SOEs), Public Enterprises (PEs) and Parastatal Organizations (POs) are synonymous terms and are deliberately used interchangeably in this paper.

clients—specifically the private sector.” In a recent global survey of various types of risks to business and investment in a country, the **Economists Intelligence Unit** (EIU) found Government Ineffectiveness risk to be the greatest risk.

Accountability and efficiency are the two sides of the same coin. Most public enterprises argue that they are not for profit. Yet, they have not given a satisfactory answer to the question: “If not for profit then for what?” As we shall see in the next section, the search for the answer to this question lies at the heart of the public enterprise accountability problem.

## 2. Accountability Barriers for Public Enterprises

We need to avoid over intellectualization of this issue. At the core, accountability is a simple concept. Basically it means holding public enterprises to account – i.e. asking PEs to present their accounts in terms of “expectations” and “achievements.” This is as true for “results,” as it is for “processes” and “behavior.” This definition is also applicable to others involved in governance—executive, judiciary and legislature. A review of literature reveals two main reasons for a lack of accountability in PEs:

### Unclear Expectations—Multiple Principal with Multiple Goals

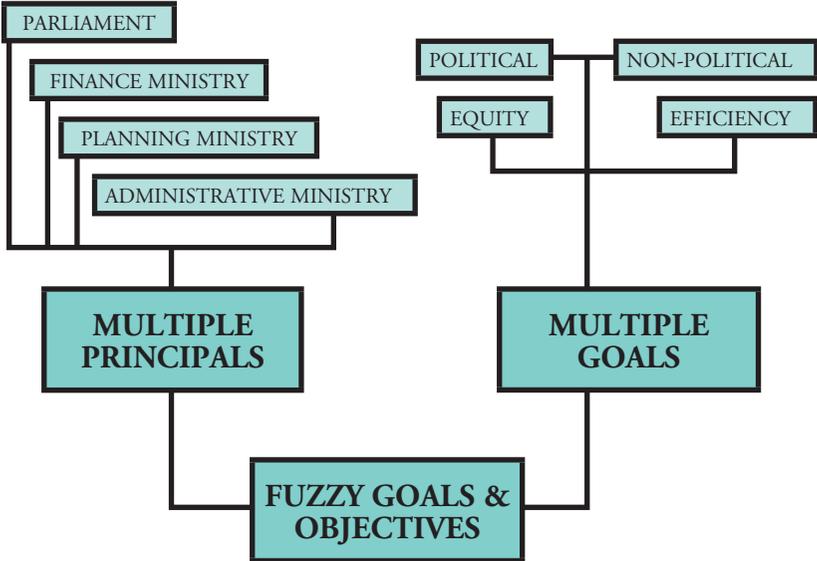
Existence of clear expectations plays a major role in achieving accountability. It is 50% of the above definition of accountability. If owners of an enterprise—public or private—are not clear about the goals of the enterprise, they can hardly expect to achieve them.

The problem facing public enterprise managers is even worse. They have multiple principals who have multiple and often conflicting goals. A number of institutions and organizations in the usual governmental structure of LDCs feel that they have a right to supervise the functioning of public enterprises. The country’s parliament feels it needs to hold PEs accountable on behalf of the people; administrative ministry feels it is charged with the responsibility to manage the sector and hence needs to supervise PEs in the sector; finance ministry believes that it has the oversight responsibility over PEs as people’s money is invested in them; country’s auditor-general doesn’t trust these guardians and wants to ensure that all process and procedures are followed; and of course the Planning ministry need to supervise PEs to ensure that they fit the plans.

In a way, this situation is similar to a private enterprise. Private sector managers too have to face a large number of shareholders. The difference between the public and private enterprise is that while all the shareholders in private enterprise have the same objective—to maximize returns to their investment—stakeholders in public enterprise often have conflicting objectives. Some stakeholders in the government wants to have efficiency while others want equity; some want profitability others want to maximize pro-

duction. As Figure 1 shows, this multiplicity of principals with conflicting objectives leads to unclear transmission of objectives to managers of public enterprises. They simply do not have a clue as to what is expected from them. Given this fuzziness of goals and objectives, PE managers do not know which race to run. That is why at the end of the year it is hard to hold PE managers accountable. They can merrily pursue their own interest through the year and justify it by pointing out to some principals who wanted this outcome.

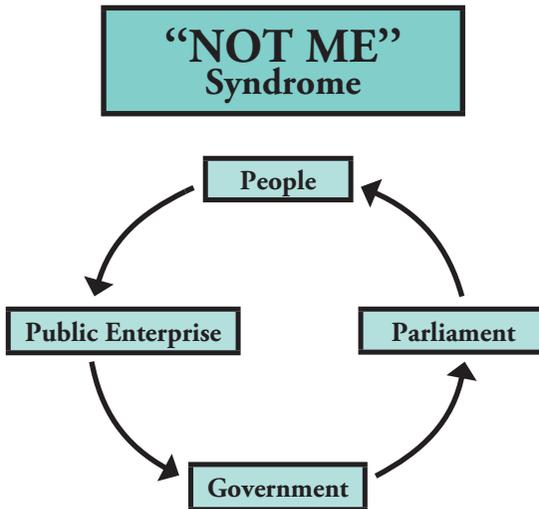
**Figure 1: Multiple Principal with Multiple Objectives**



### The “Not Me” Syndrome

Another phenomenon bedeviling public enterprise managers may be called the “Not-Me” syndrome. To explain this, let me use my favorite example of the Indian Airlines, a large public enterprise in India, infamous for its service. When customers complain to managers of Indian Airlines about the quality of their service, they are told that most of these problems arise from interference by bureaucrats in the Ministry of Civil Aviation. When civil servants in the Ministry of Civil Aviation are asked the same question, they put the blame on politicians who make them operate uneconomical routes and force them to purchase planes not suitable for Indian conditions. When politicians are confronted and asked why they cannot resist the temptation to interfere with the management of public enterprises, they appear shocked and inform the impertinent enquirer that far from interfering, as people’s representatives, they are doing exactly what people have asked them to do. As Figure 2 shows, people start complaining about poor performance of PEs and ironically they end up being blamed for it. This phenomenon of passing the buck (by claiming that they are not in-charge or responsible) results in a complete absence of accountability. In this situation, it is difficult to hold any one person accountable.

Figure 2: The “Not Me” Syndrome

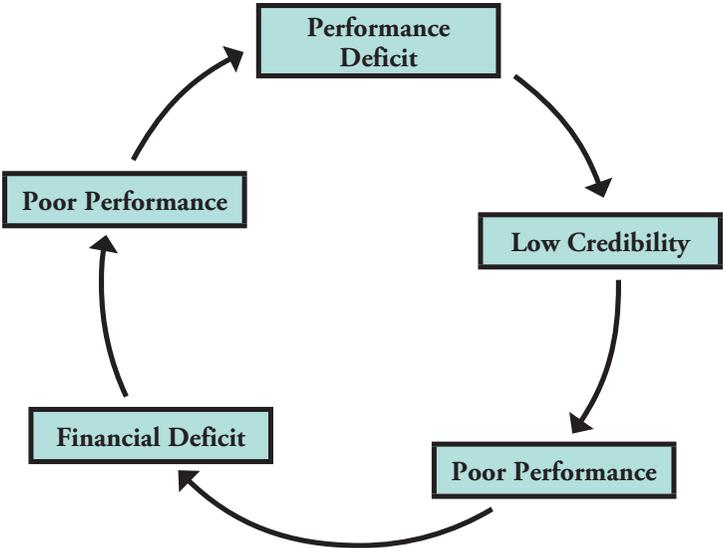


**Confusion between Cause and Effect**

The cause of accountability in PEs has also suffered because most of the attempts to reform them have focused on curing the symptoms and not the underlying basic causes for poor accountability. In almost all countries, the motivation for PE reform stems from the massive drain on the exchequer caused by loss making public enterprises. As shown in Figure 3, these losses invite a very close scrutiny of their management (tantamount to gross interference) by government bureaucrats, this leads to further deterioration in performance, which leads to even lower credibility and further budgetary cuts. This vicious cycle once started leads to making these PEs chronically sick and often beyond redemption.

**Figure 3: Vicious Cycle of Financial Deficits in PEs**

Symptom  
**Performance Deficit Vs. Financial Deficit**



### **Accountability for What?**

Some could argue that there is already too much accountability in the public sector. In fact, they could even argue that it is stifling initiative and has become a drag on the performance of public enterprises. These arguments are indeed partially true. To understand why they contain elements of truth, we need to highlight the following distinction between accountability for “results” versus accountability for “procedures.” It is true that there is a lot of accountability in the public sector for following prescribed procedures. The horror stories about being harassed for small discrepancies by the auditor abound. All countries share this unpleasant experience.

Basically, there are essentially two ways to manage an enterprise. If we can specify the expected outcomes and results, then one can manage an enterprise by monitoring these results (the so called management by objectives MBO). However, it is claimed by many that it is difficult to measure performance of public enterprises. They will give you a long list of reasons why the concept of “profit” is inadequate for this purpose. It is argued that since PEs pursue commercial and not commercial goals, it is difficult to have a “neat” bottom line. While these people will enthusiastically tell you what is wrong with profits, they fail to provide the answer to the question: “If not for profit, then for what?”

It is thus argued, that since it is difficult to measure results, it is best to ensure that all procedures are followed correctly. It is expected that by following the “specified” procedures, “desired” results will follow. Unfortunately, the history of PEs is replete with examples that belie this expectation. This experience is aptly captured by the phrase: “the operation was successful but the patient is dead.”

Fortunately, advances in the theory and practice of public management make it possible to provide an effective and relevant counterpart for the concept of profit. This allows us to focus on results rather than procedures and processes. In other words, it is now technically possible to hold PEs responsible for “results.”

Not only it is technically possible to do so, it is also desirable to do so. Monitoring procedures requires a lot more energy and time. To achieve a few key meaningful results, there are likely to be huge number of procedures relating to finance, personnel, administrative and policy issues. It is possible that a PE that follows all procedures except for a few may end up not achieving its main objectives. Because a few key procedural elements can have a disproportionate impact on the eventual results.

### **3. Autonomy for What?**

The moment the focus shifts to “results, PE managers claim that they need autonomy. As if they did not need any autonomy if they had to follow procedures. There is, however, some merit in this demand so long as we

understand the distinction between “strategic” autonomy and “operational” autonomy. Strategic autonomy refers freedom to decide the direction and goals of the PE. Whereas, the term operational autonomy refers to the freedom to achieve the goals of the PE, the former is the prerogative of the owners of the PE and the latter is a legitimate requirement for effective management. The problem arises from confusing the two. Often, PE managers ask for strategic autonomy to make long-term investment decisions and decide on the fundamental direction of the PE. Even in the private sector, owners do not allow freedom in these areas to their managers. So long as we keep this distinction in mind, there is no problem. PE managers should be held accountable for results (not procedures) and given full operational autonomy (not necessarily strategic autonomy).

#### **4. Designing Accountability Mechanisms**

In this section we will deal with three major areas: Who should initiate change? What sort of change is required? What are international best practices and options for moving forward?

##### **5.1 Relative Importance of Systems versus People**

There is a common misconception that poorly qualified people working in PEs are the main hurdle to improving PE performance. This flawed belief has led to many cases of brilliant people from private sector being brought in to manage PEs only to find them eventually failing to turn PEs around. In fact, it is much more common to find PE managers turning out to be highly successful when hired by the private sector. Many private sector owners are willing to pay a several fold increase in pay package to public enterprise managers.

To students of management this is not surprising. It is said that 80% of the performance of any organization depends on management systems and only 20% on people. Of this 20%, 80% is accounted for by the quality of leadership. Thus, as shown in Figures 4 A-C, systems account for 80% of the performance of an organization whereas leadership and rank and file account for 16% and 4 % respectively.

Figure 4 A: Relative Role of System and People

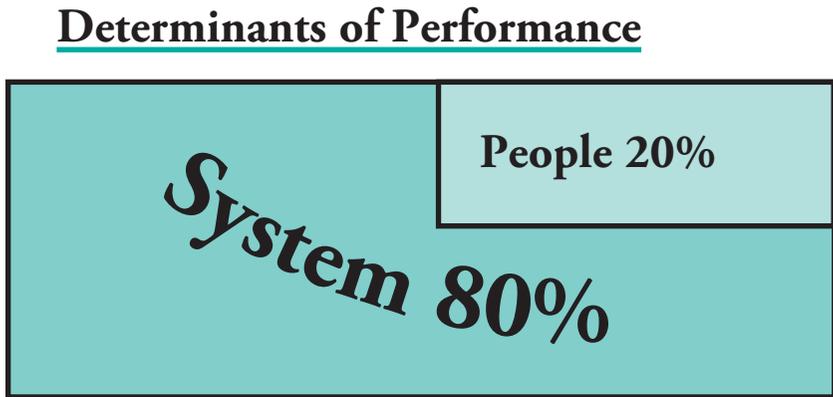
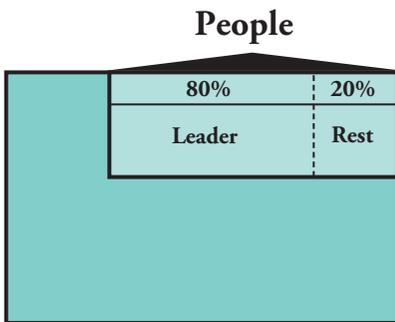
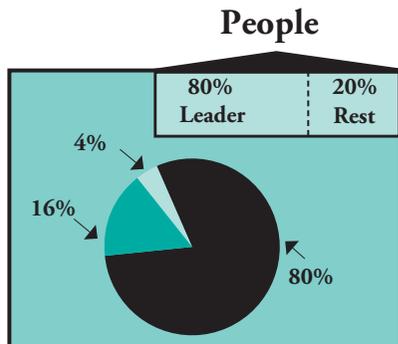


Figure 4 B: Relative Role of Leadership versus Rank and File



Determinants of Performance

Figure 4 C: Determinants of Performance



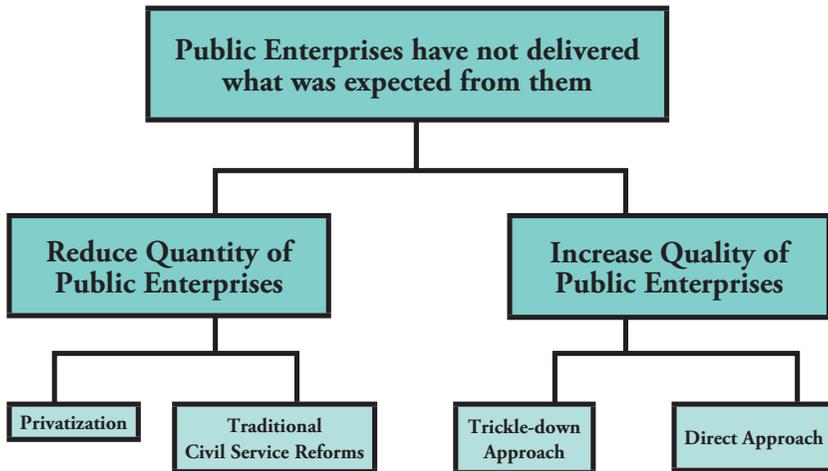
Determinants of Performance

It should be clear from the previous section that our focus should be on designing sustainable systems to enhance accountability in PEs. There has been a massive outpouring of literature in response to the perceived poor performance of PEs.<sup>67</sup>This literature can be divided into two broad categories: (i) one group deals with reducing the quantity of PEs by either privatizing or by down-sizing them using the methods of traditional civil service reforms; (ii) the other group of literature is focused on tools and techniques to improve the “quality” of PE management.

**5.2 Tools for Enhancing Accountability in PE**

At the beginning of 1990s, there was an expectation in certain circles that reforming or re-inventing PEs was a waste of time. Hence, the pendulum swung dramatically in favor of the first group focused on reducing the “quantity” of PEs. A decade later, the sobering experience of difficulties of privatization implementation has lead to a renewed interest in PE reforms. As shown in Figure 5, the tools and techniques of PE re-inventors can be further divided into two broad categories: One may be termed the trickle-down approach to efficiency and the other may be called the “direct approach” to combating inefficiency.

**Figure 5: Responses to Public Enterprise Reform Challenge**



<sup>67</sup> The use of the word “perceived” performance is deliberate. It is argued by some that most of the PEs were created in response to market failures. Hence, to use conventional yardsticks of market mechanisms would be unfair if not misleading. This is yet another example of analytical difficulty arising out of unclear expectations from PEs..

### 5.2.1 Trickle-Down Approach

The main focus of this approach is to create systems of accountability that would increase the performance of PEs in a sustainable way in the long-run. These systems are results-oriented and focused on improving performance using systemic incentives and disincentives. This approach is referred to as “trickle-down” because its focus is on accountability at the top. It is founded on the belief that if you hold the top management of the PE accountable for results, they, in turn, will hold all other layers accountable for results. The reverse, however, is not true—accountability does not trickle up. If only the lower echelons of management are held accountable for results, there is absolutely no guarantee that the top will feel responsible.

The management tool that best represents this approach is called “Performance Contract.” It is an agreement between two parties that clearly specifies their mutual performance obligations. Performance Agreements<sup>68</sup> are now as common in SOEs as in government agencies of OECD countries. Because accountability “trickles down” and does not “trickle up” it is not possible to have sustainable accountability reforms without infusing corresponding accountability in bureaucracy. It is the same principle, if the principal is not accountable, it is difficult to hold an agent accountable. Consequently, many developing countries are also moving to accountability at higher levels in the government hierarchy. Examples that come to mind immediately include: Malaysia, Thailand, Kenya, South Korea, Jordan, and Tanzania. *Appendix I*, (see annex) includes examples of performance agreements in governments of select countries.

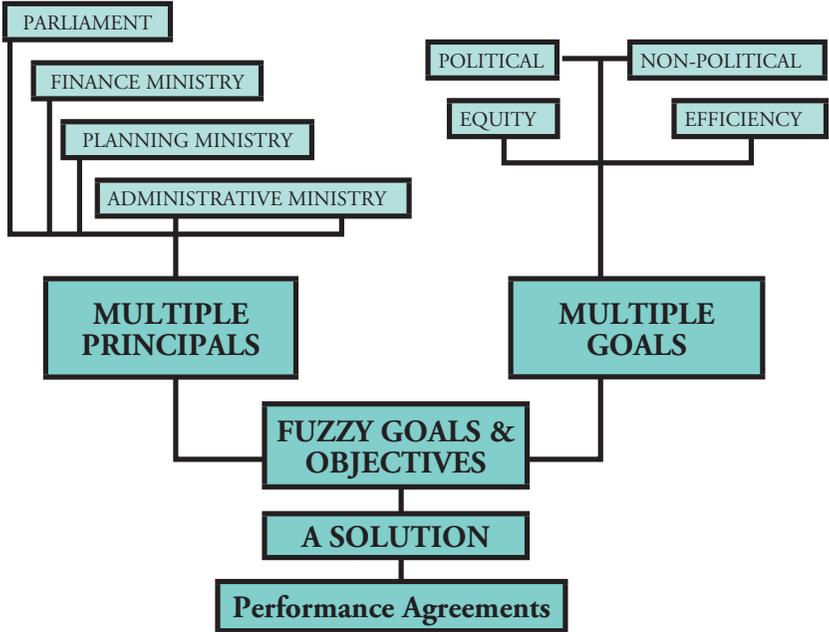
The example of Performance Agreements signed by President Clinton, under his National Performance Review initiative, is a particularly good example of how accountability trickles down. President Clinton signed Performance Agreements with his cabinet secretaries (Ministers) who in turn signed similar agreements with their subordinates (under-secretaries).

