AN ANALYTICAL FRAMEWORK FOR THE STUDY OF CARIBBEAN PUBLIC ENTERPRISE

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In any Study which seeks to assess performance and make recommendations for improvement, the application of criteria is unavoidable. Criteria can only be derived by means of theoretical analysis utilizing deductive methods of reasoning to arrive at normative conclusions. Given its limited scope, this Study must utilize existing theories of political economy, or organization, and of management from which to derive normative principles for the assessment of public enterprise in the Caribbean. Theory, to be made relevant, must be constrained by Caribbean circumstances and experience. Considerable reliance on the section "Management in Development" of the <u>World Bank's World Development Report 1983</u> is acknowledged.1

The proposed analytical framework is predicated on four issues:

(1) issues of political economy affecting the establishment of Public Enterprises (PEs).

(2) issues affecting the organization of PEs, especially in their relationship with Government;

(3) issues affecting the management and operation of PEs;

(4) issues of liquidation and divestiture of PEs.

Out of this analytical exercise should flow criteria for assessing the performance of PEs in the Caribbean.

1. Issues of Political Economy

(a) Ideology

In developing a normative theory of public enterprise for the Caribbean, we may confidently begin with the premise that the goal of all governments is to maximize the incomes and general welfare of their citizens. (If this is not the objective, then it ought to be.) Public enterprise then is seen as an important policy instrument for achieving that goal.

As in any theorizing in the social sciences, we cannot escape consideration of the values of the subjects of our concern, and we must suppress to the maximum extent possible the intrusion of our personal values into the exercise. The values of governments are expressed in their ideological positions - socialism in Guyana and revolutionary Grenada, nationalism in Trinidad and Tobago, socialism/nationalism in Jamaica, capitalism in the case of Barbados, Antigua, and the other OEC States. We do not judge these ideologies to be either good or bad. However, if we assume minimum rationality, we should regard ideology as an input of our value system, and not as the end of economic development. If an ideologically inspired programme leads to the patent decline in incomes and general welfare, it will, presumably, be abandoned or adjusted. There is certainly a strong motivation on the part of democratic governments to place economic development above ideology as a goal, since the impoverishment of the population through the pursuit of ideological goals per se would lead to defeat at the polls or some other dramatic form of social protest.

Public enterprise may be viewed as an instrument of policy for the pursuit of the primary goal of economic development. The extent to which it is employed is determined by the prevailing ideology. It will obviously be used more in socialist Guyana than in capitalist Barbados. At any rate, the effectiveness of public enterprise will depend upon economic circumstances surrounding its implementation, and on its organizational, managerial and operational efficiency.

(b) ~~Economics~~ Devt

There is considerable concensus among development theorists on the need to concentrate resources in the early stages of economic development. This corresponds to the "preconditions for take-off" phase in Walt Rostow's The Stages of Economic Growth.2 New institutions must be established and major infrastructural elements put in place. It is during this stage that public enterprise is most likely to be employed as an instrument of national policy in any developing country, whether socialist or capitalist.

The suggestion of international financial institutions and First World economists that economic development is best achieved by the workings of the free market flies in the face of the history of developed countries which, without exception, have recorded periods of intense state direction of economic activity. This position is even more astonishing in view of the recent successes of Japan, still very much a state directed economy, and the newly industrializing countries of Taiwan, North Korea and Singapore. Free market Hong Kong is an anomaly arising from its history and location.

Public enterprise makes the most sense in circumstances where the private sector is comprised of small units, and where only the superior fiscal and administrative capacity of government can achieve the critical mass needed to carry out major infrastructural tasks - airports, harbours, utilities, etc. Governments may also resort to public enterprise when the entrepreneurship required to launch promising industries is not forthcoming from the private sector or where the risk of the new venture is beyond the capability of the private sector. In many cases the technological and managerial capacity may be in place but financial markets may be too thin to absorb the risk of a proposed venture. Even in the case of developed countries gigantic projects, such as the Chunnel linking Britain and France and the Space programme in the U.S.A., are beyond the capacity of the private sector, and must either be assisted or totally undertaken by Government. Sometimes, government may use a public venture as a catalyst for new industrial expansion. For example, a cement plant may get a construction industry off the ground; a saw-mill may promote an export trade in timber.

The PE is the favoured format when the desired industrial activities are of a dynamic rather than a bureaucratic nature. Operations which are repetitive in nature, and which are carried out in a predictable environment, are generally manageable through the diligent observance of rules and, as such, are best carried out within the framework of the Civil Service. However, successful operations in rapidly changing circumstances, and in a competitive or otherwise unpredictable environment, depend on the technical and managerial skill, and the judgement of staff; they cannot be effectively executed through civil-service type procedures and in the face of bureaucratic practice. This is not meant as a denigration of civil servants. A disinterested, disciplined, and circumspect cadre of civil servants is as essential to national success as is a cadre of skilful, experienced and dynamic managers. Perhaps, even more so!

The theory enunciated above regards public enterprise as a strategic weapon in the economic arsenal. To apply another military metaphor, PEs might be regarded as the panzer divisions of the army - dynamic, elite divisions used to make openings which the slower moving infantry regiments may exploit in a more deliberate and leisurely fashion. They are not efficiently utilized in slogging matches or for garrison duties. Similarly, the use of public enterprise to achieve the ideological objective of "ownership and control" of the commanding or any other heights could be a misuse of the scarce resources required for the effective operation of a legitimate PE.

