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IMPROVING MECHANISMS OF EFFECTIVE USE OF BUDGET FUNDS FROM STATE-OWNED ENTERPRISES

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Abstract:

The article improving mechanisms of effective use of budget funds from state-owned enterprises is widely covered.State-owned enterprises(SOEs) are classified asthose enterprisesinwhich the state exerts significant control through full, majority, or significant minority ownership. This definition includes SOEs that are owned by the central or federal government as well asthe ones owned by regional and local governments(Sturesson, McIntyre, and Jones 2015). Despite a wave of privatization in the last 3 decades, SOEs still contribute significantly to economic growth of both developed and developing countries (Robinett 2006).

Keywords: improving mechanisms of effective, budget funds, state-owned enterprises, widely covered, enterprises(SOEs).

INTRODUCTION

Providing more public services with less public spending is an ongoing challenge for all OECD member countries which is becoming increasingly important in the context of ageing. Cross-country comparisons could be useful to identify best practices in delivering public services in a cost-effective manner. In practice, the paucity of data often makes it difficult to benchmark countries, but recent attempts at doing so in the education sector – where the lack of output data is a less severe constraint – reveal that efficiency shortfalls can be large. Also, the variety of OECD country approaches to managing public spending programmes provides useful insights about possible strategies for improving value for money. In that respect, stepping up the use of performance information in budget processes – "performance budgeting" – is an important dimension of the reforms undertaken by OECD countries since the early 1990s. Recent developments in public spending leave no room for complacency.

Ratios of public spending to GDP have fallen below their historical high in the early 1990s in the OECD area, Japan being a notable exception. However, the factors behind this positive development – improving cyclical conditions, privatisation and enterprise restructuring, and lower debt servicing costs, for example – are unlikely to exert the same influence going forward.3 Meanwhile, demands on social transfer systems have remained intense over the past two decades; spending on pensions, poverty alleviation programmes and core merit goods (education and health) continued on a clear upward trend during that period. Population ageing will put further significant pressures on public spending in virtually all OECD countries over the next few years. Making cross-country comparisons of public spending efficiency requires corresponding measures of the value of public service outputs and inputs. On the input side, even the public spending data available from the national accounts – which are the best internationally comparable source – are fraught with problems. Cross-country comparisons based on public spending-to-GDP ratios suggest significant differences across OECD countries.

LITERATURE REVIEW

Measuring public spending outputs is even more complex. The coverage and scope of public services differ across countries, partly reflecting societal priorities. These disparities require that public spending effectiveness be assessed by spending area, at least for the key components, including health care, education and social assistance. Even for each of these spending areas, public involvement often has various objectives (or output targets). And the outcomes of public services also depend on a number of factors that are outside the control of policy makers, at least in the short run. (Life expectancy, for example, depends to a large extent on lifestyle and diet.) Although most OECD countries have introduced performance targets and measurement tools in some parts of general government, they employ different methods. Thus, assembling a data set on public service outputs suitable for cross-country

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comparisons is, for many sectors, more an ideal than a possibility. Education is the sector where existing data allow some comparisons to be drawn on cost efficiency across countries, and the OECD has recently made a comparative assessment of performance in this area. Most OECD countries have carried out reforms to contain the growth in public spending and improve spending outcomes since the early 1990s. Reforms can be classed under three broad headings:

- making the budget process more responsive to priorities;
- making management practices more flexible, such that defined priorities are easier to achieve;
- strengthening competitive pressures among providers of public services and, where not incompatible with equity considerations, containing the demand for public services.

Because of important synergies among the three areas, getting the most out of these reforms would require that they be internally consistent. Further, since the early 1990s there has been a substantial transfer of spending responsibilities (particularly in education and health care) to sub-national governments in many OECD countries. This has had two effects. It has left central governments with responsibility for pension systems and other entitlement programmes, as well as debt-servicing costs, that are largely unaffected by these reforms. And since effective reform cannot be confined to central government, fiscal relations across levels of government must be such as to ensure that sub-national governments have the right incentives to deliver cost-effective public services. This is an issue for all countries, whether or not they are formally federal or unitary.