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<sup>68</sup> Performance Contracts are known by various other names in different countries. Some of the synonymous terms used to describe essentially the same instrument are: Performance Agreement, Contratos de Rendimientos, Contrat du Plan, Contrats de Program, Framework Agreement, Memorandum of Understanding (MOU), Compromiso de Resultados, Purchase Agreement, Results Frame work

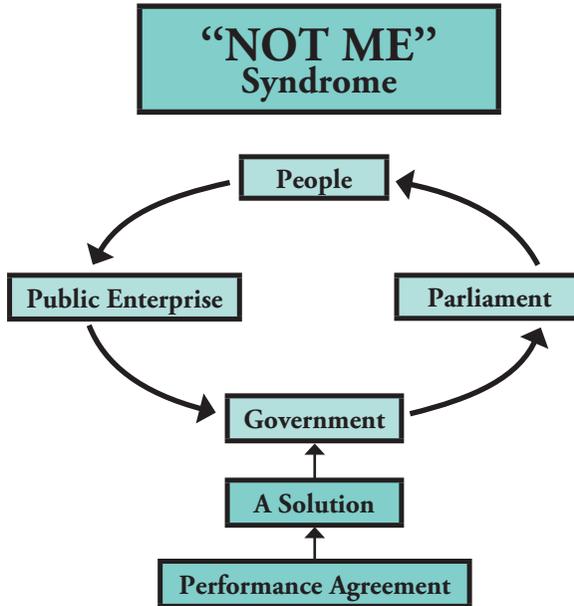
Performance Agreements (PAs) improve PE accountability and performance by preventing confusion arising from multiplicity of principals with multiple and conflicting goals. It is no one's case that the existence of PAs leads to disappearance of trade-offs between objectives and goals. Rather, the PA exercise leads to taking a conscious decision and conveying an unambiguous signal to PE managers as to what is expected from them (Figure 6).

**Figure 6: Performance Agreements Eliminate Fuzziness**



Similarly, Performance Agreements are also very helpful in breaking the vicious cycle of “passing-the-buck,” which is responsible for the “Not-Me” syndrome in PEs. They force the PE managers and stakeholders to decide who is supposed to do what and when (Figure 7).

**Figure 7: Performance Agreements break the Vicious Cycle of Buck Passing**



In addition to the above benefits, Performance Contracts (Performance Agreements) improve correlation between planning and implementation. For example, in the first year of implementation of performance contracts (Memorandum of Understanding – MOU) in India, the targets given by PEs to Planning Commission were significantly higher (often two or three times higher) than those given in the MOU documents. When asked to explain, PEs were honest enough to admit that targets given to the Planning Commission are for negotiation purposes. Given the past history of getting less than half of what they asked, PEs exaggerated their targets and hence demands for additional allocation of resources. In the MOU documents their targets were modest because they knew that their performance will be evaluated against these commitments. However, when the Government of India took a firm stand and refused to accept the two sets of targets, the two targets converged in subsequent years. This improved the quality of the

planning exercise dramatically. Similarly, because the commitments in a performance contract are negotiated within the framework of inter-ministerial coordination, the quality of coordination during implementation also improves dramatically.

The greatest benefit of performance contracts accrues in the form of an improvement in the implementation record. This creates an enabling public policy environment for other reforms. This instrument provides incentives for “achieving results” rather than following “procedures.” Once this system is in place, it would be easy to incorporate MDGs in the performance contracts. The latter provide a vehicle for effective implementation of all policy goals.

The main focus of performance contracts is on effective evaluation of PE performance. It is based on the fundamental tenets of re-inventing. This power of performance measurement is now widely recognized. The original mantras outlined by the re-invention gurus, Gaebler and Osborne are listed in Box 1.<sup>69</sup>

### Box 1

#### The Power of Performance Measurement

- What Gets Measured Gets Done
- If you Don't Measure Results, You Can't Tell Success from Failure
- If You Can't Reward Success, You are Probably Rewarding Failure
- If You Can't See Success, You Can't Reward It
- If You Can't See Success, You Can't Learn From It
- If You Can't Recognize Failure, You Can't Correct It
- If You Can Demonstrate Results, You Can Win Public Support

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<sup>69</sup> Osborne and Gaebler (1992)

### 5.2.1.1 Performance Contracts and New Public Management (NPM)

The adoption of performance contracts to manage performance in public sector is part of the international trend known as New Public Management (NPM). Figure 8 captures the general thrust of this movement and shows that Malaysia is one of the few developing countries that is at the frontiers of NPM.

The two dimensions used for classifying public sector reforms in various countries are defined as follows:<sup>70</sup>

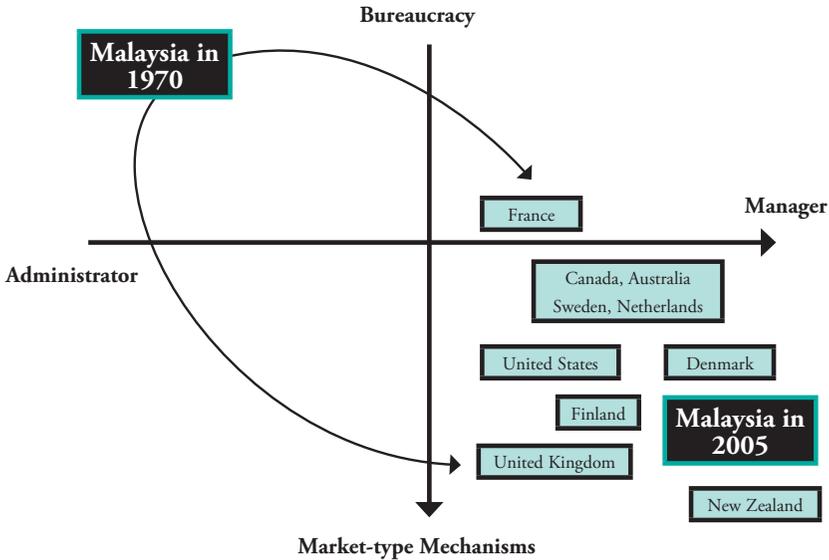
- **From Administrator Model to Management Model:** The management model represents an internal culture of making managers manage, as opposed to the administrator model which values compliance to rigid pre-determined rules and regulations. The shift to the management model in Malaysia represents an attempt to empower managers. It requires them to take greater responsibility, gives them greater operational freedom and holds them accountable for results. Malaysia has used many techniques that are used to achieve this transformation in public sector systems and culture. These techniques include: mandatory strategic planning by government agencies, explicit target setting, devolved resource management, performance monitoring and reporting, and regular evaluations using benchmarked data.
- **From Bureaucratic Model to Market Model:** The market model represents greater use of market type mechanisms, as opposed to the bureaucratic model, which operates the public services as a monopoly provider. The aim of such reforms is to let the managers manage on terms similar to their private sector counterparts. To promote performance orientation, countries have used a range of techniques such as: competitive tendering and contracting out, cost recovery, accrual accounting, and performance contracts. Malaysia has made effective use of all these techniques. As can be seen from Figure 8, only a few OECD countries are ahead of Malaysia in terms of these reforms.

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<sup>70</sup> OECD (1994 and 1997)

**Figure 8: International Trends in Public Sector Management**

**International Comparison:**  
**Trends in Public Sector Management in Malaysia**



**5.2.1.2 Do Performance Contracts work?**

Yes, they do. The main reasons for this conclusion are as follows:

First, it should be noted that “Performance Contract” is a specific example of the commonly used legal document called contracts. Just like their more generic counterparts, these documents represent mutual commitments of the two parties to the contract. Since contracts are used for managing almost every aspect of human activity, there is no reason to believe that they will not work in this case. They are used from highly specific construction projects to very subjective performance of artists and performers. All of us have already signed a large number of contracts and continue to sign them because we believe in their efficacy. Thus, there is a prima facie case for the efficacy of Performance Contracts.

Second, just like contracts in real life, there are good contracts and there are bad contracts. However, the concept of contracts has not been abandoned in spite of the existence of badly drafted contracts. Hence, we should be careful not to generalize about the efficacy of the contractual instrument

by looking at the flaws of specific cases. It is no body's case that Performance Contracts are easy to design or implement. The challenge is to learn from success stories and avoid the known pitfall in designing and implementing Performance Contracts. The alternative of absence of accountability for results is much worse.

Third, in addition to these points based on commonsense logic and practice, there is growing body of empirical evidence to strongly suggest that Performance Contracts work. Let me just cite a few key ones to illustrate this point. According to a recent study done by National Council for Applied Economic Research (NCAER), an independent think tank in India: "The MOU<sup>71</sup> system has been relevant in the past and still holds relevance in the current scenario though it needs change. Although performance measures in the form of financial indicators showed improvement since the introduction of MOU, the productivity measures did not conform to the above observation." Now this is exactly how one would have expected. The MOUs in India give at least 50% weight to financial performance and hence it is natural that is what get the attention of the PE managers – what gets measured, gets done.

If the performance contracts in India (MOUs) had specified targets for Total Factor Productivity (TFP), PE managers would work towards delivery of it. But it is patently unfair to judge the MOUs on the basis of TFP after asking managers (and MOUs) to deliver better financial performance.

A survey done for the NCAER report found that: "Majority of PSEs believes that the MOU has facilitated the top and middle level managers in becoming more analytical and articulate. MOU as an instrument for performance evaluation has become important as brand equity has been evolved around this. It has widespread impact/implications in the international/domestic markets and even within the enterprise foro it affects incentive payments in select PSEs".

The section entitled "Perceptions' Analysis: Role and Relevance of the MOU as an Instrument" is very instructive. It concludes by saying: As a whole, one can observe that a major portion of PEs recognize and appreciate the relevance of the MOU system in the Indian and the new globalized context. The MOU is seen as a tool that leads to improved levels of productivity and better utilization of latent infrastructure".<sup>72</sup>

The evidence on the effectiveness of Performance Contracts in India mirrors that compiled by the Korean Development Institute (KDI).<sup>73</sup> As

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<sup>71</sup> Performance Contracts in India are called Memorandum of Understanding (MOU).

<sup>72</sup> For further details of the NCAER's "Perception Analysis," see Appendix III (see Annex)

<sup>73</sup> KDI Working paper No. 8811, September 1988, Korea Development Institute, Seoul, South Korea

can be seen in Table 1, the number of public enterprises<sup>74</sup> making losses was increasing during the period from 1980 to 1983. In 1980 two PEs, Dae Han Coal Mining Corporation and Korea Broadcasting System made a loss of 3,883 million won.

**Table 1: Financial Performance of Korean PEs**

	1980	1981	1982	1983	1984	1985	1986
<b>Number of PEs</b>	2	2	4	5	1	1	0
<b>Deficit (mil. Won)</b>	3883	26507	35610	35911	530	560	0

  
**PC introduced**

Whereas, in 1983 five public enterprises made a total loss of 35,911 million won, a nine fold increase in losses. After the introduction of the PCs in 1984, there was a dramatic reduction in the financial losses. By 1986 they were completely eliminated.

To further corroborate the quantitative evidence, an opinion survey of 750 employees of 25 public enterprises was conducted by KDI. Since these employees had served under both management regimes (with and without a PC), they were expected to be in a good position to describe the impact of the PC. As can be seen from Table 2, 64.4 % of the respondent felt that that

<sup>74</sup> Public enterprises in South Korea are called Government Invested Enterprises (GIEs)

there was very substantial improvement in overall management as a result of the introduction of PC in the Korean public enterprises was very positive. While all categories of workers were positive, executive directors were most bullish on impact of PCs. 93.1% felt that the positive impact of PC on overall management was either substantial or significant.

**Table 2: Results of Opinion Survey on Improvement in Specific Management Functions**

	Executive Directors	Directors	Department Heads (DH)	Assistant DH	Others	All
Significant Improvement	41.4	23.9	19.8	16.5	15.3	19.0
Substantial Improvement	51.7	40.3	44.3	47.4	44.7	45.4
So So	6.9	28.3	29.3	27.4	33.3	28.3
Few Improvements	0	4.5	5.2	4.9	4.7	4.7
No Improvement	0	3.0	1.4	3.8	2.0	2.6
TOTAL	100	100	100	100	100	100

This study also surveyed the impact of PCs on various functional areas such as: personnel management, budget management, R&D management, long-term management planning, public service quality management, behavioral changes of top management and general workers. As can be seen from Table 3 (following page), majority of the public enterprise employees (80%) believed that PCs had a dramatic impact on the behavior of top management. While service quality was seen to have benefited a lot, other areas registered only modest improvements.

**Table 3: Results of Opinion Survey on Improvement in Specific Management Functions**

	Improved Significantly	No Improvement Or became worse	So So
Positive change in Top Management Behavior	79.1	6.5	14.4
Positive change in general worker attitude	71.5	13.2	15.3
Improvement in PE service quality	70.6	23	27.1
Improvement in R&D	61.4	5.9	32.7
Improvement in Long-Term Planning	57.4	11.2	31.4
Improvement in budgeting and procurement functions	55.3	6.3	38.4
Improvement in Personal Management	29.3	15.2	55.5

Another piece of evidence on the efficacy of performance contracts comes from the data on EU accession. To become member of the European Union (EU), new states had to sign an accession treaty. This treaty was like a performance contract between a country seeking EU membership and the EU. Clearly laid down criteria for performance were specified by EU in the treaty of accession. If members performed (or achieved) these results, countries were promised membership of EU. Table 4<sup>75</sup> (following page) shows the impact on the performance of EU countries as far a law and order is concerned. The rule of law sees to have increased only in the countries that had a performance contract with EU to improve rule of law in order to become a full ember of the EU. This is also generally true of other aspects of EU accession treaty—a dramatic example of what gets measured, get done.

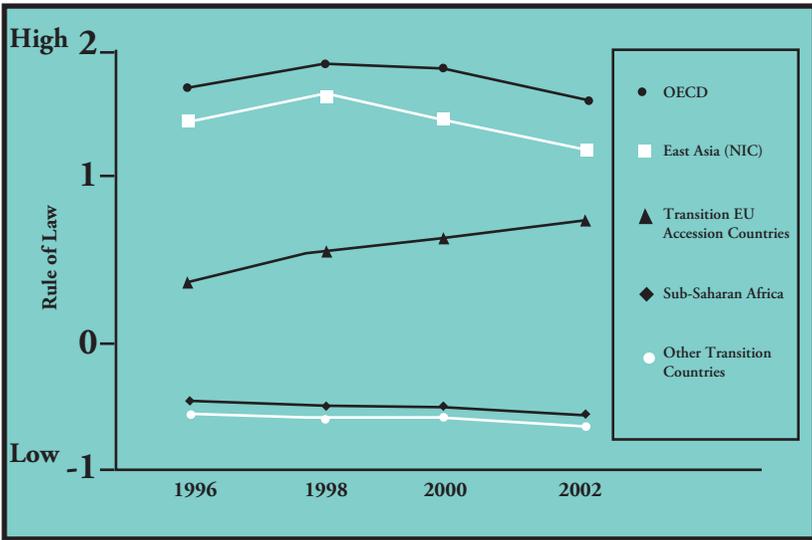
With such an array of evidence lined up in favor of PCs, why is there a lingering skepticism about them? The answer to this can be traced to the case against PCs in a widely publicized book titled “Bureaucrats in Business” published by World Bank in 1995. While a full discussion of the debate is not possible, it is worth noting the main flaws in the arguments presented in this book. First, the arguments were based on a very small sample of PCs.

<sup>75</sup> From a presentation by Daniel Kaufman, World Bank Institute.

The book examined 12 PCs on a qualitative basis and 8 on a quantitative basis. This is too small a sample to generalize about the policy. Second, the authors used criteria that were not part of the contract that were being examined. In particular, they based their conclusions on trends in total factor productivity (TFP) and labor productivity. These are good criteria and there is nothing wrong in using them. However, they should have been included in the contract. It is like evaluating a contractor who has a contract to manage a hospital for not living up to the standards of a five star hotel. While it may be desirable to run a hospital like a five-star hotel, this needs to be specified in the contract. In other words, it is unfair to judge the high jumper in athletics by yardsticks used for a broad jumper. A performance contract is an instrument to achieve the goals specified in the contract. It delivers what you expect and hence the correct measure of its success is the rate of “returns on expectations.”

**Table 4: Impact of EU accession Treaty on Comparative Performance of Member States**

On the growing between EU-accession countries and the rest of transition-Rule of Law Over Time, Selected Regions, 1996-2002



Each region has the following number of countries: OCED: 28 East Asia (NIC): 4 Eastern Europe: 16 Former Soviet Union: 12 South Asia: 8 Subsahara Africa: 47 Middle East North Africa 21: Latin America Carribbean: 38

Third, authors of the book used counterfactual scenarios to neutralize the achievements in these areas. They found that while during the period covered by PCs there were big gains in labor productivity, these gains were insignificant after taking into account a counterfactual scenario. Similarly, they found that total factor productivity increased during the period covered by PCs, these gains were negative after taking account of the counterfactual story. There are several problems with this argument. The counterfactuals are subjective and decided by the researcher. In addition, as a management tool, PCs can use only widely understood and commonly reported criteria. Rarely, if ever, private sector holds managers responsible for Total Factor Productivity (TFP). Few shareholders would understand this concept and even fewer can measure it. PCs are a class of MBO (management by objective) techniques and hence use commonly understood measures to hold managers accountable. Theoretically, it is possible that profit could increase while TFP decreases during the period under observation. A manager who is asked to maximize profits can not be blamed for decreases in TFP calculated using a very sophisticated measure.

Fourth, the authors of *Bureaucrats in Business* do not make a distinction between flawed design, flawed implementation and flawed results. Any policy, however well intentioned, can disappoint if it is not designed and implemented properly. Similarly, if the PC design is congenitally flawed, we can hardly expect it to deliver results. Many of the PCs examined had flawed design. Thus, it is patently unfair to generalize about all PCs from such a limited sample. The more productive approach would be to focus on improving the design and implementation of PCs.

Many of these flaws exist in the NCAER study quoted earlier. In both studies, authors are troubled by the fact that many PCs are rated as excellent. They think this is a symptom of the problem with PCs. Thus, they want to look for a criterion that would make most of them look bad. Clearly, this is a symptom of an ideological bias that would have us believe that all PEs are poor performers. Hence, any system that finds them to be performing well must itself be flawed. A performance contract specifies certain goals for the management. If these goals are achieved, and PEs rated highly, then PC as a system has delivered what is expected from it. Any issues regarding “hardness” or “softness” of the targets ought to be raised before the contract is signed. Indeed, poor quality of target setting is a reflection of the poor capacity of the stakeholders to govern PEs and not a reflection of poor quality of management of PEs. No subordinate (agent) ever goes to the superior (principal) and volunteers hard targets.<sup>76</sup>

Both studies need to pause and reflect (and explain) why the managers and workers find the system very useful and effective, contrary to the conclusions of the ex-post researchers.

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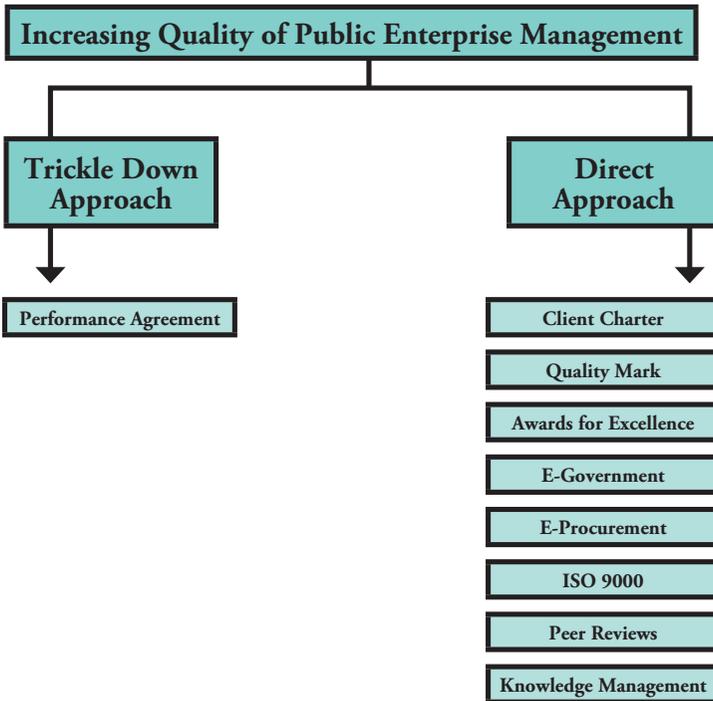
<sup>76</sup> More on this issue in the section dealing with PEGI.

