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SUMMARY

INTER-RELATIONSHIPS BETWEEN PUBLIC ENTERPRISES AND THE CENTRAL
GOVERNMENT: THEIR IMPLICATIONS FOR PERFORMANCE

Paper presented by the
ECLA Public Administration Unit

Analyses of the inter-relationships between public enterprises and the central government are usually based on a continuum from the "departamental agency", with little autonomy, at one end, to the "business enterprise", with a high degree of autonomy, at the other. The public corporation is usually placed midway.

However, the present document does not use this approach; instead it explores the informal arrangements whereby a public enterprise's effective freedom of action becomes the result of a complex system of objectives, controls, incentives and penalties. Autonomy is thus perceived as the end product of a series of inter-relationships - both formal and informal - between public enterprises and the central government, with special attention paid to the deficiencies in such inter-relationships that impair the performance of enterprises.

The central government is here defined as a central guiding nucleus or group of inter-related agencies.

The formulation and implementation of government objectives are hindered by conflicts among agencies, that is, conflicts in the government itself, or between the government and outside elements.

The components of the central guiding nucleus considered in this paper are the following: sectoral ministries; national budget bureaux; administrative reform agencies and the Office of the President. Each component has its own sphere of interests which may clash with those of others. There are also institutional factors and other variables which can give rise to disfunctional sub-objectives for the system as a whole.

The main problem is the translation of the central nucleus' interest in influencing certain actions of the enterprise into specific objectives, expressed in sufficiently explicit terms. The objectives of the central guiding nucleus may conflict with other objectives, and the enterprise may be forced to conform to policies and regulations that are inconsistent with the goal of achieving a satisfactory economic performance. Short-term problems and activities often tend to displace long-term problems and activities.

Inter-relationships between the central government and public enterprises are summarized in the table that follows.

In addition to the implicit or explicit objectives of the central guiding nucleus regarding the behaviour of public enterprises, the regulatory mechanisms - explicit or implicit, formal or informal - used by the components of the central guiding nucleus to influence the behaviour of enterprises are examined.