METHODOLOGY

The remainder of this section explores different reforms to key institutional arrangements within government which may improve public sector efficiency. However, the triple role of the government as the regulator, enforcer of those regulations, and owner of SOE assets in their respective country can sometimes undermine the SOEs' competitiveness and efficiency because of corruption, mismanagement, and technical incompetence of their staff (Büge et al. 2013). Indeed, despite their socioeconomic importance, the SOEs' performance has been "disappointing" over the years compared to their private counterparts (Sturesson, McIntyre, and Jones 2015). The underperforming SOEs not only drain scarce resources to provide essential services to people in developing countries, but can also crowd out private investment and distort domestic financial markets (World Bank Group 2014a). Many developing countries, therefore, have sought to reform their SOE management and governance structures to improve their performance. Reforms at a Glance SOE reforms have long been the focus of developed and developing countries alike. Beginning in the 1970s, member countries of the Organisation for Economic Co-operation and Development (OECD) such as France, Spain, and the United Kingdom began to seriously examine the causes of poorly performing SOEs amid the mounting fiscal constraints they faced to control their public spending and debt.

ANALYSIS AND RESULTS

Over the subsequent 2 decades, partial or complete privatization of SOEs became a key source of economic reforms initiated, at first, by OECD countries and later by most developing countries in the last 25 years. Evidence from OECD countries also strongly suggests that privatization leads to "significant" increase in profitability, real output, and efficiency of privatized firms, especially when the privatized firm operates in a competitive market where deregulation levels converge with those of the private sector (OECD 2003). However, efficiency gains from privatization are largely dependent on continued political commitment by the government to overcome bureaucratic inertia, ensuring a transparent privatization procedure, clearly delineating privatization motives and goals to the concerned stakeholders, and allocating the necessary human and capital resources to achieve those goals (OECD 2003). Many developing countries struggle to ascertain these conditions. First, most SOEs, especially in developing countries, are not just expected to be financially profitable, but are also tasked to provide crucial public goods. The provision of clean water, electricity, and sanitation services in remote towns and villages, for example, might not be as financially profitable as they would be in big towns, but they are equally essential for both sets of populations. Privatizing SOEs, which provide these essential services often at subsidized rates, thus could deprive people of critical public goods, as SOEs may stop their operations in less profitable regions. Such policies may also be fatally unpopular for governments in developing countries. Second, some countries may be unwilling for security reasons to privatize, even partly, their"strategic"industries—those that a government considers to be very important for the country's economy or safety (Cambridge Dictionary 2017). Similarly, some central Asian countries such as Tajikistan have also introduced SOE reforms as they continue to switch from a planned to a market economy.

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SOEs in Tajikistan provide almost a third of all the jobs in the economy and form 42% of the total value added and 50% of the total investment in fixed capital. As such, SOEs are major stakeholders in Tajikistan's economy. Yet, the financial and management data about most of these SOEs remain incomplete or inaccurate, which makes monitoring their performance more difficult. Nonetheless, the Government of Tajikistan instituted the SOE Monitoring Department (SOEMD) within the Ministry of Finance in 2008 to monitor SOE performance. SOEMD found that 5 of the largest SOEs (large SOEs in Tajikistan each have more than 1,000 workers and an annual gross revenue of more than 30 million somoni) contributed to 80% of the country's gross income, whereas 24 of the biggest SOEs had a $1.9 billion debt, equivalent to 97.7% of Tajikistan's public revenues of all kinds in 2013. The 3 biggest SOEs among the 24 owed 84% of that debt. By 2014, these 24 SOEs were also responsible for half of all the tax arrears. The Civil Code of the Republic of Tajikistan provides a legal framework for SOE management and monitoring, but multiple or uncoordinated functions of SOEs as well aslack of proper oversight and management by the relevant government agencies has hindered SOE performance efficiency in Tajikistan (World Bank Group 2014b). Malaysia, on the other hand, provides a successful example in SOE reforms for other Asian countries to follow. In 2004, the Government of Malaysia embarked on the Transformation Programme for GovernmentLinked Companies (GLCs).