### 5.2.2 Direct Approach to Improving Public Enterprise performance

Tools and techniques to fight public sector inefficiency under this category may remind development economists about the debates of yesteryears about the appropriate development strategy to fight poverty. There were those who argued for the “trickle down” approach while others argued for a direct attack on poverty. Similarly, system-wide initiatives like Performance Agreements bring long term benefits in terms of increased efficiency. However, it takes sometime for the efficiency to trickle down. Whereas, Client Charters and Quality Mark, ISO 9000 initiatives represent a direct attack on public sector inefficiency. It is important to note that these are complementary approaches and not substitute for each other.

To do justice to these approaches, it would take an inordinate amount of time and space.<sup>77</sup> Hence only a few select approaches from the long list shown in Figure 9 have been dealt with in this note.

Figure 9: Menu of Direct Approaches to Increasing PE Efficiency



<sup>77</sup> Unlike Performance Agreements, there is plenty of good reference material on these approaches.

**(i) Client Charter**

There is no question that governments in almost all developed countries and in some developing countries as well are becoming results oriented. The cutting edge of this new trend is represented by what is referred to as *Service Quality Initiatives*. These initiatives attempt to shift the focus of public administration toward higher-quality service delivery, and they aim at attaining the ideals of so-called responsive governments. The title of an OECD publication, *Administration as Service: The Public as Client*, captures the essence of this movement. The Citizen's Charter initiative in the United Kingdom is considered to be the best example of this approach.

**What is a Client (Citizen's) Charter?**

A Client/Citizen's Charter is a document prepared by a public agency in which it outlines the quantity and quality of public service that a citizen can expect from this agency. Under the Citizen's Charter, the common man can expect public services to:

- publish standards of service;
- be more open and provide more information;
- provide choice and consult the citizen where possible;
- be polite and helpful at all times;
- put things right when they go wrong; and
- give value for money.

**Why was the Citizen's Charter Introduced?**

The Citizen's Charter program was launched in July 1991 as a 10-year program. The first objective was to ensure the issuance of detailed Charters covering each of the main public services, setting out standards of service and what people can do if they are not met. This objective has been achieved. Currently, there are 42 National Charters in the United Kingdom covering the key public services. There are also more than 10,000 local charters covering individual doctors (General Practitioners), schools and hospitals.

The Citizen's Charter initiative took the ongoing public sector reform program in the United Kingdom a step further. The earlier reforms were about raising public sector standards by concentrating on getting the delivery systems right—the internal organizational changes needed to raise the standard of public services. But the Citizen's Charter has an equally important aim of making public services answer better to the needs of the people. The overall objectives of raising service standards and improving responsive-

ness to users are measured through individual standards and targets set for each service and reported on in detail each year in a report to the British Parliament.

### **What is the Relationship between a Citizen's Charter and a Performance Agreement?**

A good way to conceptualize this relationship is by recalling a major debate among development economists in the mid 1970s over the "direct attack on poverty through a minimum needs program" versus the "trickle-down" approach. According to the proponents of the latter approach, the best way to deal with poverty was to get the fundamentals of the economy right and focus on accelerating the growth of the Gross Domestic Product (GDP). In the short run the benefits may be restricted to a fortunate few; eventually, however, the benefits will "trickle down" to the poor. The other group argued that there were too many ifs and buts involved in this theory. Given the acute nature of poverty, some immediate action was not only desirable but necessary for long-term survival of the truly poor.

The Performance Agreement approach is like the trickle-down approach. It is postulated that the accountability for results that Performance Agreements will put in place at the top will trickle down to the lower echelons of bureaucracy and thus eventually benefit the common man. The protagonists for the Citizen's Charter approach believe that a direct and immediate attack on public sector inefficiency is required to ensure some minimum levels of public service standards.

This parallel may be instructive, but it is somewhat exaggerated. In fact there is a great deal of complementarity between the two approaches. Another way of looking at the relationship is as follows: a Citizen's Charter is, in a way, a Performance Agreement. It lays down the mutual expectations of the citizens and the agency. While it is a useful tool for putting pressure on the agency to deliver minimum levels of service, it does not have any mechanism to hold the agency accountable or provide it with incentives. The evaluation methodology of Citizen's Charters is simple, but it has several flaws. For example, criteria are not prioritized, nor is there any agreement on how to measure deviation from targets.

Thus, the framework of Performance Agreements has to be superimposed on government agencies to link the Citizen's Charters to a management control system. In fact, the Framework Agreements in the U.K. do just that. In the final analysis, the Citizen's Charter should be seen as a set of useful performance criteria for the Performance Agreement.

**(ii) ISO 9000 Accreditation**

ISO 9000 is a series of standards for quality management and quality assurance system. The objectives of seeking this certification are as follows:

- a. In the context of the civil service, it ensures establishment of an effective public service quality system with the following characteristics:
  - Consistent quality
  - Emphasis on prevention and not remedial action
  - Doing the right thing right the first time and every time
- b. More transparent administration
- c. Effective control of organization's suppliers
- d. Better cost control
- e. Higher productivity
- f. Reduction in wastage and rework

**5. Public Enterprise Governance Index (PEGI)**

The techniques for improving PE performance have been around for a long time. However, they have not been implemented with any seriousness. The blame for this lacuna can not be placed at the door steps of PE managers. They are like any other manager, merrily pursuing their self-interest. The responsibility for designing and implementing an adequate system lies squarely with the owners.

In fact, it can be argued that owners get the public enterprises they deserve. That is, poor performance of PEs is a reflection of poor governance of the PE sector. While governments are willing to pay huge sums of money to management consultants as success fee for a single privatization transaction, they are most miserly investing in governance of PEs. Most of the reforms that are implemented are cosmetic in nature. They amount to rearranging various boxes in the name of re-structuring and reforming. The endless debates on the desirability of holding company versus other forms have been a great waste of time because they never touched the core issue of accountability. This meeting can make a very valuable contribution by agreeing on an index to measure the quality of governance efforts made by policy makers to manage the PE sector in their respective countries. This paper proposes a simple index given in Figure 10.

**Figure 10: Public Enterprise Governance Index**

			Implementation Status				
	System	Weight	100%	75%	50%	25%	0%
<b>Trickle Down</b>	Performance Agreements	50					
	Strategic Plans	10					
<b>Direct Attack</b>	Performance Budget	7					
	E-Government	7					
	E-Procurement	6					
	ISO 9000 Certification	6					
	Citizen's Charters	6					
	Quality Marks	4					
	Knowledge Management	4					
<b>TOTAL =</b>		<b>100</b>					

The first column of Figure 10 list the two categories of approaches mentioned above. Column 2 lists the specific approaches under these two broad categories. Column 3 gives relative weights to these approaches. Performance Agreements are given a high weight as they are the most concrete manifestation of accountability in the long-run. Without them, other approaches would have a transient benefit. Column 4 gives the implementation status of these approaches.

For example, for Performance Agreements, we could use the scale given in Table 5 below.

**Table 5: The Rubric to Judge Implementation of a PA System**

<b>0 %</b>	Nothing has been done in this regard
<b>25 %</b>	<ul style="list-style-type: none"><li>•Performance Agreements (PAs) have been adopted as the official policy to manage the PE sector</li><li>•A state-of-the-art performance evaluation methodology has been adopted for PAs</li></ul>
<b>50 %</b>	<ul style="list-style-type: none"><li>•Performance Agreements have been signed using agreed methodology with some PEs on a pilot basis</li><li>•Proper institutional arrangements have been put in place to sign PAs with all PEs in the country</li></ul>
<b>75 %</b>	<ul style="list-style-type: none"><li>•All PEs have signed Performance Agreements and the results for all have been announced.</li></ul>
<b>100 %</b>	<ul style="list-style-type: none"><li>•An independent audit of the system has been conducted</li><li>•An incentive system is in place</li><li>•Results of PAs are the main basis for the annual performance appraisal of PE management</li><li>•Internal PAs have been signed at lower levels of management</li></ul>

It is important to note that a PA implemented with wrong methodology is at best useless, at worst can be a big waste of time and other resources. The bottom line for an acceptable methodology is its ability to rank various PEs objectively as depicted in Figure 11 (following page).

*Appendix II* (see Annex) includes an example of the best-practice methodology for arriving at the ranking in Figure 11.

The list of criteria for determining PEGI includes only those that are least controversial. No one can, for example, argue against E-Procurement. In addition, most of these items can be measured with some degree of objectivity and reliability. This list can be expanded (with great caution) to include some more subjective elements from the list of criteria for good governance published by OECD. Box 2 (following page) gives some of those ideas:<sup>78</sup>

**Figure 11: Performance Ranking of Public Enterprises**

**Performance Ranking of Public Enterprises**

Rank	Public Enterprise	Composite Score
1	National Electricity Company	4.78
2	Cement Corporation	4.44
3	National Airways	4.40
4	Rural Electrification Corporation	4.00
5	Oil and Natural Gas Exploration Company	3.85
6	National Refining and Distribution Company	3.70
7	National Tourism Promotion Corporation	3.66

<sup>78</sup> These Guidelines are based on and complementary to the OECD's Principles of Corporate Governance, created in 1999 and revised in 2004, that are the benchmark for national codes of governance in members as well as non-member countries.

## Box 2

**Governments need to be better owners of state-owned enterprises, says OECD**

The OECD has approved new Guidelines on Corporate Governance of State-Owned Enterprises to give concrete advice to countries on how to manage more effectively their responsibilities as company owners.

The Guidelines aim to help make state-owned enterprises more competitive, efficient and transparent.

In many OECD countries the state remains an important owner of large firms operating in key sectors, including energy, utilities and infrastructure. But a recent OECD study reveals the challenges facing such firms, including conflicting corporate objectives, unclear board responsibilities and opaque appointment procedures.

To address these issues, the Guidelines call on governments to:

**Ensure a level-playing field for state-owned enterprises competing with the private sector by**

- Clearly separating the state's ownership role from its regulatory role
- Allowing more flexibility in capital structures while making sure that state-owned enterprises face competitive access to finance

**Become more informed and active shareholders by**

- Simplifying the chain of accountability through centralizing or more effectively coordinating shareholding responsibilities within the state administration
- Reducing political interference in day-to-day management
- Introducing a transparent nomination process for boards, based on competence and skills

**Empower boards by**

- Clarifying their mandates and respecting their independence
  - Separating the role of Chairman and CEO and giving boards the power to appoint CEOs
- Systematically monitoring the board's performance

**Improve transparency by**

- Strengthening internal controls
- Carrying out independent, external audits based on international standards
- Disclosing any financial assistance from the state
- Producing aggregate performance report

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# The Question of the Public Enterprise and Africa's Development Challenge: a Governance and Leadership Perspective

John-Mary Kauzya

*"In the ill judged execution of the well judged plan of things, the call seldom produces the comer".* (Thomas Hardy in Tess of the d'Urberville)

## **Africa's Challenge and the Question of the Public Enterprise.**

Of all the challenges Africa is facing, the most critical is that of poverty reduction and development in general. This challenge is well detailed and documented in the New Partnerships for African Development (NEPAD) and the United Nations Millennium Development Goals. The relevance of discussing the topic of re-inventing the Public Enterprise in Africa needs to be seen in this light. The important question to pose here concerns what the role of the State should be in the achievement of the MDGs, NEPAD objectives, and development in general, and how the institutions and organizations of the State in Africa should be structured to successfully fulfill this role. In this paper our main argument is that historically in Uganda, and perhaps in many other African countries, the Public Enterprise was misused and then blamed for poor performance. The gist of the paper is that if used for the intended purpose the Public Enterprise as one of the structures for government investment, can register impressive performance and serve as a catalyst for development.

To a non critical eye, the demise or rather the decline in the dominance of the Public Enterprise in the economy in most African countries started with the introduction of Structural Adjustment Programs (SAPs) in the 1980s. However, the reality is that given the miserable performance of the Public Enterprise sector in many of these countries, a more analytical observation would notice that the Public Enterprise was basically dead or at least very sick well before the SAPs. What then would be the logic of re-inventing the Public Enterprise if its demise was caused by its poor performance? Was the poor performance of the Public Enterprise inherent in the structure (the Public Enterprise), or was it a result of factors that are external to the structure? Has privatization resolved all the issues of the Public Enterprise, i.e. fulfilled the role the public enterprise had been conceived to fulfill? In other words, can the private enterprise alone help Africa to meet its development challenge as specified in the NEPAD objectives and the Millennium Development Goals? Or does the Public Enterprise still have a critical role

to play? The overriding question in all these also concerns whether the status of the Public Enterprise in African countries is clearly known given the privatization and restructuring that has been going on. These are some of the questions this paper seeks to discuss. But first we need to pay attention to the diversity of the situation in African countries.

### **1: Africa is not one homogeneous entity.**

There is often a tendency to regard Africa as one homogeneous entity. It is true that, especially now with the Africa Union and one development program (NEPAD), it should be at least convenient to talk about Africa as one entity. However, for diagnostic and analytical purposes on a subject such as Public Enterprises, taking all the fifty or so countries of Africa to constitute one homogeneous entity can lead to erroneous conclusions. In different African countries, public enterprises were formed differently, at different times, and probably for different purposes. They were certainly managed differently and with varying successes or failures. A case in point is the relatively successful Ethiopian Airlines compared to the miserable performance and eventual demise of Uganda Airlines. Certainly the situation in Somalia is not comparable with the situation in its neighbor Ethiopia; just like the situation in Liberia can not be compared to the situation in Ghana just a few miles away. Because of this, in the paper we will guard against assuming that Africa is one entity in all aspects. The paper will largely base its discussion on Uganda although, where available to the author, some examples from other African countries will be given.

### **2: On definition of the public enterprise**

Discussing Public Enterprises in the 21<sup>st</sup> Century brings back memories of the various ambiguities that surrounded this field when the Public Enterprise was dominating the involvement of the State in economic activities. Some of the ambiguity in fact stemmed from the nomenclature itself. The terms utilized were numerous and included Public Enterprises (PEs), State Owned enterprises (SOEs), Parastatals, Public Companies, Public Corporations. The intense debate that surrounded the subject of the Public Enterprise especially during the 1960s and 70s subsided before the ambiguities were ironed out and we do not believe that they will ever be. Consequently we will not dwell on the nomenclature in this paper. The question that may be more interesting now is the following: Did the public sector reform programs that have been on-going in Africa since the structural adjustment programs (SAPs) of the 1980s make any shift in the nature and meaning of the Public Enterprise or should we assume that we are dealing with a very well known animal which does not need to be defined? But then, what would “re-inventing” the Public enterprise entail if the definition has not changed? In as far as Uganda is concerned most of the industrial, commercial and service public

enterprises have been privatized. We may need a definition that fits the ones that have been created through the public service reform programs (see paragraph on this further down in the paper). We will take the Public enterprise to refer to an organization established by government under public or private law as a legal personality which is autonomous or semi-autonomous and produces/provides goods and services on a full or partial self-financing basis and in which the Government or a Public body/agency participates by way of having shares or representation in its decision-making structure.

### 3: The Resilient Public Enterprise: Why the Public Enterprise?

In Uganda, like in many other African countries that were former colonies or protectorates, the participation of the state in economic activities by way of establishing, owning, and operating Public Enterprises started during the era of colonial administration when the country's first 10 year development plan of 1946 was elaborated. Various regimes in the country's history have established, abolished or privatized Public Enterprises giving various and sometimes contradictory reasons. Sometimes the reasons given for the creation or privatization of the Public Enterprise were not seriously genuine. Judging from the privatization process which in fact started during the times of Idi Amin's dictatorship<sup>79</sup> and became intensified during the regime of the National Resistance movement under the presidency of Yoweri Museveni, one would quickly conclude that the creation of Public Enterprises was complete. As this paper shows this is not true. We believe that as long as there is government, there are likely to be Public Enterprises since they actually represent a form of political expression of the economic intention of the government; or sometimes an economic expression of its political intention. What is often forgotten in the whole debate about the Public Enterprise is that it represents a structural arrangement through which government or other public authorities can make investment for a number of purposes some social other economic or even political. The reasons that justify public investment via public enterprises have been well documented in the history of the Public Enterprise and in contexts of extreme poverty, and weak private sector, most of these reasons cannot be overlooked<sup>80</sup>. That is why the Public Enterprise remains resilient even in the face of severe assault from proponents of Reaganomics<sup>81</sup>, ("President Reagan taught us that while free markets aren't perfect, neither is government. In fact, government often presents

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<sup>79</sup> Iddi Amin Dada ruled Uganda under a military dictatorship from January 1971 to April 1978.

<sup>80</sup> See for example, Georges Vedel et al, *Droit Administratif 2*: (Presse Universitaire de France, Paris 1990)

<sup>81</sup> The term **Reaganomics**, a portmanteau of **Reagan** and **economics**, was used to describe, and decry, the economic policies of U.S. President Ronald Reagan during the 1980s.

serious and debilitating imperfections. As he often said, “Government isn’t the solution to our problems; government is the problem.”<sup>82</sup> Thatcherism<sup>83</sup> and private sector-led economic growth. What were the reasons for the creation of Public Enterprises in the first place?

In Uganda, the reasons for the creation of Public Enterprises kept shifting depending on the regime that was making the policy. During the 1940s the colonial government gave the following official reasons: the private sector was too weak to make the necessary investments for the country’s development, the government needed to plan and control the development of the economy, the government needed to make investment to foster local entrepreneurship, there was a compelling need for economic independence, there was the need to stimulate capital development, and to build the required infrastructure. This is a very interesting set of reasons within the context of colonialism. It is very likely to doubt whether they were genuine given that, ultimately, the private entrepreneurs that were developed were those from Britain or British of Asian origin. One would also regard with suspicion the reason of having economic independence for Uganda within the context of colonial administration. What needs to be noted here is that the colonial administration had an objective, hidden or declared, of exploiting the country’s natural resources and expropriating the surplus. It found the Public Enterprise a very relevant and useful structural arrangement for accomplishing this and used it successfully. To its credit, the Uganda Electricity Board (UEB) was created to generate and distribute electricity, the Uganda Development Corporation (UDC) and a number of its subsidiaries were created to engage in manufacturing, mining, and other types of commercial ventures, and the Lint Marketing Board (LMB) was established to commercialize Uganda’s cotton produce. At independence, the Public Enterprise sector was performing well even if the ultimate beneficiary of this commendable performance was not the common Ugandan. This observation makes one conclude that as a structural arrangement for government investment, the Public Enterprise does not have an inherent natural tendency for poor performance. It is an instrument that can be used well or badly depending on the user!

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<sup>82</sup> Jeffrey A. Aisenach et al: *History and Culture: Reaganomics*: (Hoover Digest, 2004 # 4, fall issue).

<sup>83</sup> According to Encyclopedia Hutchinson, Thatcherism is a “Political outlook comprising a belief in the efficacy of market forces, the need for strong central government, and a conviction that self-help is preferable to reliance on the state, combined with a strong element of nationalism. The ideology is associated with the former UK premier Margaret Thatcher, but stems from an individualist view found in Britain’s 19th-century Liberal and 20th-century Conservative parties, and is no longer confined to Britain”.

During the post-independence first regime of Milton Obote<sup>84</sup>, the East African Community continued to provide infrastructural services through the East African Railways Corporation, the East African Airways Corporation, and the East African Posts and Telecommunications Corporation. However, the Obote government later added a number of other Public Enterprises including; the Produce Marketing Board, the National Housing and Construction Corporation, the National Insurance Corporation, the Coffee Marketing Board, and the Uganda Dairy Corporation. The major reason given by the Obote government was that the Public Enterprise was a catalyst for local economic development. However, with the nationalization policies announced later on in 1969 the whole policy of using the Public Enterprise was suspected of being aimed at using such enterprises to strengthen the structure that would maintain the ruling group in power and the private sector out of the money economy. Again one notes the divergence between the officially announced reasons and the underlying or suspected ones.