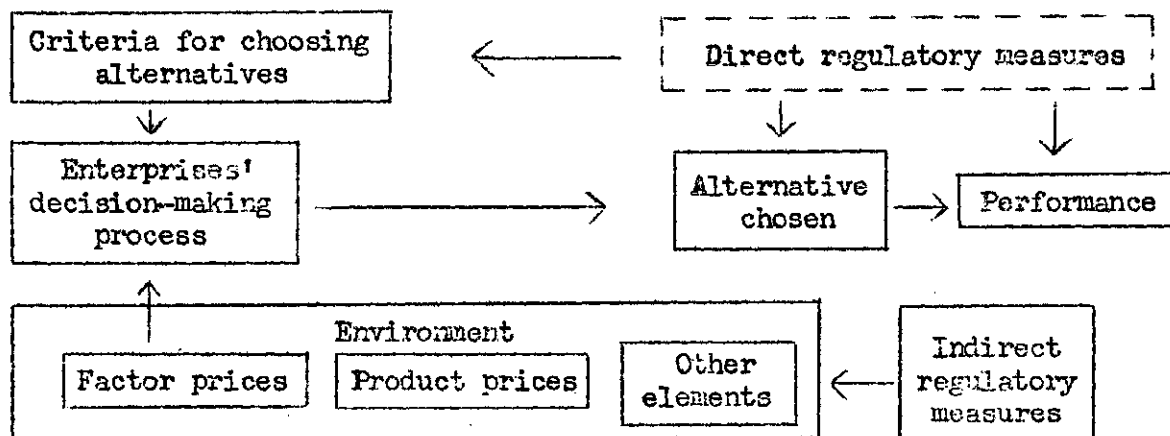
/INTER-RELATIONSHIPS

**INTER-RELATIONSHIPS BETWEEN THE CENTRAL GOVERNMENT AND
PUBLIC ENTERPRISES**

Component units of the central guiding nucleus	Main responsibilities	Causes of functional distortions	Nature of functional distortions	Definition of enterprise objectives
Sectoral ministries	Harmonization of enterprises and sectoral policies	<ul style="list-style-type: none"> - Weakness or inexistence of sectoral planning agencies - Consequently, lack of sectoral policy - Insufficient power of analysis at the ministerial level 	<ul style="list-style-type: none"> - Over-riding interest in short-term affairs - Analyses carried out intermittently and ritualistically 	<ul style="list-style-type: none"> - Explicit objectives in very broad terms - Objectives relating to functional distortions generally remain implicit
National budget bureau	Co-ordination of the programmes for large units, by using the budget as a planning instrument	<ul style="list-style-type: none"> - Substitution of ends by means - Negative image of the public enterprise 	<ul style="list-style-type: none"> - Excessively detailed discussion of public enterprises' expenditure particularly when run at a loss - Concern over curtailing expenses over the short term 	<ul style="list-style-type: none"> - Implicit
General planning agencies	Harmonization of enterprise policies with general development plans	Inadequate characteristics and techniques of the planning process	<ul style="list-style-type: none"> - Analysis bears mostly on public enterprise investment - Greater attention paid to medium- and long-term problems, without excluding short-term problems 	<ul style="list-style-type: none"> - Generally explicit
Ministry of Economic Affairs	Harmonization of enterprise policies with the government's economic policies	Pressure exerted by short-term problems	Variable according to the nature of short-term problems	<ul style="list-style-type: none"> - Generally explicit
Administrative reform agencies	Transformation of the administration into a development instrument	Inadequate strategies for change	<ul style="list-style-type: none"> - Emphasis on structural and formal aspects - Excessive powers of conditioning attributed to formal organization 	<ul style="list-style-type: none"> - Very broad objectives are made explicit - Strategies and objectives relating to functional distortions generally remain implicit

/The following

The following chart shows the enterprises' decision-making process and the possibilities of influencing it.



Direct regulatory measures are based on the power relationship between the central guiding nucleus and enterprises, and are usually expressed in terms of orders and instructions. Acceptance of and compliance with such instructions will depend on the relative power of the imparting authorities, that is, on the probability of their being obeyed, which can in no case be equal to unity, since there will always be some divergence between the aim of such instructions and what is obtained in fact.

The extent of the divergence will depend on several factors, inter alia: (a) the possibility of complying and the clearness with which such orders or instructions are issued; (b) the degree of consistency between such instructions and the preferences of those receiving them; (c) the incentives and penalties, whether tangible or intangible attached to compliance, and (d) the efficiency of the compliance control system.

Although the administrative cost of indirect regulatory measures is very low, they are little used in Latin America, mainly because they are closely connected with all the remaining elements of the decision-making process. Thus for example, a rise in the rate of exchange will lead to a saving in the use of foreign exchange if the enterprise is trying to maximize profits. However, if the purpose of those controlling the incentives and penalties system is to raise production, or if the

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enterprise is trying to minimize technical problems in a production process, the measure adopted may have no influence whatsoever on the use of foreign exchange.

In addition, although the use of indirect mechanisms has a low cost, the processes of preparation and calculation are very difficult. Thus, there is no great problem in making up the deficit of a railway from budgetary resources, but it is a complex matter indeed to conceive a differential subsidy scheme.

Finally, mention is made of the fact that those in power tend to mistrust indirect measures, the use of influence, incentives, etc. This basic attitude and the consequent tendency to use imperative forms of action are not only some of the main underlying problems in the inter-relationship between the public enterprise and the central government, but also give rise to some of the major criticisms levelled at the administrative reform strategies applied in some Latin American countries.