The program has realistic and performance-based objectives in line with international benchmarks. Itwasoverseenby the PutrajayaCommittee on GLC High Performance chaired by the Deputy Finance Minister and comprising representatives of all key SOE shareholders and external experts. The program introduced key performance indicators (KPIs), as well as performance-based contracts and compensation, along with a change in the composition of GLC boards and senior management. It addressed the root causes of underperformance in SOEs, upgraded the legal and operational framework of the SOEs to corporatize them, and infused newer management from the private and public sector into SOEs. Management were given a clear mandate and sophisticated indicators to improve SOE performance within a set time frame. These reforms helped instill a performance-based culture, and improved SOE management through better utilization of capital and other resources, all of which translated into higher profitability. Between 2004 and 2014, Malaysian GLCs tripled their market capitalization generating a return on equity equivalent to those recorded by the listed companies. The GLCs also grew 11% annually during this time (Luna-Martinez 2016). Inspired by the success of the GLC transformation program, the government initiated the New Economic Model, which required GLCs to expand their operations globally. By 2014, GLCs had operations in 42 countries and the 20 largest SOEs operating overseas had tripled their revenue to $22 billion from $7 billion in 2004 (Luna-Martinez 2016). The foremost challenge facing SOEs in developing countries is the separation between its ownership and management entities. Unlike most private enterprises, SOEs in most developing countries are likely to have board members from the ruling political party or the government who are difficult to remove or replace. This, along with a lower probability of bankruptcy of many SOEs, reduces incentives for board members to contain costs and improve performance through competition. At worst, most board members could exploit SOEs for personal and partisan benefits while compromising short-term efficiency and long-term efficacy of the SOEs (Robinett 2006). To address this problem, countries must institute a balance between a state's ownership mandate (appointing boards and providing oversight) and improving SOE competitiveness simultaneously. They should begin by introducing a clear legal and regulatory framework supported by a strong coordinating mechanism for oversight (World Bank Group 2014a). Some Latin American countries, for instance, have centralized SOE ownership within a single entity which oversees SOEs and maintains their separation from government activities that could obstruct competition. Moreover, the SOE board members must be carefully selected through competitive and professional recruitment based on their technical, financial, and corporate governance skills.

They must be safeguarded against political interference and be autonomous in their commercial decision-making (World Bank Group 2014a). In Peru and Chile, for example, board members are appointed on these merits and not on political affiliation. This empowers them to make autonomous decisions (Weiner, Ivins, and Riveira Cazorla 2015). Nelson and Nikolakis (2012) in their study also cite empirical evidence from 6 Australian state forest agencies to corroborate the claim that corporatization of these 6 SOEs helped improve their performance through operational efficiency. In particular, they argue that an independently appointed board of directors with greater managerial autonomy was responsible for redirecting their respective SOEs' focus onto commercial interests, which led to short- and longterm performance improvement. Their findings were also consistent with similar research conducted on public enterprises in the

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United Kingdom. These studies, therefore, offer compelling empirical evidence for appointing independent management bodies for running SOEs (Nelson and Nikolakis 2012). Second, the governments should explicitly delineate realistic, time-bound, and quantifiable outcomes to better guide and evaluate SOE performance. This includes drafting a clear scorecard that evaluates progress on not only the financial viability and strengths of SOEs but also social objectives such as job creation, public service, welfare provision, and other social benefits (Figure 1).