During the regime of Idi Amin, the Public Enterprise sector expanded using only one reason "economic war and returning the economy to Ugandans." But as it turned out the only Ugandans that benefited from Amin's economic war were his soldiers and henchmen who, not having any experience and business know-how, let the production of the enterprises that had been confiscated from the Asians decline to almost zero sending the whole national economy into limbo! Again the official reasons given and the real ones were very different. The conclusion from this account is that the Public Enterprise is a structure that can be used. It all depends on the leadership of the country and the governance situation in general. If the leadership really wishes to utilize the Public Enterprise structure for a specific cause and sticks to it, it is likely to work as was the case with the colonial administration and the East African Community which collapsed in 1977.

In 1988, the Museveni<sup>85</sup> Government at the time stipulated the criteria for government participation in Public Enterprises as follows:

- i. Political criteria: (activities providing information and broadcasting services). Up to this month (November 2005), the government owned Radio Uganda, Uganda Television and a number of News papers. These have now been handed over to the newly created Uganda Broadcasting Corporation which is a Public Enterprise. However, broadcasting and print media have been liberalized allowing extensive participation of private operators in FM radio stations, television houses and news papers.
- ii. Security: (activities that provide internal and external security (e.g. oil supply and airlines): As it turned out the only airline owned by the

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<sup>84</sup> Milton Obote ruled Uganda, first as Prime Minister and later as President from 1962 to 1971

<sup>85</sup> Yoweri Museveni has been president of Uganda since 1986 up to today.

- government (Uganda Airlines) totally collapsed and all suppliers of petroleum products are multinationals. This criterion seems therefore not to have been sustained.
- iii. Essential services: (particularly health and education that cannot be met by the private sector): The Government is providing Universal Primary Education, owns a number of universities and other tertiary institutions and Hospitals. However, in these areas the private sector has been also operating along side government. The combined efforts seem to be working out successfully.
  - iv. Natural monopolies: (requiring large capital investment e.g. utilities and railways): There seems to have been a turn around in this. Currently the Uganda Electricity Board has been disbanded and instead its activities separated to create a generation company and a distribution company leaving the government owning the regulatory agency. Equally the National Water and Sewerage Corporation is redesigned to allow private operators especially in Kampala. Finally Uganda Railways recently joined Kenya Railways and offered a joint concession to private operators to undertake common rail transportation in Kenya and Uganda. This deal is not yet operationalized.
  - v. Environment: (preservation and conservation of Uganda's wildlife and natural environment e.g. national parks): This criterion is behind the formation of the National Environment Management Authority and the Uganda Wild Life Authority.
  - vi. Capital intensive and resource based projects: (which require investments and technology in priority sectors which the private sector is not able to or willing to provide (e.g. chemicals, fertilizers, metals, cement): Here may be the government at the time had not counted on globalization. For example now cement is being mined and processed by a foreign firm.
  - vii. Geographical distribution: In the least developed areas, the government would have to encourage and promote both agricultural and industrial development.

In effect, the above constitute the reasons that should have guided the current government in its participation in running Public Enterprises. However, as some of the brief comments we make on them above show, it seems the government is no longer following them to the letter. But looked at in light of the low level of development of the country and the obligation of government to meet the Millennium Development Goals by 2015, it is possible and in our view even desirable that the government invoke the same criteria to intervene in activities it considers neglected and critical to development. For example, to bridge the development gap between the northern and southern parts of the country one would expect the government to invest a lot in the north because given the security situation there it will take a long

time before the private sector gains sufficient confidence in the area to take investment to that region.

Elsewhere in Africa, for example in Nigeria, the reasons for establishing the Public Enterprises were more or less similar. (shortage of local capital for expansion and technological improvements; control of commanding heights by government to prevent a few elite enriching themselves at the expense of majority of Nigerians; correction of market failure resulting from public monopoly and misallocation of public resources; facilitating regional development through location of public enterprises and their branches; job creation, and provision of social services.)<sup>86</sup>

#### **4: Recent trends in creation of the Public Enterprise**

The formation of the Public Enterprise has not ended and those celebrating the demise of this structural arrangement for State investment and service delivery may have to tone down their celebrations. Before the wave of privatization, it was well known that the Public Enterprise had several ways through which it could be formed. It could come into being through partial or total nationalization of a private enterprise. It could be formed by law establishing it as a body corporate under a specific statute with all or some of its shares owned by the State or a public authority (for example a local government or another state enterprise). It could be established by law under company law with some or all of its shares owned by the State or a public authority. There are many Public Enterprises that, (especially under dictatorships such as the one that reigned over Uganda during the 1970s), came into being through outright confiscation by the State of private enterprises. Many of the Public Enterprises that were privatized could fall into any of these modes of formation. The various modes of formation of Public Enterprises can be found in a lot of literature on the subject<sup>87</sup>.

However, there is one way through which Public Enterprises have recently been formed which has not attracted attention. This is the process of public service reform. In recent times, public service reform and privatization programs worked hand in hand to reshape the Public Enterprise sector. While the process of privatization pushed enterprises (wholly or partially) from the public sector to the private sector, the process of public sector reform pushed some departments from mainstream public service to the public enterprise sector.

From the privatization process a big chunk of the Public Enterprises, including those which had not been earmarked for privatization (for example Uganda Electricity Board) have been privatized in one form or another.

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<sup>86</sup> Bureau of Public Enterprises – Nigeria, official Web site

<sup>87</sup> See for example: Georges Videt et al: *Droit Administratif 2* : (Presses Universitaire de France, 1990)

Information available indicates that by 2002 out of the 139 State-owned Enterprises listed for privatization, only 34 were still remaining to be privatized. It is informative to note how wide-spread the Public Enterprise was in all sectors of the country's economy.

From the process of public service reform a number of Public Enterprises have been formed including: the Uganda Revenue Authority (URA)<sup>88</sup>, the Uganda Investment Authority (UIA), the Uganda Wildlife Authority (UWA), the Uganda Tourist Board (UTB), the National Environment Management Authority (NEMA), the National Drug Authority (NDA), and the Capital Markets Authority (CMA) etc. All these Public Enterprises were created from units within Ministries during the process of reforming the public service. While it can be argued that in terms of numbers these are few compared to the ones that were privatized, in terms of the impact or influence on the economy that some of them, such as the Uganda Revenue Authority and the Uganda Investment Authority have, their weight is sizable. There are also arguments to the effect that these are, technically, not Public Enterprises. We do not agree with this argument. These bodies provides services and at a fee and therefore qualify to be called enterprises.

## **5: Did the issues on Public Enterprises end with privatization?**

The question that imposes itself here is that of knowing whether with privatization and public sector reform the issues that had driven these two processes have been resolved. The argument in this paper is that the basic issues, because they concerned governance in general, have not been resolved and the newly created Public Enterprises are suffering more or less the same old diseases especially in terms of mismanagement and corruption. Below we single out some of these issues and highlight them.

### **5.1: What became of the commanding heights of the economy?**

Looking at what has been happening in the country in terms of liberalization, privatization and disengagement of the government from the Public Enterprise sector; one may ask the following question: One of the reasons for which the Public Enterprises had been established was based on the argu-

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<sup>88</sup> At the time of inception, URA took over from the former collecting departments of Income Tax, Inland Revenue and Customs and Excise, all duties and properties thereof. The Authority was created as a quasi-autonomous unit with a Board of Directors appointed by and responsible to the Minister of Finance, Planning and Economic Development. The URA Statute grants considerable degree of independence to the URA Board. URA is a corporate body with perpetual succession and a common seal and is capable of suing and can be sued in its corporate name. It is a government agency under the general supervision of the Minister responsible for Finance.

ment of the need for the State to take control of the commanding heights of the economy. Although the “commanding heights of the economy” was not defined, it was understood that each country would examine its socio-economic structure and decide which of its productive aspects would remain wholly or partially under the control of the State via the Public Enterprise. Following this logic for example in Uganda, Agricultural Marketing Boards were created (Coffee Marketing Board, Lint Marketing Board), generation and distribution of electricity remained a monopoly of the State under the Uganda Electricity Board (UEB), etc. In the zeal to promote privatization many countries were forced to abandon what was in fact logical at the beginning of the Public Enterprise. The consequence has been that because of the economic weakness of the private sector, some of the economic activities which require heavy investment have been neglected. For example, Uganda has hardly had any functioning railway system. The public transport system in Kampala (the capital city) was left to the private sector which could only afford the cheap “*Matatus*” (small mini-vans) which has led to an unsolvable problem of congestion in city. The second example is electricity. The State had invested in the generation and distribution of electricity. However, the economic development after 1986 would have required further and heavier investment in this sector. But the private sector cannot afford the heavy investment involved in dam construction. The results have been blackouts and inadequate electricity for industrial and commercial purposes. Bringing in foreign enterprises to cover this unending lacuna has raised political questions which have stalled the process of constructing more dams on the River Nile to increase output of electricity in the country. How the country expects to meet its development agenda with a severe energy lacuna is not easily imaginable!

What we would like to propose in this paper is that the Government needs to study very closely the Millennium Development Goals, the NEPAD objectives as well as the national development and poverty reduction strategy and based on these needs and priorities redefine in its own context what would constitute the “commanding heights”. It may then be absolutely necessary for the Government to engage heavy investment in these heavy commanding heights in order to stimulate and sustain economic growth and development for the achievement of MDGs, NEPAD objectives, and national development priorities. Disengaging from the Public Enterprise sector for the sake of liberalization and privatization may constitute a step back from the responsibilities of the government in the development process of the country.

## **5.2: The issue of corruption in Public enterprises:**

One of the factors which lead to abolishing the revenue departments in the Ministry of Finance was that bureaucrats were corrupt. A revenue authority was created with the following rationale:

- Public revenue enhancement reflected in higher tax ratios and real revenue growth.
- Greater efficiency in public resource utilization via financial and administrative independence/autonomy.
- Employment of a competent, disciplined, and more qualified staff via the freedom to offer higher compensation than the civil service and the freedom to put in place and budget for own human resources without the usual government funding constraints.
- De-politicization of tax administration.
- Reduced corruption, thereby improving the credibility of taxation in particular and government in general.
- Improved taxpayer services and reduced taxpayer compliance costs.
- Better work ethic and modification of administrative culture from reactive, bureaucratic, and hostile to proactive and professional.
- Comprehensive accounting for all customs duties and tax revenues.
- Integration of tax and taxpayer-related databases.

We will not dwell on each of the above to assess how the Uganda Revenue Authority has fared against each. Suffice to say that revenues have increased from revenue to GDP percentage of about 6% in 1990 to about 13 % in 2004. This is great improvement. However, As far as reducing corruption is concerned, the situation is not rosy. Faced with alleged rampant corruption in the organization, President Yoweri Museveni appointed a Judicial Commission of Inquiry into Allegations of Corruption in URA. The Commission, whose report was released in March 2004, revealed what most people had known all along. The Uganda Revenue Authority was:

- “Infested with bribery” and the organization abetted tax evasion, nepotism, cronyism, sectarianism, smuggling, dumping, fraud, undervaluation of taxable goods, and conversion or embezzlement of even the little tax collected.
- Experiencing poor leadership; poor management policies; unstable organizational structures; weak administrative and procedural controls; inadequate logistical support; poor terms and conditions of service and staff indiscipline
- Suffering the influence of political patronage and a poor taxpaying culture,
- Manned by a number of officers involved in activities in conflict with their mandate, such as customs officials owning clearing and forwarding companies in contravention of the URA’s Human Resource Management Manual.

It became clear that if the bureaucrats under revenue collecting departments of the Ministry of Finance had been corrupt, the creation of a semi-autonomous Uganda Revenue Authority did not solve the problem of

corruption in revenue collection and tax administration. To those who had followed the debate on the Public Enterprise in Uganda, this should not have been surprising. The Public Enterprise had been believed to provide a structural arrangement that escaped the controls of the civil service as well as to a certain extent public scrutiny and therefore becoming a breeding ground for corrupt tendencies.

In our opinion, the whole issue of corruption in the public sector whether in Public Enterprises or in the mainstream public service was not given a clear diagnostic analysis. Bureaucrats in the revenue collecting and tax administration departments of the Ministry of Finance went away with corruption because the systems of control were too weak to enforce public service ethics, values, regulations and laws. In the same way, some people in the Revenue Authority were bound to practice corruption since the systems of control are still very weak. Finally, corruption was being encouraged by the overall socio-politico-economic governance situation. While it is true that the regime of Museveni has provided better governance than all the previous ones, it is also true that the same regime has been characterized by accusations of high level and rampant corruption. In other words, people are not corrupt because they work in a Public Enterprise or in main stream public service. People are corrupt because the socio-politico-economic governance situation lets them be and the systems of control are so weak that the incentive for corruption becomes overwhelming for the weak hearted. Moralists will also say that people are corrupt because the society they live in is corrupt. But we would rather not pursue this line of argument. It is too big for this paper.

### **5.3: The issue of governance, leadership and performance:**

The performance of Public Enterprises in Uganda had been since the 1970's very disappointing. However, even the good performance of Public Enterprises in the country before the 1970s needs to be regarded with caution. First during the colonial period, the Public Enterprises may have been performing well, but this was largely to the benefit of the colonial society. After independence, signs of poor performance in the sector began to show. Matters got totally out of hand with the arrival of the military regime in 1971 especially after the confiscation of the properties and businesses belonging to foreigners and citizens of Asian origin. What was at issue here is the general governance and leadership environment in the country which impacted very negatively on the corporate governance of the Public Enterprises and crippled their performance. The privatization drive that was introduced through the Structural Adjustment Programs of the 1980s did not pay particular attention to this naked fact. The problem was not only lack of inputs (financial and raw materials or even technological know-how and managerial competence). These could be easily procured. The real prob-

lem was that the governance and leadership environment could not nurture any corporate governance to enable the enterprise recover and perform. This is well captured by the Nigerian Bureau of Public Enterprises.

*“There is virtually no public enterprise in Nigeria today that functions well. While they were created to alleviate the shortcomings of the private sector and spearhead the development of Nigeria, many of them have stifled entrepreneurial development and fostered economic stagnation. NITEL, NEPA and the Nigerian National petroleum Corporation (NNPC) are the best examples of these. Public enterprises have served as platforms for patronage and the promotion of political objectives, and consequently suffer from operational interference by civil servants and political appointees”*

The above statement, to a critical ear, rightly sounds like a clear accusation of the governance of the country and not the Public Enterprise as a structural arrangement. Weaknesses of governance and leadership systems still persist in many African countries. Consequently good corporate governance in Public Enterprises cannot flourish. Even enterprises in the private sector are facing the consequences of poor governance in the public sector. The leadership and governance issue is also directly linked to the issue of corruption. In as far as the performance of Public Enterprises is concerned, the issue is not only the financial, material or technological inputs. The critical lacking ingredients are general leadership and governance.

#### **5.4: The issue of Ugandanization**

One issue that has been prominent in the creation of Public Enterprises concerned Ugandanization. Because of the socio-politico-economic history of the country which had put most of economic and commercial sectors in the hands of foreigners (British and Asians), there was a generalized feeling that the economy of the country needed to be brought under the control of Ugandans. Ugandanization was started during the 1960's under the first Obote regime. Ugandanization referred first to replacing the departing British administrators with Ugandans. Later during the nationalization of 1969 and 1970 it meant the government obtaining 60% of the control of enterprises in almost all sectors in the country. During the military regime of Idi Amin, Ugandanization referred to getting rid of all foreigners and even citizens of Asian origin who dominated most of the industrial and commercial enterprises in the country. This was the “economic war”.

During the privatization debate, a section of Ugandans opposed the policy stating that it was selling the family silver spoon and handing the country's economy to non-Ugandans. At the time, the President played this opposition down saying that there was no silver spoon to sell. He probably

was right given that the Public Enterprises were not delivering any goods and services. But he forgot one true thing. When popular sentiments set in, anything can become silver! The issue still lingers on. Because it is mainly sentimental, any politician can use it to excite the sentiments of society against the foreign enterprises that have obtained shares in Uganda's privatized companies. It would be comforting to believe that enterprise management is not about nationalities. However, unfortunately sentimentalism does not think like that. Even within the context of globalization it will always take skillful politicians and leaders to steer the society away from sentimental reasoning about Ugandanization and family silver spoons. We are back to the issue of leadership and governance. Most of the issues in Public Enterprise management cannot be sorted out within the context of poor leadership and governance.

### **Conclusion:**

In conclusion we would like to consolidate our argument in the paper as follows:

- i. Africa is striving to be one and most of us are hoping to live up to the time to witness the moment. However, for purposes of understanding the situation in Africa in its entirety, diagnostic analysis of issues such as Public Enterprises needs to be conducted on a country by country basis.
- ii. In the context of extreme poverty, weak private sector and civil society and given the commitment of government to get the people it leads out of the poverty situation, government investment is highly desirable in sectors that are critical to poverty reduction where private capital can not be attracted. The concept and argument of commanding heights of the economy is still valid. However, it will take a very well informed and committed leadership within a framework of good governance to design and present development priorities and argue out the case for government investment via the Public Enterprise. Re-inventing the Public Enterprise cannot take place within the context of poor leadership and bad governance!
- iii. Attention and research need to be dedicated to Public Enterprises that came about as a result of public service reform programs and not only to privatization and its outcomes.
- iv. The Public Enterprise as a structure is usable. It will succeed or fail depending on the way it is used. It does not contain inherent characteristics of failure. There are numerous examples where the Public Enterprise has performed wonderfully and indeed where the private sector enterprise would not even have started!
- v. The critical inadequate factor in Public Enterprise performance is not only financial, technological know-how and raw materials. The

most critical inadequate input is the general leadership and governance environment. Indeed the failure of the Public Enterprise in Uganda is testimony of inadequate leadership and governance in the country. The public enterprise has been a readily available scapegoat. It is not the public enterprise that is corrupt. It is the political leaders, the managers, and the people themselves in general who engage in corruption. If it is not in the Public Enterprise, it can be in the mainstream public service or even in the private sector. It is again an issue of leadership and governance.

- vi. The issue of national ownership, even if admittedly sentimental, cannot be wished away. With nationalization it was high on the agenda, and with privatization it is still high on the agenda. It can only be handled by skilled political leadership and governance. Otherwise it can explode any moment.

The final comment we wish to make is that the Public Enterprise has been misused in Uganda and in many other African countries. The reasons for which the Public Enterprises were created in many instances are not the same that guided their management and performance. Consequently as Thomas Hardy wrote in his tragic novel *Tess of the D'Urberville* (*The Pure Woman*), "In the ill judged execution of the well judged plan of things, the call seldom produces the comer". The Public Enterprise having been used for purposes other than those for which it had been created, could not produce the originally expected outcomes!

## Part 2

# Issues on Public Enterprise Management\*

## A. Introduction

Public enterprises (PEs) were created mainly for the purpose of expediting and facilitating economic development. In developing countries especially, PEs were the cornerstones in the overall national development strategy. Despite some successes, PEs continue to be criticized for their lack of productivity, efficiency, and transparency, and are subject to demands for reforms from myriad sources.

In the past thirty years, public enterprises have undergone several institutional shifts in attempts to better reflect and fulfill their social and economic objectives. During this period, institutional reforms have had both progressive and regressive impacts. This report examines the various forces, trends, and theories acting upon and within PEs in order to outline possible trajectories for PE reform strategies.

As PEs have experimented with different degrees of market orientation, management has emerged as a cross-cutting issue. PE management reform requires addressing the challenges of human resources and the underlying administrative structure. By overcoming these obstacles, PEs have greater potential to fulfill their economic and social objectives. The management section of this report examines the various factors including corruption, cronyism, redundant labor, and low staff capacity that have contributed to the management failures of PEs and spurred reforms. It then evaluates the various corrective measures such as human resources, transparency, incentives and accountability mechanisms that can be applied across the spectrum of public private partnerships (PPPs).