The relationship between the public enterprise and the central guiding nucleus has such a variety of forms that it is impossible to analyse in general terms what influence such problems have on the performance of enterprises. However, in this variety a continuum can be observed, at one end of which are the enterprises subjected to the numerous conflicting pressures exerted by the various components of the central guiding nucleus, to many regulatory measures which have a paralysing effect and to ambiguous power relationships. At the other extreme are the enterprises which maintain univocal power relationships with some components of the nucleus, generally the Office of the President, relations which are similar to those of a feudal lord with a king.

Most Latin American public enterprises tend to one of these extremes. The ideal solution would be a system in which the central guiding nucleus could use the public enterprise as a keystone in the development process without impairing its internal efficiency.

The strategies suggested to this end tend to be ineffectual because they are not comprehensive enough. A great deal of the literature on this subject points out that inefficiency is due to structural and organizational defects. Stress is laid on the need for public enterprises to use modern

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methods, such as cost accounting, for the establishment of efficiency bureaux, for better sales and personnel policies, for more efficient operation of internal reporting and control systems and for less concentration of decision-making at the higher levels. However, when such decisions are adopted in an isolated manner and are imposed from above, the desired effect vanishes as soon as the motive force disappears, since efforts are concentrated on consequences rather than on causes, and due account is not taken of problems arising from the basic attitudes of those participating in the process. Another theory that is often put forward is that the whole problem boils down to placing outstanding men in the key posts. Those who advocate this solution forget that, in order to be feasible, a strategy for change should be based on average men and attitudes. The qualifications of leaders are always relative, although there is no doubt that good progress could be made if flagrant cases of miscasting, as are sometimes to be observed in the region, could be corrected.

The improvement of inter-relationships between public enterprises and central government should be effected on the following four fronts:

(a) Centralization. Disgregation and lack of co-ordination in the action of or influence exerted by the components of the central guiding nucleus have a negative impact on the public enterprise. The relative success of some holding companies can be attributed to the fact that the relationships with the subsidiary enterprises are clear-cut, stable and functional. Although this type of solution is not always suitable in the conditions to be found in Latin American countries, it might be useful in certain cases, particularly for industrial enterprises. As a general measure the planning and research capacity of sectoral ministries should be reinforced and relations with the rest of the government should be channelled through them.

(b) Clear and consistent definition of objectives. Centralization of relationships between the enterprise and the rest of the government does not mean that the remaining components of the central guiding nucleus will have no influence in determining the objectives of the public enterprise, but that a degree of harmony will be reached in an agency

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which can understand the problems and aims both of the enterprise and of the other government agencies. When objectives are thus made consistent they should be transmitted to the enterprise as clearly as possible.

(c) Change in the type of regulatory measures. The most common kind of regulatory action imposes a certain type of behaviour on the enterprise without considering over-all effects. The number and salaries of staff are restricted; rigid manning tables are imposed; and inflexible regulations are applied for recruitment, promotion and dismissal. The enterprise must often operate with an itemized budget. Preventing dishonesty rather than securing efficiency is the watchword for purchasing procedures. The enterprise's borrowing capacity is limited to such an extent that some do not use the banking system even to cover transitory or seasonal cash requirements. Such regulatory measures should be used only exceptionally and for short periods.

(d) Changes in the system of incentives and penalties. Preference should be given to incentives no matter how difficult they may be to apply. Penalties, particularly removal of executives, should be applied sparingly and always on clear and objective grounds.

The main problem facing the central government with respect to the execution of its plans is that of creating the conditions which will allow for, and stimulate, change, and for this purpose the existence of adequate inter-relationships is indispensable.

The first task is to reinforce sectoral ministries by creating strong planning and research teams in them. This measure has the added advantage of reinforcing the general planning system in an aspect which has frequently been neglected.

At the same time the network of regulations which hampers the activities of enterprises should be almost completely abolished, without excepting enterprises in chronic deficit, which are most in need of freedom of action.

Finally, the central government should pay particular attention to the selection of adequate executives for public enterprises, since they will be responsible for all changes.

These are not easy solutions, but in the measure that planning teams are formed and qualified executives appointed a step forward will have been taken in the process of attaining an efficient public sector.