In Sweden, for example, the national rail operator is asked to maintain and report on industry standards for returns on equity (13%), interest coverage (2:1), and minimum debt-to-equity ratios (1:1) regularly. Similarly, the New Zealand Railways Corporation operates urban commuter trains in two major regional centers on behalf of their regional councils (which are responsible for providing affordable public transport there). The operational costs of these trains are sustained by a mix of passenger fares, council payment for contracted services, and government grants. Without these subsidies, the railways corporation would likely be commercially unviable. The government regularly monitors the corporation's performance by setting up a transparent and detailed mechanism for cost declaration to prevent mismanagement of funds and by instituting penalties to discourage underperformance (Christiansen 2013).

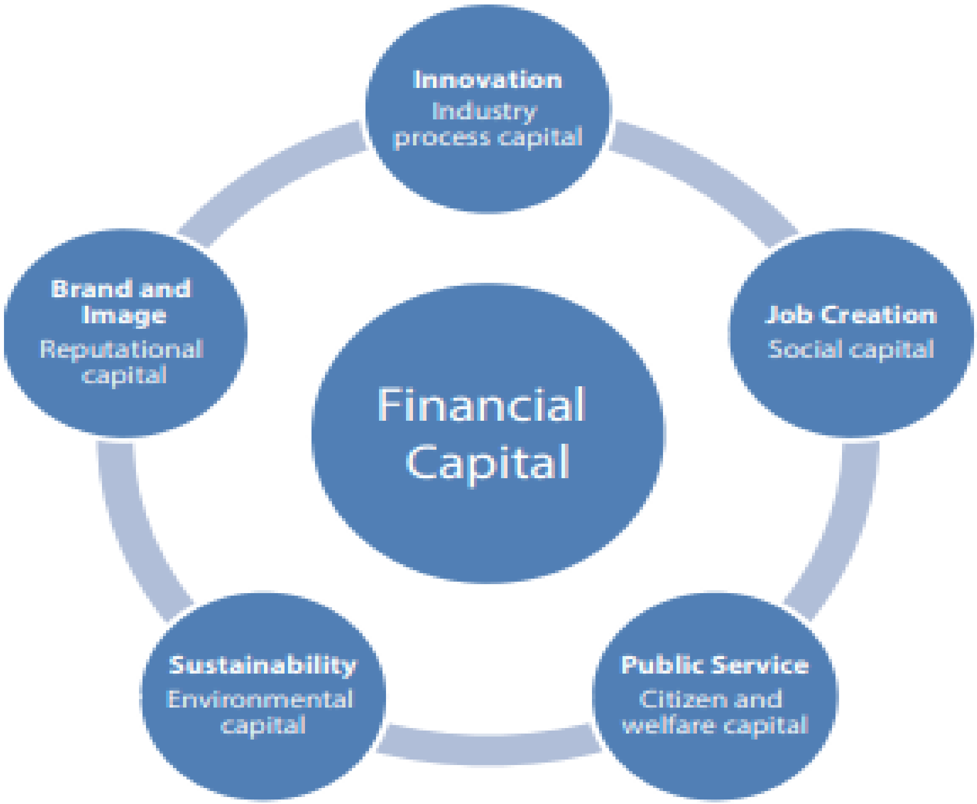

Figure 1 Model Scorecard for Performance Management of State-Owned Enterprises

Third, regular monitoring and evaluation of SOEs should also be a key responsibility of SOE ownership entities. These entities must track SOE performance through annual performance reviews, reporting, regular board meetings, and internal and external audits to detect underperformance early on and rectify it to promote a "continuous cycle of improvement" (Figure 2).

In Italy, for instance, the Ministry of Finance and Economy as the country's SOE ownership entity requires each SOE to provide an annual budget for the coming year, biannual financial and performance review reports, and yearend projections. Shareholders can also request this information from each SOE through their appointed representatives on the board of directors and board of auditors. Fourth, SOEs must attract and encourage meritorious people to join them. The perception that SOEs are hierarchical and bureaucratic, where job promotions are based more on personal connections and seniority rather

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thanperformancemaydiscourage talentedpeople tojoin their ranks.