The legal and political framework are vital to ensuring the suitability and sustainability of institutional reform, both internal and external. Governments, as a simultaneous shareholder, regulator, and coordinator, are responsible for providing an appropriate legal frame. As PEs engage in more diverse methods such as commercialization, privatization, and public private partnerships to increase global competitive advantages, it is essential that the legal framework adjust accordingly, to facilitate fulfillment of economic

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\* The issues presented in this Chapter have been synthesized from the papers and discussions that ensued from the Expert Group Meeting on "Reinventing Public Enterprises and their Management." Authorship is attributed to Jacinto De Vera, Numayr Chowdhury, Mary Christine Ong-Reyes, Tara Collier, Chunhee Lee, Carrie Hasselback and Irena Budimova.

accords with shareholders and social obligations to beneficiaries. The legal and political framework section of this report includes an analysis of the relationship between the government and PEs, the oversight management roles of the governments, and the basic framework that underpins the continued existence of PEs. It examines the various contributions of governments in the advancement of PEs as simultaneous shareholders, regulators, and coordinators, based on country experiences in India, Mexico, and Uganda. It further examines the effects of the emergence of regional trading blocs in post 1980s on the development and reform efforts of PEs.

Global conditions can provide opportunities for a PE's success or establish limits on its growth. National and supra-national actors are grappling for authority to steer PEs toward their respective economic, social, and political agendas. Management of PEs, whether public or private, domestic or foreign, must maintain a commitment to its mission regardless of the strategic social, economic, and political interests of external actors. The justifications for state ownership vary according to the cultural, economic, and sociopolitical considerations of the nations involved. In the geopolitical considerations section, this report examines the impact of the European Union's (EU) policies on the evolution of France's PEs and also explores how the economic development strategies shaped Mexican PEs.

Public private partnerships (PPPs) are increasingly being used as a policy tool to transform the role of PEs in public service delivery, infrastructure development, poverty alleviation, capital market development, and governance around the world. Partnerships offer the opportunity to overcome the weaknesses of state ownership, while taking advantage of the benefits of private management. From the 1990s and onwards, many nations have grafted private sector financing and operations into traditional public service enterprises. These PPPs are being used to fundamentally change the governments' role in public service delivery, infrastructure development, poverty alleviation, and capital market development. The multilateral donors and financial organizations who play an active role in developing countries have also praised PPPs as an effective mechanism for influencing economic development and modernization strategies.

PEs have been eroded by mismanagement, challenged by liberalization, shaped by geopolitical forces and throughout it all, have remained relevant to national development. PEs are currently being reinvented in order to maximize their economic and social performance, and make progress towards achieving the Millennium Development Goals (MDGs).

They are faced with the opportunity to learn from the era of privatization to innovate their civil service, administrative structure, legal framework, and interaction with other agencies, the private sector and civil society. PEs are at an optimal time for reinvention, due to gains in technology, communication, cross-sectoral strategy and most importantly, insights from the preceding era.

## **B. Definition and Evolution of Public Enterprises**

Before elaborating on the issues affecting PE Management, it is necessary to briefly discuss the fundamentals of the public sector. The term “public sector” includes all activities of the government (Basu). Although there is no consensus on the international definition of public enterprises, this report uses the following generally accepted definition: “A Public Enterprise” is an organization established by the government under public or private law as a legal personality which is autonomous or semi-autonomous and produces/ provides goods and services on a full or partial self-financing basis, and in which the Government or a public body/agency participates by way of having shares or representation in its decision-making structure (Kauzya).

PEs can take the form of departmental undertakings, statutory corporations and joint stock companies. They can be categorized into four types based on their activity: the activities of the first are privately remunerative, the activities of the second are socially profitable but not privately remunerative, the activities of the third are privately remunerative but not capable of private execution, while the fourth category acts as natural monopolies (Basu). Additionally, PEs can also be categorized into four types according to their role: promotion, facilitation, regulation and commercial orientation (Otobo).

Since its inception, PE management has undergone several phases of evolution in order to respond to its own pitfalls and successes. PE has evolved over the years, as countries have undertaken different activities in order to promote economic development. The state has been influential in stimulating economic growth commencing in the first half of the 20<sup>th</sup> century and its role has continued to increase in both developed and developing economies. However, since the late 70s, the developmental orientation of PE has come under attack due to:

- 1) Growing economic/financial problems accompanying worldwide recession (late 70s);
- 2) Resultant debt crises in Africa and Latin America;
- 3) Succession of politically conservative governments in North America (Reaganomics) and Europe (Thatcher) in the 80s;
- 4) Shift to market economies in Asia, Latin America, and Eastern Europe in the 90s;
- 5) 25%-50% of all outstanding domestic debt and substantial portion of foreign borrowing in developing countries accounted for by PEs (1980 World Bank study); and
- 6) Heavy demands by PEs for capital squeezing private investors out of capital markets in some countries, and limiting the private sector's access to borrowing for investments that could generate jobs, income and public revenues (Rondinelli).

Today, in the era of the MDGs, the insight gained along the evolutionary trajectory must be integrated into a multidimensional and innovative framework for reinventing PEs and realizing their potential to fulfill both economic and social objectives. This re-conceptualization and reinvention of PEs is paramount in order to achieve the MDGs. Although adequate provision of health and education are the most obvious indicators of a state's commitment to the MDGs, access to said services and their impact are hinged on the availability and quality of infrastructure, electricity, telecommunications, water and other utilities. Given the tremendous strides required of PEs in order for countries to reach the MDGs, the analysis and reform of PE management must address organizational, social, political and institutional characteristics of PEs, at every degree of market orientation. It is very important to address the specific factors that hinder excellent PE management, many of which will be addressed below, in order to transform PEs and release their potential. It is an auspicious moment for PE management because there is an increasing array of technological inputs, best practices and endogenous innovations that will make positive transformation possible.

Given the aforementioned conditions, the reinvention of PE requires a comprehensive performance review to be conducted by a government commission or agency, to identify objectives, assets and resources, assess financial assets and liabilities, evaluate PE performance in meeting objectives and demonstrate PEs contribution to economic and social development. Additionally, a strategy needs to be developed that sets out a clear vision for how PEs are expected to contribute to development. Finally a clear mission and performance criteria for each PE must be defined (Rondinelli).

Governments undertaking reform must revise the legal framework to clarify the ownership relationships between the state and PEs, impose internationally accepted accounting and financial reporting standards, outline governance options, enact policies that strengthen the business climate and competitiveness within the economy, create effective regulatory frameworks and corporate laws that protect the rights of businesses, consumers, workers and citizens and impose hard budget constraints on those enterprises that remain in state ownership (Rondinelli).

Although there are a variety and combination of factors that affect the success of public enterprise management, this section will concentrate on the following overarching aspects: Governance and Management Issues, Legal and Political Frameworks, Geopolitics and Other Considerations and Public Private Partnerships. The themes discussed in the following sections pertain primarily to the public enterprise management experiences of Uganda, Mexico, France, Italy, Malaysia, and India – derived from the discussions and presentations of experts from the EGM on Reinventing Public Enterprise and Its Management.

## C. Governance and Management Issues

In order for PEs to pursue efficiency with welfare in line with the MDGs, governance and management reforms need to be undertaken. Governance is the process of interface and interaction among three sets of actors that include the state, civil society and the private sector (Cheema). Governance must be based on sound corporate principles, technical expertise in the management of PE and the three Es: Effectiveness, Efficiency and Equity (Otobo). EGM participants agreed that governance and management issues must be placed at the forefront of discussions relating to the reform of PE management. PE has been prone to political influence and delayed reaction, hindering its ability to be an effective provider of goods and services in a competitive market-oriented environment. Tackling the inability of the public sector to effectively deliver MDG related services in line with pro-poor development management is at the core of public sector reform. While promoting growth with equity, the association between PE and the Government brings the danger of compromising accountability and efficiency. Many of the PEs' shortcomings can only be ameliorated through management reforms. Internal obstacles are mostly related to human resources and administrative structure. In order to better fulfill their potential, the culture and structure of civil service must be reinvented through interconnected and mutually reinforcing vehicles of human resources selection, capacity building, incentive provision, accountability mechanisms and strategic management.

### *Redundant Labor*

Governments have often created PEs with the intent of using them as convenient medium for absorbing surplus redundant labor (Rondinelli). This is particularly useful when unemployment rates tend to be very high. The government gains in the immediate term by pointing to rising employment and defraying resultant social disaffection that accompanies high unemployment. The long-term effect of this temporary reprieve is the creation of gross inefficiency and under-employment in the PE sector.

### *Human Resources Selection*

Reinventing human resource management should be a substantial component of reinventing PEs by minimizing the quantity of labor and maximizing the output and quality of work. Job classification and descriptions will also need to be revamped in accordance with the focus from quantity to quality. Applicant screening mechanisms can contribute to better matching of skills and reduced opportunities for nepotism.<sup>89</sup>

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<sup>89</sup> UNDP Management Development and Governance Division "Critical Issues in Public Sector Management", <http://mirror.undp.org/magnet/Docs/!UN98-21.PDF/Psm.htm>.

*Building Managerial Cadres*

Procedures should be established to assist managers to clarify clear objectives for the organization. Managerial failure results from the inability of governments to build effective and efficient managerial cadres that have the necessary autonomy to run PEs. There exists a need to establish a readily accessible pool of professionals that can be drawn upon. Professional, executive and administrative management pools need to be created like the ENA in France and the Career Executive Service in the Philippines and Iran (Basu).

*Recruitment of Foreign Professionals*

Procedures should be established for ensuring the recruitment of competent professional management as well as skilled workers and support staff, irrespective of nationality. There has been a growing trend, both in developed and developing countries, to recruit foreign professionals experienced in the management of PE. This trend has led to the evolution of a recruitment system that is based more on merit, as foreign professionals bring alternative management styles and a diversity of perspectives. For example, the CEO of China National Offshore Oil Corporation (CNOOC) recruited experts from Shell and Goldman Sachs in 2005 as part of the company's executive board. The experts went on to play a crucial role in the preparation of CNOOC's bid for US petroleum giant Unocol. The move was strategic given that CNOOC was bidding against Chevron - another major player in the US petroleum industry and one with which the recruited experts were likely to have a greater level of familiarity. Conversely, in India all the CEOs and Directors of PEs are appointed by the Indian government. Currently, there are 630 CEO and Directorial posts, half of which are filled by regular incumbents while the rest are filled by pro-tem arrangements (Basu).

*Leadership*

Leadership requires not only clarity of objectives but also the commitment to follow through on these objectives (Otobo). Cronyism and nepotism hurt PE leadership given the doling out of directorial and managerial level positions to retired military officers, high level civil servants, relatives and friends (Rondinelli). The source of PE failure in Uganda can be attributed to inadequate leadership and governance. While PEs are made out to be scapegoats to account for corruption, it is not the PEs that are corrupt. Rather, it is the political leaders, the managers, and the people in general who engage in corruption - be it in PE, in mainstream public service or the private sector. Re-inventing PE necessitates an informed and committed leadership (that adheres to a framework of good governance) to design and present development priorities and argue for state investment via Public Enterprise.

### *Capacity Building*

Capacity building is indispensable to improving PE management. Personnel capacity varies across countries but disproportionate amounts of low-skilled and semi-skilled employees are particularly problematic in developing countries.<sup>90</sup> Moreover in developing countries, low capacity in the civil service is compounded by brain drain, as the best and brightest pursue more lucrative opportunities in the private sector or with international organizations or firms. The need to pay highly skilled foreign consultants imposes even greater constraints on PEs. Capacity building in the civil service should cover an array of technical, policy-making, administrative and managerial skills.<sup>91</sup> While it is critical to develop leadership and more complex comprehension of process among management, pertinent training opportunities must be extended to the various ranks and categories, including administrative support staff.<sup>92</sup> Training procedures should be adaptable, according to content, process and environment.<sup>93</sup> The enhanced skill sets and credentials of personnel will make them even more attractive to the private sector but proper incentives can work to counteract this effect.<sup>94</sup>

### *Personnel Incentives*

Incentives are fundamental to maximizing the performance of personnel. Remuneration is the predominant incentive in both the private and public sector. Increased salaries are touted as an effective strategy for reducing corruption<sup>95</sup> and also prevent divergence to the private sector. Attaching performance goals to salary bolsters morale and rewards performance gains.<sup>96</sup> It is essential for the remuneration and salary structure of upper level management in PEs to be comparable to that of the managerial cadre in the private sector, including incentives like stock options and other performance based benefits (Basu). Performance based benefits provide incentives for greater productivity while competitive salaries attract the best minds to this sector.

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<sup>90</sup> UNDP Management Development and Governance Division "Critical Issues in Public Sector Management" Public Sector Management, Governance, and Sustainable Human Development Discussion Paper 1. Accessed at: <http://magnet.undp.org/Docs/!UN98-21.PDF/Psm.htm>

<sup>91</sup> UNDESA (2003), Capacity Development Workshop: Building the Human Capital in the Private Sector. Prepared for the Global Forum on Re-inventing Government Mexico City, 5-6 November 2003.

<sup>92</sup> Ibid.

<sup>93</sup> Healy, Padraig (2001), "Training and Public Sector Reform: An Integrated Approach" Public Administration and Development. Vol. 21, pp 309-319.

<sup>94</sup> Klitgaard, Robert (1997), "Cleaning Up and Invigorating the Civil Service", Public Administration and Development. Vol. 17, 487-509.

<sup>95</sup> Klitgaard, Robert. "Cleaning Up and Invigorating the Civil Service".

<sup>96</sup> Farazmand, Ali (March 2004), "Innovation in Strategic Human Resource Management: Building Capacity in the Age of Globalization" Public Organization Review Vol. 4, Issue 1.

Khazana, the Malaysian government's investment arm, introduced fixed term contracts for senior executives with extension and pay based on performance (Sundaram). However, unlike in the private sector, PE managers can leverage another social and moral currency, i.e. the employees' own sense of connection to the enterprises' social mission. The strategy of creating a line of sight to a broader civic duty and social cause has tremendous potential.

### *Corruption*

Corruption is the culprit behind major revenue losses and beyond the immediate effects of lost revenues. It spurs a loss of public confidence, which can diminish public support of PEs and potentially the willingness to pay taxes and fees. It also undermines investor confidence which has a ripple effect on the private sector. At the root, corruption corresponds as much with morals as it does the governance structure. As explained by PE expert John-Mary Kauzya, "People are corrupt because the socio-politico-economic governance situation lets them be and the systems of control are so weak that the incentive for corruption becomes overwhelming for the weak hearted."

### *Labor Unions*

PEs are characterized by powerful unions that use economically crippling tools like strikes and shutdowns to wrangle for salaries and benefits that are far more lucrative than those received by workers in comparable privatized sectors, even though the productivity of the latter may be greater. Considerations of productivity and efficiency are left on the wayside when governments literally "buy" loyalty and electoral votes through the provision of a wide array of lucrative social benefits to union members.

### *Multiple Management Concerns*

As far as the management of PE is concerned, efficiency is a key issue if an optimal allocation of resources were aimed at. However the profit maximization criteria cannot be the point of reference. Clear objectives and result-orientation for PEs do not bring the need to be managed as private entities. If that were to be the case, there would not be any justification for the existence of PEs. PE management is influenced by a plurality of concerns that include long term considerations (such as the impact on the environment), public interest, national interest and social dimensions. PE is a pioneer in social management in France, where a typical management board includes three stakeholders: the state, representatives of the employees and representatives of the users. While the standpoint of the government normally prevails, employee interests are also taken into account. For example, public utilities - subsidized by the public budget, promote services and fares accessible to all potential users, irrespective of income and localization. The profit-maximization criterion common to private entities does not take into account this diversity of objectives. (Le Nay)

*Information Technology*

Acknowledging that civil servants act within a bureaucracy, reinventing PE management through technology implies addressing the constraints of civil servants, including the technical framework within the bureaucracy. According to the OECD, information technology is the “most important ‘physical’ enabler of burden reduction”, providing “strong dynamics and pressure to reduce burdens.”<sup>97</sup> Information technology acts a physical enabler of burden reduction in modernizing the public sector for greater efficiency, allowing civil servants to find records, create blueprints, analyze data and complete calculations more quickly. Information technology also facilitates greater communication among various branches of public administration, fomenting better coordination and power-sharing.

*Supply-Side Orientation*

One of the major differences between public and private enterprises pertain to their orientation. Private Enterprise, where the bottom line is clearly demarcated by profit maximization, is unambiguously demand-oriented, responding quickly and efficiently to the demand of the consumer who is its king. On the other hand, most Public Enterprises tend to be supply oriented given that they face multiple priorities including equity in distribution and allocation. Profit maximization does not even figure into the equation. Consequently, the attention given to the demand side - to the needs of individual users and clients should play a limited and secondary role in PE management and strategy.

*(Re) Define Commanding Heights of the Economy*

The establishment of PE in Uganda and other African nations is based on the need for the state to take control of the commanding heights of the economy. Although this concept is not clearly defined, each country must examine its socio-economic structure and decide which of its productive aspects will remain wholly or partially under state control via PE. As a necessary first step, the government must familiarize itself with national development policies, poverty reduction strategies, MDGs and NEPAD objectives in order to formulate pertinent needs and priorities. The government must then proceed to redefine within its own context, the constitution of the “commanding heights”, and if necessary, undertake heavy investment to stimulate/sustain economic growth and achieve developmental objectives and priorities (Kauzya).

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<sup>97</sup> OECD (2003), “From Smart Tape to Red Tape: Administrative Simplification in OECD countries”, OECD Policy Brief.

### *Supervisory Government Body*

The governance structure should not mix operational, regulatory and supervisory responsibilities within government ministries. The creation of a supervisory government body (or an overarching state enterprise company) with the responsibility of auditing PE finances and ensuring compliance with laws and regulations is essential to PE reform. Measures should be taken to ensure that the operations and procedures of the public enterprise governance body are transparent and open to inspection. Additionally, adequate checks and balances should be created to limit inappropriate political interference in the governance body's decisions (Rondinelli).

As noted by Basu, the State Asset Supervision and Administration (SASAC) in China, Temasak (Singapore), and Khazana (Malaysia) are partnerships between governments and PEs that were made successful by clearly defining the responsibility of PE management.<sup>98</sup> SASAC of China was established to supervise the management of finances and evaluations of PEs. PEs therefore, report to SASAC rather than to a government supervisor.<sup>99</sup> The dysfunctional Indian system is a clear case for necessary reform, given that 38 supervising ministries control and oversee 240 PEs without any stipulation for accountability or responsibility for performance. PEs suffering from such losses require administrative and management restructuring similar to SASAC. Further, SASAC has the mandate to transform a group of thirty to fifty PEs into globally competitive leaders in their respective industries by 2010. As a necessary step, SASAC replaced scores of administrative ministries in the Chinese government such that PEs in China no longer report to supervisory ministries but to SASAC (Basu). In France, the autonomous French Government Shareholding Agency (FGSA) has the power and autonomy to impose standard rules of governance on PEs. On the other hand, in India, 38 government supervising departments supervise 240 PEs under a central government without any responsibility for their performance.<sup>100</sup>

More and more government organizations are being established for the efficient control, management evaluation, and supervision of PEs. However, a clear definition of relationships and sharing of responsibility among supervising organizations, governments, and PEs are increasingly important to ensuring the successful management of PEs.

### *Revenues*

The major theoretical distinction between public and private enterprise lies in the mode of revenue disbursement. In a Public Enterprise, the state

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<sup>98</sup> Basu, Prahlad K., "Reinventing PEs and Its Management as the Engine of Development and Growth", October 2005.

<sup>99</sup> Ibid.