Therefore, performance-based competitive salary and benefits packages must be designed to attract talented people. Some SOEs such as China Mobile, the PRC's largest mobile service operator, offer salary packages comparable to those offered by multinational corporations. When applicable, SOEs should also provide higher compensation packages in tenured jobs to offset the benefits of long-term employment. One Eastern European telecommunications company, for instance, offers higher salaries for short-term contracts for some positions. In addition to increased benefits, SOEs must invest in and encourage consistent job training of its employeestoupgradetheirskills andexpertise(Budiman, Lin, and Singham 2009). Employee performance should then be evaluated fairly and regularly with incentives for higher performance. Finally, while laying off consistently underperforming employees may be unpopular and difficult at times, SOE management must make those difficult decisions to develop a competitive and effective work culture (Budiman, Lin, and Singham 2009).

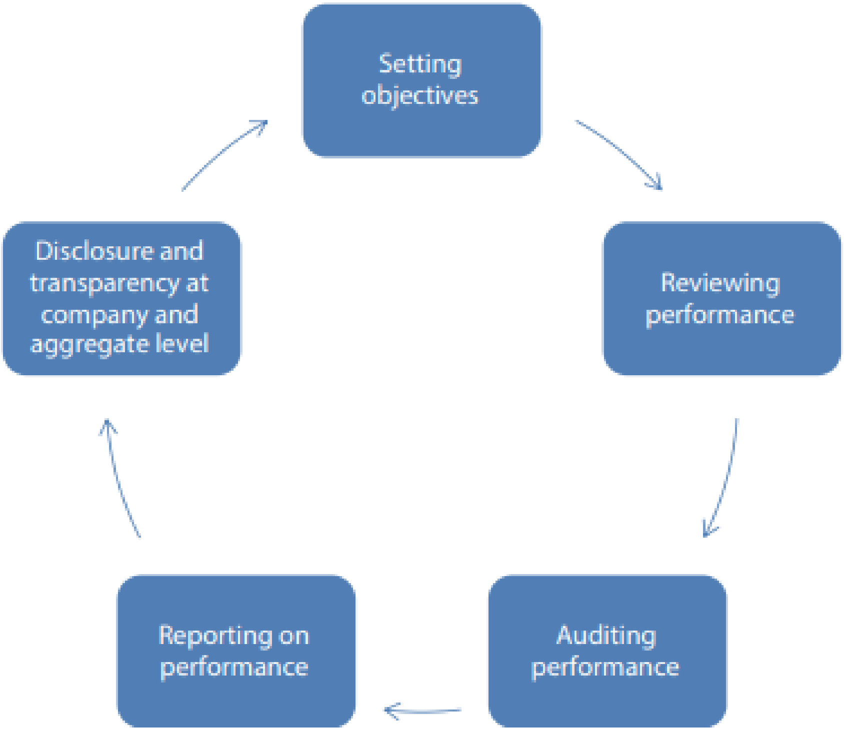

Figure 2 Continuous Improvement Cycle in Management of State-Owned Enterprises

SOEs remain a critical source of employment, public service provision, and socioeconomic development in most developing Asian countries. However, the overlapping ownership and management functions of most developing countries' governments coupled with the unclear and indefinite mandates for most SOEs have severely undermined the efficiency of SOEs in their countries for several decades. The lack of a centralized and credible database on SOEs in some countries has made monitoring and evaluating their performance even harder.

CONCLUSIONS

Therefore, to improve SOE performance in their countries, developing countries in Asia must ensure separation between the ownership and management functions of SOEs. Second, they must chart clear and quantifiable short- and longterm goals, and appoint autonomous and competent management to strategize how to achieve these goals. Third, SOE management must institute transparent and independent monitoring and evaluation mechanisms to share regular performance reports of SOEs with all of their key shareholders and suggest improvements whenever needed. Finally, SOEs must attract qualified and talented people to join their ranks with competitive salary packages. These employees should be rewarded for better performance and penalized for chronic underperformance to establish a professionally competitive work culture and improve SOEs' efficiency and profitability

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