<sup>100</sup> Basu, Prahlad K., "Reinventing PEs and Its Management as the Engine of Development and Growth", October 2005.

reinvests profits for the provision of social services that benefit the populace, whereas in a private enterprise profits are generally distributed exclusively among the company's shareholders. However, theory and practice can vary greatly and the productivity of a particular industry can often be gauged from the mechanism employed for the collection and distribution of revenues. For example, the Malaysian government does not touch the profits of its state oil company Petronas. Rather Petronas pays taxes to the government based upon a pre-established criterion, thereby limiting the possibility of the government to siphon PE profits for personal gain. Distribution of revenues through unambiguous channels (taxes) leads to greater accountability in the management of PE (Ng Yen Yen).

Conversely, the Mexican government expropriates all profits derived from Public Enterprises without having to account for their disbursement, resulting in ample opportunities for the redistribution of profits among well placed government officials. Additionally, the government covers PE expenditures and losses by depleting the public budget without the corresponding need to be accountable. Consequently, it is the populace that has to pay the price for PE inefficiency. PEs have no incentive to undertake internal management reform due to the absence of mechanisms that reprimand PE for losses incurred or reward PEs for positive turnovers through profit-sharing (Gordillo).

### *Outsourcing*

Outsourcing allows the government to maintain ownership of PEs while improving management by contracting it out to the competitive private sector. In addition to deriving revenues from leases, management fees and service concessions, this arrangement increases efficiency, decreases vulnerability to employee actions and contractor failures, ensures protection against the monopolistic behavior of contractors or government agencies, provides a dual yardstick for measuring and comparing performance and provides substantive knowledge and understanding of service delivery (Rondinelli).

### *Burden of Proof*

Given the record of Public Enterprise failures, some experts believe that the "burden of proof" must be placed upon governments to justify continued state ownership. Governments have to decide whether the PEs they preserve have a role to play in the development of the economy, or whether the task can be performed more effectively by the private sector (Rondinelli). However, other experts reject that such a burden should be placed on the government, given that governments never remain the same and consequently, it would be unfair for a new administration to account for the mismanagement of its predecessor. Indeed, as a counter-argument, past failure does not necessarily confirm future failure. Rather, past failure can actually form the basis for reflection and future success. Uganda is a case in point

where the former argument would necessitate that the progressive Musaveni government be accountable for the suicidal economic policies pursued by the brutal dictatorship of Idi Amin – a regime with which Musaveni’s government had no direct association (Kauzya).

#### **D. Legal and Political Framework**

The institution of Public Enterprise is established by law and its competence and power is further circumscribed by it. A legal and political framework for PE management determines the nature of the relationship that exists between various public authorities and the conditions that will enable them to achieve their goals with efficiency.<sup>101</sup> The government’s role is to establish effective and appropriate legal and regulatory frameworks that simplify and streamline legal structures for PE operations, specify obligations, protect the rights of stakeholders, and create standards and procedures for effective internal and external auditing, transparent and accurate accounting, and public financial disclosure.<sup>102</sup>

PE management is dogged by faulty regulation, political mismanagement, cronyism and corruption, jeopardizing its effective functioning. An adequate legal and political framework that includes requisite checks and balances essential for budget control must be created, supported and advanced. The legal and political framework guiding PE varies by nation according to the prevailing socio-economic circumstances and the evolution of its political process. This section reviews the experiences of particular nations in an attempt to glean insights about innovations and missteps on the road to creating an enabling environment for enhanced PE management.

##### *Unclear Definition of the Role of the State*

The state should serve as an owner of PEs, as well as a regulator and coordinator. As an owner of PEs, the state should establish the policies, procedures, and organizational structures that guide PE operations to achieve social and economic objectives.<sup>103</sup> As a regulator, the state should propose a legal and regulatory framework that is effective and appropriate for its economic activities. As a coordinator, it should mediate among the numerous related organizations that affect or interact with PE activity and provide appropriate measures for transparent economic activities. The level at which the state intervenes in national economic activities is directly related to PE creation, extinction, and development.

<sup>101</sup> Marcou, Gerard, “The Legal and Regulatory Framework of Public Administration, August 1995

<sup>102</sup> Rondinelli, Dennis A., “Can PEs contribute to development?”, October 2005

<sup>103</sup> Keened, Richard M. and Jones, Leroy P., “Reforming State-Owned Enterprises: Lessons of International Experience, Especially for the Least Developed Countries,” Working Paper No.11, Vienna, Austria: United Nations Industrial Development Organization, 2003.

The dilemma for PE in Mexico lies principally in defining the role that the State must play as a direct participant in the economy, which according to the constitution was to develop under a mixed public-private scheme. However, there exist neither clear limits nor parameters that allow development activities to be clearly demarcated. This vagueness has resulted in an extremity in responses, from unnecessarily over-reaching to limited economic participation, all under the same text and constitutional model.<sup>104</sup>

#### *Discretionary Power of Executive Authority*

Pre-meditated ambiguity in governmental participation in economic activity is based on cumbersome levels of discretionary power granted to governmental authorities. In Mexico, this starts at the peak of the pyramid with successive presidents who have condemned the legislature to subordinate roles for seven decades- one of the primary obstacles to clearly conceptualizing and specifying the role of PEs in Mexico. According to the 1917 Constitution, state participation in the economy was restricted by the official promotion of a free market model. Erratic and prolonged executive intervention, justified through an ambiguous, discretionary and multifaceted social focus, transformed the economic focus into a mixed economy model. The most prominent Mexican PEs were created through combining the “implicit” power of federal laws as granted by the Constitution, to the “explicit” authority to legislate in the field of commerce. Fifty seven PEs were created as a result, including the Mexican Petroleum (PEMEX), the Federal Electricity Commission (CFE), the Mexican Telecom (Telmex) and the Bank of Mexico. Active government intervention in the national economy was realized, based on obvious political aims that incorporated a relevant social focus to justify its action (Gordillo).

#### *Committee Recommendations not Legally Binding*

The recommendations of performance review committees incorporating management professionals from the government and private sector, lead to naught if PE are not legally bound to implement them. The state should provide detailed guidelines concerning PE investment and pricing policies, but misleading investment decisions by the state may negatively affect the PEs’ management. PE expert Prahlad K. Basu described an example of how the Indian government fell into this trap<sup>105</sup>. In 1987, a high-profile committee chaired by India’s foremost industrial magnate recommended the merger of several agencies including the Public Investment Board, Project Appraisal Division and Plan Finance Division into a financial institution to account

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<sup>104</sup> Gordillo, Ismael Gomez, “Reinventing PE and Its Management: The Mexican Experience”, October 2005.

<sup>105</sup> Basu, Prahlad K., “Reinventing PEs and Its Management as the Engine of Development and Growth”, October 2005.

for the implementation of decisions. Eighteen years later, the issues and the recommendations are yet to be considered by the Indian Government. Therefore, attaching the legal obligation for implementation ensures that crucial investment, pricing and reform policies are acted upon, thereby greatly reducing delays in project management.

#### *Passage of Legislation to Monitor Productivity and Accountability*

PE suffers from lax governance and poor oversight due to the absence of checks-and-balances that come with private ownership. This includes pressure that shareholders and external directors can exert on managers to improve efficiency, pressure that capital markets can exert on companies to allocate scarce resources economically and operate within “hard budget” constraints and pressure that managers (responsible to shareholders and outside directors) can exert on workers to improve productivity (Rondinelli). In the absence of these conditions, the government can play a pro-active role through enacting legislations to monitor productivity and accountability. The passage of the “Government Performance and Results Act of 1993” and the “Sarbanes Oxley Act of 2002” by the US Congress are examples of government initiatives to monitor the performance of civil servants as well as private enterprises (Basu).

#### *Commercialization*

Commercialization is used to promote greater efficiency and productivity to those PEs which remain under government ownership. Commercialization at the very minimum allows for the deregulation of relevant sectors of the economy to allow for greater market competition in providing public goods, particularly where PE initiatives have failed or proved to be woefully inadequate. Commercialization policies challenge the monopoly status of PEs and prevent (through anti-trust laws) excessive collusion among private businesses that would constrain competition or fix prices artificially for socially-beneficial services. Governments can advance commercialization by allowing prices to reflect true relative scarcities in the economy and encouraging public-private enterprises to adhere to fair and equitable market rules, that include finding effective ways to implement structural adjustment policies, liberalizing trade and investment, creating and strengthening property rights and developing a legal framework for business activities.

#### *Membership in Regional Trade Groups*

Regional trading blocs provide a regulatory framework for PEs. Regional trading blocs have been gaining momentum over the past twenty years in nearly every continent including the likes of the EU (Europe), NAFTA (North America), Mercosur (South America), ASEAN (Asia) and ECOWAS (Africa). It has often been the case that the partners in such alliances are separated by wide disparities in economic efficiency and capacity. Consequently,

it has become imperative for the state to radically reform inefficient PEs through the passage of drastic legislations, in order to stand a chance of benefiting from such regional alliances.

In 1983, the French government undertook such a radical shift in its policy orientation, opting for pragmatic management of the French economy under the market friendly aegis of the European Community. This resulted in inefficient PEs losing the political patronage they have enjoyed since World War II, being progressively privatized in a pragmatic fashion. While left and right leaning parties alternated as the dominant force in French politics from 1986 to 2005, the imperative of PE reform remained unaffected (Le Nay).

Italian integration into the European Union also witnessed pressure from the upper echelons of the government to liberalize and decentralize PEs, resulting in the destruction of the monopoly privileges enjoyed by PEs (Police). Additionally, the liberalization of the utilities market in Europe came as a result of prolonged negotiation at the World Trade Organization on General Agreements on Trade in Services (GATS) in the late 80s.

#### *Top-Down Approach*

Public Enterprise liberalization and privatization in Italy resulted from an effective top-down approach. The Italian government developed the PE sector based on formulas prescribed by advisory organizations that may have been too far detached from this sector to clearly contemplate requisite reforms. Absence of popular grassroots participation in PE reform, characterized by a bottom-up approach to PE development and management has resulted in a lack of transparency and accountability in PE management (Police).

### **E. Geopolitics and other Concerns**

Unlike private enterprise management where the bottom line is solely contingent upon commercial viability, public enterprise management has multiple (and often conflicting) considerations beyond mere profitability. Primary among these concerns is geopolitics which refers to the causal relationship between political power and geographic space and its impacts upon a nation's foreign and economic policy. Geopolitical considerations have prompted drastic economic measures (nationalization, forced takeovers) considered vital to the maintenance of national integrity and often at the expense of economic viability or prompt deregulation and privatization of PEs. Consequently, cost-benefit analysis is often left on the wayside when determining the services that are to be provided by the state and their mode of delivery.

*Colonial Legacy*

Colonial legacies of PEs are impediments to their successful operation. Many of the current PEs trace their roots back to the colonial era where they were established to exploit the country's natural resources and expropriate the surplus rather than deliver public services in an equitable fashion to the local populace. Colonial administrators found PE to be a useful structural arrangement to legitimize the pillaging of the native populace. For example, colonial administrations established the Uganda Electricity Board (UEB) to generate and distribute electricity, the Uganda Development Corporation (UDC) to engage in manufacturing, mining, and other commercial ventures, and the Lint Marketing Board (LMB) to commercialize Uganda's cotton produce. While these PEs were economically efficient both before and after independence, the ultimate beneficiary of their commendable performance was not the common Ugandan. The expectation that these colonial offshoots will deliver public services in an equitable fashion is a contradiction given their arrangements (Kauzya).

*National Unification and Reconstruction*

The rationale of national unification and reconstruction served as the primary justification for the creation of PEs, often through the nationalization of private and foreign holdings in post-colonial Asia and Africa as well as in post-war Europe. The Mexican Revolution was institutionalized from 1917 to 1940 through the creation and expansion of PE to every possible sphere, to materially support the conception of national unification (Gordillo). France nationalized its railways in 1937 not only to symbolize national reunification through the control of a strategic transportation industry that spanned the entirety of its territory, but also for the enormous capacity of this industry to generate public works in a war-torn economy. The market was not considered as the appropriate tool to undertake such enormous reconstruction. Despite the fact that the firm was not profitable, France decided to nationalize because it was considered as an essential step in the reconstruction of the nation and its economy.

*Maintain National Control over Strategic Resources*

The recurrence of international conflict continues to provide justification for the need to maintain strategically important sectors under strict government control in the guise of public enterprises. Strategically, important sectors can be classified as industries that are vital to maintaining the territorial, economic and political sovereignty of a nation, without which, or if controlled by hostile powers, the effective function of a state could potentially collapse. Indeed following World War II, the principal French industries to be nationalized included transport, heavy industry (steel and coal), public utilities (electricity, gas) weapons, aeronautics as well as firms that cooperated with the German occupation forces such as Renault (Le Nay).

Petroleum is not only one of the most sought after resources in the world today given the increasing energy consumption needs of emergent economies. It has also time and again proved to be the source of conflict among nations. Additionally, given that the petroleum industry is often the largest public sector employer in many countries, it comes as no surprise that it remains in the governments' interest to control the industry. The Mexican government hindered foreign companies from possessing rights to petroleum exploration, through the passage of a law in 1938 that led to the creation of PEMEX (Mexican Petroleum). This process was furthered in 1940 when Article 28 of the Constitution was reformed to declare it legally impossible for private entities to attain petroleum extraction rights and concessions. Further amendments to the Constitution led to the generation, conduction, transformation, distribution and supply of electricity to fall under the exclusive domain of the state, constitutionally validating the restricted domain of the Federal Electricity Commission created through executive decree (Gordillo).

With regards to aviation, having a national airline is often seen as symbolic of a nation's sovereignty, irrespective of economic viability, practicality and safety issues including the quality of the carriers. A case in point is the France national carrier operating flights to the island of Corsica. Despite the fact that such an operation is economically inefficient, what is more important is the symbolic capital attained by France from maintaining a continuous presence in this remote outpost known for its separatist tendencies (Dandelot).

#### *Nationalist Sentiments*

While the French welcome cash inflows from foreign and private investors, they remain unwilling to exchange cash for "control" over PEs that remain under government control. The French have always maintained this attitude towards the role of government which can be expressed in their saying that it is better to be "French and inefficient" rather than "foreign and efficient" – the legacy of the influence of Colbertism (Basu). Nationalism also remains to be an obstacle to integrating PEs into one market as the EU doctrine states.

#### *Import Substitution Industrialization (ISI)*

From 1940 to 1952, the number of PEs in Mexico expanded rapidly to 158 as a consequence of the government's strategy to follow the path of Import Substitution Industrialization. This was a response to the Great Depression of the late 1920s and early 1930s, when the global economy contracted at unprecedented rates. Latin American economies that were dependent upon a primary export oriented economy were particularly severely hit. Consequently, to counterbalance the vulnerability that the national economy faced from being heavily dependent upon external economic conditions

beyond their control, the ruling party decided to shield and strengthen the Mexican economy through ISI that heavily favored the creation and expansion of Public Enterprises (Gordillo).

#### *Authoritarian Regimes and Personal Agendas*

PEs are often created, maintained and promoted to sustain the personal power ambitions of authoritarian rulers and military regimes. This was very much the case in Latin America in the 1970s when most of the countries were under military rule. Having neutralized political dissent, military regimes nationalized nearly all major industries, extracting public resources for private gain and hindering the economic elite from exerting their influence and presence. Additionally, PE ownership allowed authoritarian rulers to control powerful labor unions by manipulating their leadership.

The post-independence regime of Milton Obote (1961-1971) in Uganda adopted the Nationalization Policy in 1969 to strengthen the structure that maintained the ruling group in power while keeping the private sector out of the money economy. The succeeding brutal regime of Idi Amin (1971-1979) witnessed even greater nationalization of private entities into PEs with the overt intent of returning the economy to the Ugandan people. This period witnessed the launch of an “Economic War” and confiscation of private enterprises belonging to Ugandans and foreigners of Asian origin, in a scale that was unprecedented in post-colonial Africa. This policy of “Ugandanization” crippled the national economy for decades to come as skilled professionals fled the country. The sole benefactor of this aggression was Idi Amin who used the spoils of the economic war as a leverage tool to control the military and suppress political opposition (Kauzya).

#### *Promotion of Political Ideology*

Nationalization of private holdings into PEs was often undertaken to comply with the economic leanings of particular political doctrines, particularly during the Cold War when the world was polarized into capitalist/communist, left/right and east/west spheres. This was very much the case in Africa and the experimentation with “African Socialism” by the likes of Tanzania and Ethiopia without a clear understanding of its economic implications. Goaded by promises of developmental aid from the Eastern Bloc, they nationalized agriculture, agribusiness, mining and natural resource industries into public enterprises, despite the lack of expertise or financial capacity to manage them effectively.

The reverse holds true in the case of France where leftist organizations are stereotyped as being extremely supportive of the creation and extension of the role of PE. The left has long been a reluctant partner/observer in the nationalization of enterprises within the context of capitalism. They have been openly critical of the “nationalization of losses” when unprofitable firms are nationalized. Following World War II, the left favored nationaliza-

tion not on any ideological basis, but because they realized that they could play an important role in PE through their control over the Union movement (Le Nay).

#### *Control Information Dissemination*

The broadcast and print media including radio, television and newspapers are often among the first industries to be nationalized into public enterprises. The majority of nations, developed and particularly developing countries, both share the common trait of having some level of state control or presence in the broadcast and print media through the creation of state-run broadcasting companies. For example, in Uganda, the media is controlled and regulated as a PE to promote official state propaganda (Kauzya).

#### *Ethics*

Private enterprise has minimal consideration for ethical standards. For specific goods such as food, genetics and pharmaceuticals, it is the public sector that provides regulatory boards necessary to enforce the implementation of principles and rules protecting consumer rights. Optimal market resource allocation often contradicts security, health (tobacco industry), human rights and environmental concerns. Within this perspective, it is essential to maintain the independence, integrity and efficiency of regulatory boards that are often set as Public Enterprises (Le Nay).

#### *Efficiency*

Within the realm of economic theory, efficiency is the point where marginal revenue is equal to marginal cost - or where the difference between total revenue and total costs is the greatest. However, this definition of efficiency fails to account for externalities. Additionally, it cannot explain why the level of public goods produced fails to qualify as socially optimal. For example, a profit maximizing “efficient” public utility (water) is unlikely to want to service remote rural areas where the cost of provision is not covered by revenue. Hence, where efficiency is tantamount to profit maximization, monopolistic PEs (without competing rivals) can always be “economically efficient” and derive profits without satisfying the criterion of social optimality which would incorporate serving all potential consumers. For example, it is patently absurd to suggest that the service of electric supply is “efficient” when 70% of households are not connected to the grid – as in the case of several African countries (Katsiaouni)

#### *F. Public Private Partnerships (PPPs)*

Collaboration between public (central, state and municipal government) and private (small businesses, non-government organizations and civil society organizations) entities to provide socially-beneficial goods and services tend

to be referred to as a Public Private Partnership (PPP). The private sector has played an increasingly engaged role in the delivery of services that were once considered to be the domain of the government. PPPs are being used more and more as policy tools to transform the role of the national and local government in public service delivery, infrastructure development, poverty alleviation, capital market development and governance. Since 1990, almost every country has embarked on an effort to promote private sector financing and operation of public services. Multilateral and bilateral donors and financial organizations increasingly recommend the adoption of PPPs as an economic development and modernization strategy. PPPs have potential benefits for both the citizenry and the government. They can increase competition and efficiency in service provision, expand coverage, and reduce delivery costs. Additionally, PPPs facilitate risk distribution to the organizations that can most effectively manage it. However, this does not come without challenges, both institutional and political.

#### *Overcome Budgetary Constraints*

PPPs equip PEs with additional sources of capital allowing them to develop sectors with substantial start-up costs that they were previously unable to reach given budgetary constraints. For example, the Chinese government used joint ventures between PEs and private foreign companies to make new investments in infrastructure and manufacturing facilities. The expansion of telecommunications equipment facilities in the Shanghai area for example, was financed through joint ventures. Shanghai Bell Telephone Equipment and Manufacturing Company was taken over by a joint venture among China's Ministry of Posts and Telecommunications, Alcatel Bell, and the Belgian government to produce switches for telephone companies in China (Rondinelli).

#### *Facilitate Risk Distribution*

PPPs allow the public sector to expand its provision of essential public services to larger segments of the populace. Not only does this allow the government to increase its participation in the national economy, it also engages the private sector in areas where they were either barred from participation or found the economic risk too high to engage in by themselves. For example, in 2002, the municipality of Ajman in the United Arab Emirates formed an equal ownership joint venture - the Ajman Sewerage Company- with a consortium of Black and Veatch, Thames Water, and other companies, to invest \$100 million in a wastewater network that would deliver services to 300,000 people in the desert emirate. The government granted the joint venture a 27 year concession to recover costs by levying tariffs for services to be paid for by consumers (Rondinelli).

*Increased Costs*

A host of factors can make PPPs a costlier alternative to PEs. Poorly designed and supervised PPPs result in inept management and higher costs. This is often the product of a non-competitive bidding process that leads to the approval of tenders from entities that are not financially sound. Contract management costs can also be substantial, draining away any potential savings from improved management. Lack of sufficient competition can also prompt PPPs to resort to monopolistic behavior and consequently marginal cost pricing requisite for efficient productivity may well be violated with consumers generating abnormal profits for firms due to the lack of alternatives. On the other hand, overtly restricting concessions or creating too many can deprive PPPs of economies of scale. Additionally, involvement of the private sector in the provision of services that were formerly free or subsidized by the government can lead to increased prices that place poor segments of the population at a significant disadvantage (Rondinelli).

*Synergy between State and Market*

Efficient PE management models have been developed through synergy between the state and the market. The Chinese economy was opened up to incorporate the active participation of private enterprises without having to privatize Public Enterprises. Partnership and competition between Public and Private Enterprises resulted in improved management. This was achieved through active governmental involvement and leadership as well as new norms of corporate governance – where PEs were legally required to cover their costs and to generate revenues under hard budget constraints, leading to efficiency with welfare. China's 9.4% growth in the first quarter of 2005 can be attributed to the efficiency of its 197,000 PEs (Basu).

**G. Conclusion**

In the past thirty years, many new practices and structures have emerged within the framework of PEs, redefining them to include commercialized and privatized companies, reorganizing them to allow corporate governance structures and other regulatory shifts, revamping them with civil service reform and modernization of the bureaucracy, and compelling them to greater symbiotic interactions with the private sector and civil society. This process of reinvention has been reinforced by a deepening understanding of the PE's role not just within its own nation but in the world, allowing PEs in developing states to have greater autonomy in the face of foreign imposition, while at the same time, gleaning insights from other nations. While reinventing PEs must be an endogenous process that responds to the national economy, the strength of the private sector, the level of human development and strategies to improve it are critical issues that every PE should consider in its evolutionary process.

While it takes an enabling legal and political framework to shape and regulate these entities, their potential for economic efficiency and service delivery is contingent on management. Even with the will for improved management, there are impediments such as self-interest, nepotism, and lack of incentive or accountability. In improving management, public administrations must recognize that managers grapple with competing forces—the dichotomy between economic efficiency and social impact. Moreover, the management must balance geopolitical considerations. In some cases, public-private partnerships have been responsive to both sides of this dichotomy but these partnerships should also be designed on a case-by-case basis, as they are not a panacea for what ails most public enterprises.

PE reinvention must commence by confronting the human component that drives performance, the personnel:

1. Performance-based accountability mechanisms can drive productivity by identifying a deliverable linked with each employee;
2. Incentives, particularly salary increases, can also combat corruption and improve performance. Incentives can be linked with capacity building to work synergistically;
3. The social impact of PEs must be leveraged to create a sense of esteem and connectivity to the mission that boost morale among personnel; and
4. Technology is one of the most important mechanisms for making the bureaucracy more efficient and successful.

Internal reinvention is only possible up to a certain extent without concomitant legal and regulatory shifts. Governments can and must manage the financial, regulatory, and coordination frameworks to facilitate more efficient PE management.

1. There must be clarity over the government's role in economic development in order to prevent politicization of the PE strategy; and
2. Legal and institutional devices to monitor PEs' efficiency and productivity will also contribute to the establishment of good governance in PEs.

As commercialization, privatization, and PPPs emerge as measures to increase global competitive advantages, they can also lead to further reforms. PPPs have emerged in recent years with the potential to revolutionize PEs, by allowing them to disperse the investment, risk and responsibility among partners.

Finally, PEs must exist within a system of global and regional interdependencies, which can be leveraged for the advancements of social and economic welfare. Governments and PEs must learn from the past, from the era of structural adjustment and conditionality, in order to understand appropriate conditions and processes for reform.

With 2015 fast approaching, governments must steer PEs toward meeting the MDGs. Fortunately, PEs are more prepared and more compelled toward endogenous solutions. Central actors in PE management are more prepared to identify the sectors they can afford to privatize, sectors that can benefit from partnerships or sectors whose social mission can only be charged to the state. They are more insightful regarding the effects of private monopolies and the importance of establishing a regulatory framework for market reforms as well as the customization of civil service reform for their particular needs. In sharing best practices with other administrations and in collaborating with multinational institutions, PEs have greater possibilities than in any previous era for fulfilling their economic and social objectives.

# Annex

United Nations Department of Economic and Social Affairs Division for  
Public Administration and Development Management

**EXPERT GROUP MEETING ON RE-INVENTING PUBLIC ENTERPRISE  
AND THEIR MANAGEMENT**

**AGENDA**

**Thursday, 27 October 2005**

**16<sup>th</sup> Floor Conference Room, Two UN Plaza, New York**

- 9:00 a.m. Registration
- 9:30 a.m. **Welcome address**  
*Mr. Guido Bertucci*, Director, Division for Public Administration and Development Management (DPADM)  
Department of Economic and Social Affairs (DESA)
- 10:00 a.m. **Introduction of Expert Group Meeting (EGM) Background and the EGM Panel/Theme**  
*Mr. Adil Khan*, Chief, Socio-Economic Governance and Management Branch (SGMB), DPADM
- 10:15 a.m. **Organizational matters**  
*Mr. Jacinto de Vera*, Chief, Policy Analysis and Coordination Unit and EGM Coordinator  
  
*Session 1: Moderator – Mr. M. Adil Khan, Chief, SGMB*
- 10:20 a.m. **Re-inventing Public Enterprises and Their Management as the Engine of Development and Growth**  
*Professor Prahlad K. Basu*, Minister of State, Government of India, and Chairman, Board for Reconstruction of Public Sector Enterprises
- 10:50 a.m. Discussant: *Mr. Shabbir Cheema*, Principal Adviser and Programme Director on Governance Institutions, Office of the Director, DPADM
- 11:05 a.m. Open Discussion

- 11:25 a.m. **Re-inventing Public Enterprise Management: The French Experience**  
Mr. Marc Dandelot, Conseiller d'Etat, State Advisor to the French Minister for Foreign Affairs State and former President of France Telecom North America (FTNA)
- 11:55 a.m. Discussant: *Mr. Jean Le Nay*, Interregional Advisor, SGMB, DPADM
- 12:10 p.m. **Public Enterprises and Subsidiarity: From the Interventionist State to the Free Market: the Italian Experience**  
*Mr. Aristide Police*, Full Professor of Administrative Law, Faculty of Law, Università degli Studi di Roma Tor Vergata, Italy
- 12:40 p.m. Discussant: *Ms. Elida Recci*, Governance and Public Administration Officer, SGMB, DPADM
- 12:55 p.m. Open Discussion
- 1:15 pm. Lunch
- Session 2: Moderator - Ms. Elida Recci, SGMB*
- 3:00 p.m. **The Question of the Public Enterprise and Africa's Development Challenge: a Governance and Leadership Perspective**  
*Mr. John-Mary Kauzya*, Chief, Governance and Public Administration Branch (GPAB), DPADM
- 3:30 p.m. Discussant: *Mr. Ejeviome Otobo*, Acting Director, Office of the Special Advisor on Africa (OSAA)
- 3:45 p.m. Public Sector Enterprise as a Partner in Development: The Mexican Experience  
*Mr. Ismael José Gómez Gordillo*, Professor and General Coordinator, High Management Program on Public Entities, National Institute on Public Administration, Mexico

- 4:00 p.m. Discussant: *Mr. Julio D'arcy*, Interregional Advisor, SGMB, DPADM
- 4:15 p.m. Open Discussion
- 4:45 p.m. End of first day

### Friday, 28 October 2005

- 9:30 a.m. **Summary of previous day's proceedings**  
*Mr. Jacinto De Vera*, Chief, Policy Analysis and Coordination Unit and EGM Coordinator
- Session 3: Moderator – *Mr. Jacinto De Vera*, SGMB**
- 9:45 a.m. **What Can Public Enterprises Contribute to Development?  
A Critical Assessment and Suggestions for Management Improvement**  
*Mr. Dennis Rondinelli*, Senior Research Scholar, Duke University and Member, UN Committee of Experts on Public Administration (CEPA)
- 10:15 a.m. Discussant: *Mr. John-Mary Kauzya*, Chief, Governance and Public Administration Branch (GPAB), DPADM
- 10:30 a.m. Open Discussion
- 11:00 a.m. Coffee break
- 11:15 a.m. **Designing and Implementing Mechanisms to Enhance Accountability for State-Owned Enterprises**  
*Mr. Prajapati Trivedi*, Economic Advisor, Ministry of Economy and Planning, Government of Saudi Arabia
- 11:45 a.m. Discussant: *Mr. Olympios Katsiaouni*, Interregional Advisor, SGMB, DPADM
- 12:00 p.m. Open Discussion
- 12:30 p.m. Lunch

Session 4: Moderator – *Mr. Guido Bertucci*, Director, DPADM

2:00 p.m. **The Role of Public Enterprises in Developing Countries**

*Mr. Jomo Kwame Sundaram*, Assistant Secretary-General for Economic Development, DESA

2:30 p.m. Open Discussion

3:15 p.m. Summary and Conclusions

*Mr. Jacinto De Vera*, Chief, Policy Analysis and Coordination zUnit and EGM Coordinator

3:30 p.m. Concluding remarks

*Mr. Adil Khan*, Chief, SGMB, DPADM

# Appendix I: Example of a Performance Agreement in the US

*Performance Agreement between The President of the United States William Jefferson Clinton and The Secretary of The Interior Bruce Babbitt*

## **I. Introduction**

The American people deserve a government that works better and costs less. The departments and agencies of the federal government hold vital keys to improving performance and to restoring the faith of the American people in their government. Many changes will need to take place for this broad goal to be realized. The purpose of performance agreements with senior officials is to establish clarity and consensus about the priorities for departmental management. They are intended to improve the management of the Executive Branch and are not intended to and do not create any legally enforceable rights. From these agreements should flow the program and management priorities of the departments. These agreements represent a beginning, a basis for continuous improvement as we reinvent our government to meet the needs and expectations of the American people.

## **II. The Department of the Interior**

This Agreement reflects the major objectives developed by the Secretary for the Department of the Interior to achieve over the next several years as well as specific performance measures to be accomplished in Fiscal Year 1994. It also describes areas of specific support the Administration intends to provide for the accomplishment of these objectives.

The Secretary undertakes to accomplish the following at the Department of the Interior:

### **Establish the National Biological Survey**

*The Secretary is committed to establishing a new organization within the Department that will serve as an important nation-wide repository for biological data for government customers and the public, and that will provide an integrated natural resources scientific database including a national status and trends survey. This information will be used to develop sound natural resources management and development decisions.*

### **Reform Land Management at the Department of The Interior**

*The Secretary is committed to reforming rangeland programs administered by the Bureau of Land Management in order to restore and improve the ecological condition of the rangeland, to manage for biodiversity, forage production and sustainable ecosystems; and to establish a fair and equitable grazing fees for private use of public lands. The Secretary is committed to implementing a comprehensive reform of mining activities on public lands in order to eliminate land patent giveaways, charge a fair royalty for public minerals and provide strong environmental protection for public lands.*

### **Reinvent the Bureau of Reclamation**

*The Secretary is committed to transforming the Bureau of Reclamation from a civil works agency into the leading water management agency that is cost-effective in serving its customers.*

### **Strengthen the Commitment of the National Park System to Employees and the American Public**

*The Secretary is committed to improving the morale and working conditions of employees in the National Park Service. The Secretary is committed to resolving the professional discrepancies between full time and seasonal temporary employees and enhancing professional development opportunities for Park Rangers and other Park Service employees.*

*The Secretary is also committed to the entrepreneurial management of the national parks through improved fee applications and collections and contract negotiations. Creative use of private funds to mitigate the problems of employee housing is an important goal of the Secretary*

### **Act as a Partner with Indian Tribes**

*The Secretary will demonstrate this Administration's commitment to fulfillment of the federal Indian Trust responsibility and the creation of a mutually respectful, beneficial government to government partnership by achieving progress necessary to accomplish national Indian self-determination objectives and address the concerns of Congress.*

### **Make the Endangered Species Act Work**

*The Secretary is committed to reforming the administration and implementation of the Endangered Species Act to minimize conflicts, maximize flexibility for conflict resolution, and conserve our Nation's ecosystems for future generations.*

## **Champion Collaboration and Performance at the Department of The Interior**

*The Secretary will champion the Administration's commitment to a government that works better by demonstrating creative patterns of collaboration, organization and communication with other employees, other agencies, and citizens.*

*With the leadership of the Secretary, the Department of the Interior will develop one of the best appraisal processes among federal agencies for its Senior Executive Service managers, measuring progress on three common departmental elements: increased cross organizational cooperation and action, increased employee diversity, and improved matching of decision-making level to decision needed.*

### **III. Measurement of Performance**

To measure progress against the above objectives, the Secretary is committed to accomplishing specific measurable results. Specific measures for Fiscal Year 1994 are described in Annex A. To maintain focus and a sense of urgency and to have a real impact on performance, there will be periodic reviews of progress including discussion of difficulties encountered. These reviews will be held between the President and/or his designees and Department officials.

### **IV. Administration Support**

In order to accomplish the above described objectives and measures during Fiscal Year 1994, it is the Administration's objective to provide the Department of the Interior with the following specific support:

- Support for passage of authorizing legislation to establish the National Biological Survey.
- The Office of Management and Budget will provide generic clearances for customer surveys within two weeks of submission of requests by the Department of the Interior.
- Lead responsibility for mining law reform to the Department of the Interior to work with all affected federal agencies. In addition the White House will establish a mechanism to provide effective liaison with the Department during mine legislation conference proceedings.

**V. Miscellaneous**

This Agreement is intended only to improve the internal management of the Executive Branch and is not intended to and does not create any right, benefit, trust or responsibility, substantive or procedural, enforceable at law or equity by a party against the United States, its agencies, its officers, or any person

**VI. Term of Agreement**

This Agreement will remain in effect until modified. It is expected that it will be updated at least annually to reflect significant changes in budget, policy, personnel or other factors that may affect the accomplishment of objectives.

This agreement represents our joint commitment to a Department of the Interior that works better and costs less and fulfills our sacred trust to the American people.

Attachment: A-annex A: Performance Measures. Fiscal Year 1994

## Annex: Performance Measures, Fiscal Year 1994

During Fiscal Year 1994 (FY 1994), performance will be measured by the successful accomplishment of the following specific measures:

### 1. ESTABLISH THE NATIONAL BIOLOGICAL SURVEY

- a. The Secretary commits that the National Biological Survey will be a functioning organization as soon as FY 1994 appropriations become available. The National Biological Survey will maximize its programmatic work and minimize its administrative structures as it draws upon existing resources across the Department.

The Secretary will delegate to the Director of the National Biological Survey responsibility for expanding the current Department research program to include projects related to populations and ecosystems. The Secretary will publish clear research priorities for the National Biological Survey by the end of FY 1994. Those priorities will reflect the recommendations of users communicated through surveys and other forms of customer response.

- b. The National Biological Survey will develop an implementation plan by the end of FY 1994 to integrate the Department's biological database systems with other relevant federal and state databases.

- c. By the end of FY 1994, the National Biological Survey will publish a generally accepted definition of natural resource status and trends that will provide information needed by the Nation to help avert endangered species crises and to aid in wise management and development decisions.

The National Biological Survey will provide information on populations and ecosystems to those government agencies, states and other entities that rely on biological data to administer programs and will work with such agency customers to insure that their needs can be met.

### 2. REFORM LAND MANAGEMENT AT THE DEPARTMENT OF THE INTERIOR

- a. Subject to outcomes of the Conference Committee the Secretary will take final action on the administrative proposal that as first announced in August 1993 to improve management of rangeland

ecosystems and provide for more effective administration of livestock grazing on public lands.

- b. In early 1994, the Department will publish a draft Notice of Proposed Rulemaking for public comment and a draft Environmental Impact Statement regarding rangeland reform. The Secretary is committed to implementing changes in the grazing fee formula that will be used to set fees for grazing on federal lands. The Secretary also will eliminate the existing Grazing Advisory Boards and District Advisory Councils and replace these with new Resource Advisory Councils that can better represent the many constituencies concerned with public lands and respond to the needs of rangeland managers within specific geographical areas.
- c. The Department will develop an experimental set of outcome measures for successful changes in grazing management. Development of these measures will involve the Resource Advisory Board members. These will be included in the final Administrative Proposal to be published by the end of FY 1994.
- d. The Secretary will commit significant personal time and appropriate staff resources during FY 1994 to insure passage of mining law reform legislation, under the principles that have been enunciated by the Administration.

### **3. REINVENT THE BUREAU OF RECLAMATION**

- a. A policy directive will be published in early FY 1994 that will articulate a new mission and structure for a streamlined Bureau of Reclamation. This mission will commit the Department to shift its emphasis from large civil works to water and environmental management.
- b. In conjunction with Executive Order No. 12862, pertaining to customer service, the Bureau of Reclamation will strengthen relationships with the environmental community, water users and other customers during its transformation. In FY 1994, the Bureau will experiment with customer opinion surveys to measure the level of service expected and received.

#### **4. STRENGTHEN THE COMMITMENT OF THE NATIONAL PARK SERVICE TO EMPLOYEES AND THE AMERICAN PUBLIC**

- a. The Secretary will make significant progress in FY 1994 to develop a mechanism to provide seasonal and temporary employees greater benefits in line commensurate with the contribution they have made to the National Park Service. In addition, the Secretary will propose a plan to transfer eligible seasonal and part-time employees to Full Time Equivalents.
- b. The Secretary, will delegate to the Director of the National Park Service responsibility to initiate comparable employee career development activities for other Park Service employees by the end of FY 1994.
- c. The Secretary will prepare legislation to eliminate prohibitions that restrict the collection of entrance fees at national parks and to raise entrance fees in those parks where fees is currently charged. In addition, concession reform will commence with new negotiations of current contracts early in FY 1994.
- d. A portion of increased fee revenues will be used to complete infrastructure improvement projects. The National Park Service will develop by the end of FY 1994 ongoing visitor opinion surveys to assess satisfaction with park services and facilities.
- e. The problems of inadequate employee housing will be addressed during FY 1994 with a major Department initiative to fund needed housing improvements through private sector partnerships.

#### **5. ACT AS A PARTNER WITH INDIAN TRIBES**

- a. In order to assist the tribes in better preparing themselves to compete and prosper in the 21<sup>st</sup> century, the Department will develop mechanisms to support the renewed federal/tribal partnership envisioned as the Administration develops its Indian policy position. To carry out this commitment, the Secretary will finalize and implement regulations pursuant to Pub. L. No. 93-638 as soon as possible in FY 1994 and will continue expansion of the self governance initiative.
- b. The Secretary will emphasize continued consultations with the tribes and Congress to develop an appropriate vehicle for the management

of Indian trust funds including alternatives other than operations within the Bureau of Indian Affairs.

- c. Through the reauthorization process for the Indian Education Act in 1994, the Department will develop a sound legislative plan for education of all Indian children in concert with the tribes, Indian parents, Congress, the Department of Education and other federal agencies which have funding and responsibility for Indian Education, and other concerned organizations and individuals.

## **6. MAKE THE ENDANGERED SPECIES ACT WORK**

The Secretary will initiate key administrative reforms to the Endangered Species Act of 1973, as amended by issuing four policy directives before the end of FY 1994:

- 1) A directive that provides a definition of species for listing purposes.
  - 2) A directive that establishes standards for evaluating and accepting proposals to list species as threatened and endangered.
  - 3) A directive that streamlines the Habitat Conservation Planning process.
  - 4) A directive that stresses the need to conserve candidate species and the ecosystem in which they occur before further declines occur.
- a. The Secretary will delegate to the Director of the Fish and Wildlife Service in consultation with the Assistant Secretary for Indian Affairs the responsibility for expanding and clarifying the role of states and tribal governments in implementing the Endangered Species Act of 1973 as amended.
  - b. The Secretary also commits to developing a departmental strategy to reauthorize the Endangered Species Act. The Department of the Interior will provide leadership in developing the Clinton Administration strategy to reauthorize the Endangered Species Act.
  - c. The Department will provide leadership with the White House to promulgate an Executive Order by February 1 1994 that will direct Federal agencies to use their authorities to promote conservation of listed species.
  - d. The Secretary of Interior commits to timely action on individual species including a section 4(d) rule for the northern Spotted Owl by March 1, 1994 (subject to the alternative timetables dictated by the completion of the FEMAT "Option 9" FEIS); a section 4(d) rule for

the California Gnatcatcher by February 1, 1994: and an expedited processing of the Travis County, Texas, incidentals take permit upon receipt of a completed permit application from Travis County.

- e. Interior will measure its commitment to avoiding impasses through an analysis of the outcomes of the Northwest Summit and the California Gnatcatcher.

## **7. CHAMPION COLLABORATION AND PERFORMANCE AT THE DEPARTMENT OF THE INTERIOR**

- a. In carrying out the performance commitments of this agreement, Interior managers and employees will work across traditional organizational boundaries, whether internal or external. All implementing plans will establish working groups with cross-bureau and cross-agency membership, common goals and common measures of success.
- b. The Secretary will delegate to the Deputy Assistant Secretary for Human Resources the responsibility for initiating in FY 1994 measures of accomplishment: including exit interviews with employees; analysis of appraisal data; and use of baseline employee opinion research.  
The Department of the Interior's Minerals Management Service will conduct pilot opinion research with employees and external customers in FY 1994. The research will identify areas for future change.
- c. In FY 1994, The Department of the Interior will sponsor a pilot project pursuant to the Government Performance and Results Act of 1993 to develop and test results-based performance measures for a single departmental function carried out across at least four bureaus.

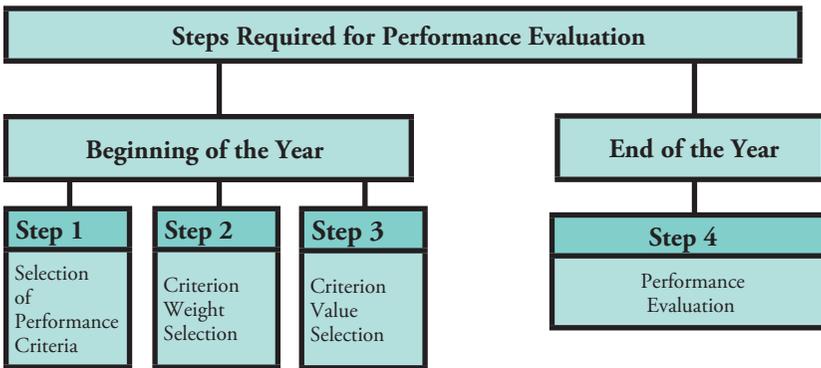
## **8. MISCELLANEOUS**

The Performance Measures set forth herein are intended only to improve the internal management of the Executive Branch and are not intended to and do not create any right, benefit trust or responsibility, substantive or procedural, enforceable at law or equity by a party against the United States, its agencies, its officers, or any person.

## Appendix II: Suggested Best Practice Evaluation Methodology for Performance Agreements

The proposed methodology for performance evaluation involves four key steps. First three steps are taken at the beginning of the year and the last is taken at the end of the year. Figure 1 describes these steps.

**Figure 1: Steps for Performance Evaluation**



Each step is a necessary condition for an objective performance evaluation exercise. The language used to describe these steps may and, indeed, does differ from country to country, yet the spirit of each step as described in the following sections has to be present to enable a meaningful performance evaluation.

### Step 1: Selection of Performance Criteria

Defining performance is the first step in any performance evaluation exercise. This is accomplished by selecting a set of criteria against which performance will be measured. The following basic principles should guide the selection of these performance criteria:

- Performance criteria should reflect the objectives of the agency.
- They should be simple and monitorable.
- They should be “fair” to the manager and “fair” to the country.
- There should not be too many criteria in a Performance Agreement.

### Step 2: Criterion Weight Selection

In the second step we deal with criterion weight selection. Whenever there is more than one indicator, we must decide what the relative priorities are so that the agency management can allocate its time more effectively in achieving those priorities. This is not an academic issue. Rather, by not specifying the priorities among the indicators we run the risk of either being unable to evaluate performance at the end of the year or appearing to be subjective in performance evaluation. In either case, the effectiveness of *the Performance Agreement* is greatly diminished.

Specification of weights is essentially a “normative” exercise. There is no rule or law that mandates a particular weight for a particular criterion either across programs or over time. This is a judgment that the two parties will have to make and agree to. As part of its fiduciary obligation, it is the prerogative of the government to reserve the ultimate right to determine these weights.

### Step 3: Criterion Value Selection

The third step in the performance evaluation system relates to criterion value selection — that is, the level of performance expected with respect to different indicators. To understand this step we need to distinguish between “criterion” and “criterion value.” We know that miles per gallon is a criterion to measure the efficiency of all types of motor vehicles (e.g., cars, scooters, trucks). However, a performance level of 10 miles per gallon may be excellent for a truck but terrible for a scooter. This value, 10 miles per gallon, is the criterion value — value that distinguishes various levels of performance. There are many ways of incorporating criterion values into the *Performance Agreement*. One way is to have a 5-point scale, where:

- 5 = Excellent
- 4 = Very Good
- 3 = Good
- 2 = Fair
- 1 = Poor

Table 1: Example of a 5-point Scale Depicting Criteria Values

Criterion	Units	Criterion Values				
		5 Excellent	4 Very Good	3 Good	2 Fair	1 Poor
Number of Children Immunized	Thousand	400	385	350	300	250

**Step 4: Performance Evaluation at the End of the Year**

The fourth and final step is taken at the end of the year, when we look at the achievements of the government agency, compare them with the criterion values, and determine the composite score. For example, suppose we take the 5-point scale depicted in Table 1.

At the end of the year, we compare this scale with the actual achievements. If the management has successfully immunized 385,000 children they earn a score of 4. If they have achieved an immunization level of 350,000 children, they earn a score of 3. If their achievement is in between these two levels, then their score is between 4 and 3. This is how we calculate the score (called the Raw Score) for all the indicators included in the *Performance Agreement*. Once we have done that, we take a weighted average of all these raw scores and arrive at a composite score. The value of the composite score will also lie between “5” and “1.”

The *composite score* is a key concept in the Performance Agreement exercise. It measures the ability of the managers of government agencies to meet their commitments. It also allows us to link the incentive scheme to the managerial performance in an objective and “fair” manner. In addition, it allows us to compare and rank various government agencies according to their respective composite scores at the end of the year. While the commitments of the managers may be different—for example, the commitments of government agencies under the Ministry of Education are likely to be different from those of government agencies under the Ministry of Health—through the Performance Agreement exercise we are able to compare their ability to meet their respective commitments.

In the Performance Agreement system the review meeting at the end of the year is important to adjust the criterion values for factors that were genuinely unanticipated by both parties to the Performance Agreement (i.e., factors that could not have been predicted by either party, such as natural

disasters, wars, etc). This is essential to keep the system “fair” and prevent managers from losing their motivation.

**HOW TO CALCULATE THE COMPOSITE SCORE**

Since the **Composite Score** is the heart of the Performance Agreement exercise, it is essential to have a clear understanding of how it is calculated. In this section we illustrate the calculation of the composite score with the help of a hypothetical example.

**A Hypothetical Example**

Imagine that at the beginning of the year a government agency, such as the Ministry of Health, signed a Performance Agreement containing the targets given in Table 2:

**Table 2: Hypothetical Performance Agreement Signed at the Beginning of the Year**

Criterion	Units	Weight	Criterion Values				
			5 Excellent	4 Very Good	3 Good	2 Fair	1 Poor
1.Number of Children Immunized	Thousand	.50	400	385	350	300	250
2.Increase in level of Hygiene Awareness	%	.30	80	70	65	60	55
3.Construction of Rural Medical Facility	Months	.20	6	8	9	10	12

At the end of the year the achievements of this program were as follows:

- i) Number of Children Immunized                      385 K
- ii) Increase in Level of Hygiene Awareness            75 %
- iii) Construction of Rural Medical Facility            5 months

How would you evaluate the performance of this program? The answer to this question is summarized in Table 3.

**Table 3: Calculation of Composite Performance Score at the End of the Year**

Criterion	Units	Weight	Achievement	Raw Score	Weighted Score
1.Number of Children Immunized	Thousand	.50	385	4	2
2.Increase in level of Hygiene Awareness	%	.30	75 %	4.5	1.35
3.Construction of Rural Medical Facility	months	0.2	5	5	1
<b>COMPOSITE SCORE</b>					4.35

**Calculation of the Raw Score**

In this step we have to calculate where the program achievement falls on a scale of 1 to 5. For example, for “Number of Children Immunized” the Raw Score is exactly 4 because it corresponds to point number 4 on the 5-point scale mentioned in Table 1. However, for criterion 2 “Increase in Level of Hygiene Awareness,” the Raw Score is between 5 and 4. Since the achievement of 75 percent with respect to this criterion is exactly halfway between the two points, the Raw Score for the criterion “Increase in Level of Hygiene Awareness” is 4.50. The Raw Score must be calculated by interpolation when the achievement is in between points on the 5-point scale.

The calculation of the Raw Score for “Construction of Rural Medical Facility” raises interesting issues. The target for excellence for this criterion was six months, whereas the project was completed in five months. Should we give a Raw Score of 5 or more than 5 for such performance? It is possible to find supporters for both positions. Those who argue for giving a score of 5 usually base their contention on the fact that the Performance Agreement system does not provide for a score of more than 5. The other side responds by saying that not giving a score of greater than 5 under these circumstances would be unfair to high performers since the system would fail to recognize their special efforts.

It turns out that those arguing for giving a score exactly equal to 5 are correct, although for the wrong reason. To understand why, we have to ask what are the possible reasons for this discrepancy between the target of six months for Project Implementation and an achievement of five months. There are three main reasons why this might happen.

First, it is possible that both parties to the Performance Agreement had genuinely failed to anticipate the future correctly and made an honest mistake. For example, based on past experience, both parties may have assumed that it would take a certain amount of time, say one month, to procure a particular item from a third party. Fortunately, this time the third party delivered the required item almost instantaneously because they happened to have it in stock. Therefore, the resultant good performance was a windfall gain, and the program cannot claim credit for it. In other words, the initial assumption was wrong, and it would be improper or unfair to the country to reward such mistakes.

This is analogous to truly unanticipated events that can hamper performance. Take the example of a government agency being affected by a serious accident. No one can predict acts of nature or Divine interventions. Therefore, it would be unfair to blame the managers of government agencies for such an eventuality. The correct course of action for the program affected by such unforeseen events is to bring them to the notice of the government at the end of the year.

In addition, it is worth pointing out at this juncture that for certain indicators, exceeding the target is not necessarily desirable. For example, if the Performance Agreement target for the provision of additional hospital beds is 4000 in the case of a government agency in the health sector, it is not clear that it is desirable from a national point of view for this program to provide 6000 beds in the absence of excess demand for additional beds. Likewise, in the case of project implementation, it is often reasonable to say that finishing the project much ahead of the scheduled date may be undesirable if the matching end-use facility and systems are not available.

Once we have the raw scores for all three criteria, the next step is to multiply the raw scores by the respective weights for the three criteria and get the weighted raw scores as shown in the last column of Table.3. The sum total of this column gives us the Composite Score of 4.35.

### **How to Interpret Composite Scores**

The primary function of the composite score is to provide an effective link between managerial performance and incentives. The composite score shows the degree to which the government agency in question was able to meet its commitments. If it had met all its commitments in the Performance Agreement, it would have received a composite score of 5. On the other hand, if it had done a miserable job on all fronts, it would have received a composite score of 1. The fact that it got a score of 4.35 in our hypothetical example implies that its performance was close to “excellent,” all things considered.

The second function of the composite score is to allow us to compare and rank the performance of all government agencies signing Performance

Agreements. While the commitments of all Performance-Agreement-signing programs are different and one-to-one comparisons of their commitments cannot be made, the “ability” to meet these commitments is certainly comparable. For example, while it is meaningless to compare individual criteria of different ministries, their composite scores can still be compared.

## Appendix III: Perceptions' Analysis: Role and Relevance of the MoU as an Instrument<sup>106</sup>

Among the Manufacturing Industries (Light, Medium and Heavy Engineering PSEs) the general opinion is that the MoU has had a positive impact on the productivity of the enterprise and has helped bring out latent infrastructure, in way of Social, Physical and Financial into play. They also claim that it has increased both accountability and autonomy which has in turn helped in shifting the focus of the management from the peripherals to key areas. They advocate public enterprise governance along the lines of corporate governance. They feel that the MoU has adapted to the changes that have come about with globalization and is highly relevant both in the Indian and globalized context.

The pattern remains more or less the same in the case of Industrial Development and Technical Consultancy Services PSEs. Here too, they feel that the MoU has been a tool for productivity increases. They largely believe that the MoU is relevant in the globalized context and has helped achieved both autonomy and increase accountability. All the same, there have been mixed perceptions on whether the MoU has actually helped in shifting the focus of management to the key areas. These industries feel that though the task force members should be neutral bodies, they should still include experts drawn from industry/administrative services with a past track record and technical expertise on issues confronting the industry. Ideally the Task Force experts should be drawn with a track record of having worked in the Industry groups and Administrative Machinery with similar characteristics, for instance knowledge intensive industries or enterprises operating in mature markets.

Amongst the Trading and Marketing Services PSEs, the MoU system has been successful in increasing productivity and making use of social, physical and financial infrastructure to a certain extent. Accountability and autonomy has not improved as a result of the MoU and that public enterprise governance along the lines of corporate governance would be highly beneficial. Also, shift in management toward key areas has shown minimum improvement. They feel that the task force members should not be neutral bodies but should be managers of other PSEs within the same functional group.

The PSEs in the Services Sector feel that the MoU system has helped in productivity improvement and has brought out latent infrastruc

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<sup>106</sup> Source: **Study of the Revamping of the MOU System**, National Council for Applied Economic Research, September 2004

ture in the PSEs. Though it has helped increase accountability and provide autonomy, it has not been very successful in shifting the focus of management to key areas and corporate governance for PSEs can be very helpful in this regard. Also, some of the financial services/insurance companies feel that the MoU is not relevant in the globalized context and needs to be upgraded.

It has been observed that the Manufacturing Sector PSEs give high relevance to MoU because they have helped increase productivity and bringing out the latent infrastructure. They also feel that the MoU has helped increase accountability and give greater autonomy to the PSEs. They concur to the importance of public enterprise governance, which will facilitate the shift in focus of management to key areas. Also, they are of the view that though the MoU is quite relevant in the Indian context, it may not be so in the globalized context and needs to be adapted for the same. Though a certain set of PSEs feel that the task force members should be neutral bodies, there is another set that feels that the task force should comprise of NE managers within the same functional group.

On the whole, the MoU has emerged as a productivity improvement tool, has increased autonomy and also improved accountability. It has tapped the latent infrastructure. All the same, most PSEs feel that public enterprise governance along the lines of corporate governance is something that would make the MoU more effective than it is today and help focus on key issues of the organization. Most PSEs feel that the MoU has been upgraded with the increased globalization and its parameters have been duly changed to respect the changed in the globalized world and within India.

There exists a feeling that Task Force members could be drawn from experts with a track record of having worked in industry/administrative services with technical expertise on issues confronting the industry since they are experts in the field and would improve the quality of the target setting and negotiations procedure, provided there is no conflict of interest. Unfortunately, despite the above, a lot of PSEs feel that the MoU is only a routine thing that is carried out year after year.

Among the Navratna PSEs it can be observed with the lone exception that the MoU has aided in productivity enhancement and has at the same time brought about an increased usage of the latent infrastructure-social, physical and financial. The general perception is that the MoU has increased the level of autonomy and accountability that the PSEs enjoy which has in turn been successful in shifting the focus of the management from peripherals to key areas. All PSEs agree that public enterprise governance on the lines of corporate governance is necessary for improved performing of PSEs. On the whole, the better performing Navratnas feel that the MoU holds relevance in both the Indian and the new globalized context. The perception of some CEOs is that the MoU has degenerated into just another routine it

does however, still have the effect of setting the calendar for the year akin to the planning process.

There is a common perception within the Miniratna PSEs that the MoU system has helped in increasing productivity and that it is a useful tool to make better use of the latent infrastructure of these PSEs. Most PSEs in the Miniratna category I feel that the MoU has improved the focus of the PSE management to key areas; this view is however not shared by the PSEs in the Miniratna category II.

## CONTRIBUTORS

### EXPERTS

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Mr. Prahlad K. Basu currently serves as Chairman (with the rank and status of Minister of State) of the Board for Reconstruction of Public Sector Enterprises, Government of India. He has over 30 years experience in the civil service of India, and retired as Permanent Secretary, Government of India. He has a distinguished career in academia having held prominent professorial level positions at institutions like Cambridge, Harvard, Indian Institute of Management and Indian Institute of Technology. He is also Fellow of King's College, Cambridge University, UK. Prof. Basu published extensively in the field of public enterprises, public sector management and monitoring and evaluation.

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Mr. Marc Dandelot currently serves as a Judge at the Conseil d'Etat - the French Administrative Supreme Court. He is also a State Advisor to the French Minister for Foreign Affairs. He has a long and distinguished career at France Telecom, having held senior management positions. Mr. Dandelot was a professor and lecturer at several French universities and has published articles in all major French Legal Reviews.

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Mr. Aristide Police currently serves as Professor of Administrative Law at the University of Rome ‘Tor Vergata’. As a member of the firm of Franco Gaetano Scoca, he has represented numerous public companies and officials in the capacity of lawyer at the Bar of Rome since 1993. Mr. Police has taught at the University of Teramo and has authored five books and over 60 articles, essays and papers published in Law Reviews worldwide.

**Dennis Rondinelli**

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## Public Enterprises: Unresolved Challenges and New Opportunities

This publication features the papers presented and views expressed during the Expert Group Meeting (EGM) on “Re-Inventing Public Enterprises and Their Management” held from 27 to 28 October 2005. It examines the role of Public Enterprises in today’s economy, especially within the context of the realization of the Millennium Development Goals (MDGs) and their management, more particularly, the performance monitoring issues of Public Enterprises. The first part of the report focuses on conceptual issues, theories and models associated with Public Enterprise (PE), as well as on new management approaches relevant to PE in the contemporary world. It also presents a model for a public enterprise governance index (PEGI) and explores its possibilities in assisting on-going performance monitoring systems of PEs in several developing countries. The second part of the publication analyses the salient issues and challenges unique to country case studies of France, India, Italy, Malaysia, Mexico and Uganda. This report attempts to advance the debate on the subject further and articulate more clearly the needs and options of Public Enterprises so that the Member States are in a better position to determine the usefulness of PEs in the implementation of their national development goals as well as of the MDGs and to address the geopolitical, institutional and administrative challenges in the management of Public Enterprises.

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