The use of the PE as a means of providing employment for the party faithful or others is also contra-indicated. (In any case, PEs are usually quite capital intensive and do not generate many jobs.)

To saddle PEs with such extraneous duties is to blunt their strategic capabilities. As Peter Drucker reminds us, "Governments can do well only if there are no political pressures ... And as soon as a governmental activity has more than one purpose, it degenerates."3 If the PE was properly conceived from the beginning, its effective operation should create additional job opportunities in the economy at large, far in excess of possible redundant posts or a bloated payroll. Even more serious, the unhealthy overweight would reduce its ability to achieve the strategic objectives set for it. Ineffectual and loss-making PEs are worse than no public enterprises at all, for they represent the destruction of existing capital rather than the creation of additional income flows.

2. Organizational Issues

(a) Resources

The first responsibility of any government to a PE is the provision of adequate resources at the time of its establishment. Necessary resources include finance, land space, accommodation and, above all, human resources - technical, professional and managerial.

Too often in developing countries PEs are established with inadequate capital resources, especially working capital, which they are expected to borrow from commercial banks. Frequently funds earmarked from the Treasury are not forthcoming as required and PEs are forced to depend on delayed payments, or goods and services purchased

(c) Control

The next problem is that of exercising adequate control over the PE. The PE is established by Government to achieve certain objectives in the interests of the community. Government is responsible to the community at large, which is the ultimate owner and provider of its resources. Clearly Government has a duty to ensure that the PE carries out its mission efficiently. Hence the problem of control! Here the primary concern of Government should be for the results of the organization, not for the detailed steps taken to achieve the results; with the understanding, of course, that the PE operates within the law, and within the accepted norms, practices and general guidelines laid down by the Act establishing it.

Control itself is a well established function in engineering. The principal elements of a control system are:

(1) a criterion of performance, (2) a feed-back mechanism and (3) a corrective mechanism. Translated into managerial terms, the controllers of an organization must first establish specific criteria for judging the performance of the organization. Secondly, there must be provision for reporting back the actual performance so that it may be compared with expected or standard performance. Thirdly, there must exist a corrective mechanism for restoring actual performance to the desired performance. Any attempt by a Minister to control the day to day activities of a PE not only produces confusion, but removes the responsibility of the management for its success.

from the private sector organization as a means of financing their ongoing operations. Such hand-to-mouth financing absorbs an inordinate amount of top managerial attention and prejudices the success of the PE. Niggardly capital financing leads to inadequate public sector accommodation. The inadequacy of the public sector accommodation is proverbial in developing countries. The quality of accommodation is not perceived as contributing to the achievement of the organization's objectives, and working conditions approaching the quality of that in the private sector are viewed as luxurious. Accommodation should be perceived as a management tool for the promotion of the productivity of the physical and, especially, the human assets of the enterprise.

(b) Management

The most important precondition of success is the provision of adequate management - this includes an experienced and knowledgeable board of directors and a capable chief executive of impeccable integrity. The CEO and his senior staff should either be familiar with the operations of the enterprise or be capable of learning its operations in a short period of time. In the absence of nationals who fit the bill, there should be no hesitation about calling upon non-nationals to work on contract. The development of competent executives is a long-term proposition and the drop-out rate is high.

If an adequate control mechanism is in place, the principle of "management by exception" may be observed. If the results of the PE's operations are consistent with the expected standard of performance, there is no need for the Minister to intervene. If results are not satisfactory, there are three appropriate points of intervention. First, the standard of performance may be inappropriate; secondly, the feed-back system may be malfunctioning; third, the corrective mechanism may have broken down. In any case it is Management which is responsible for this situation, not operators further down the line. It is from the above considerations that we derive the principle of operational autonomy.

For the control system to function then, the mission and objectives of the PEs must be clearly defined in advance and the criteria of performance unequivocally established. If there are conflicting objectives, these must be resolved by Government and the Management in advance. If, for example, Government insists on a lower-than-market price for the produce of the PE or on maximum staffing levels to bolster employment, it should be made clear by Management that profits cannot be maximized in these circumstances or that losses are likely to result.

Another requirement is the determination of which operational results are to be monitored, and how often reporting of results should take place. Annual financial and operating reports are a minimum. Quarterly reports of critical indices of performance are normal. In financial operations, for example commercial banks, monthly operational data should be insisted upon. It does not take very long for financial operations to go sour.

(d) Operational Autonomy

The principle of operational autonomy which flows from the arguments above is based on an engineering model. It holds even if we invoke an anthropogenic model of the organization. This approach sees the PE as primarily a group of people with a personality analogous to that of the individual. Professor John Kenneth Galbraith makes the point beautifully:

> Individual achievement is at its best when the individual has a clear set of goals and the means, including of course the knowledge, with which to pursue these goals under the stimulus of his own will. As with the individual personality so with the corporate personality. Autonomy, the independence to pursue specified goals, is equally important for the producing corporation. So are clearly specified goals. Indeed these are more than important; they are the only administrative arrangements that are consistent with the effective corporate being.4

The World Bank Development Report 1983, has coined the expression "control without interference" to describe the appropriate supervision of PEs by governments.5 The corresponding responsibility of the PE is captured by the term "accountability".

(e) Monitoring Function

The final organizational issue has to do with the administrative system used by governments to exercise control over PEs.

This requires the establishment of a focal point in the government bureaucracy for monitoring the performance of PEs. The focal point should serve as a communication channel for the transmission of government criteria and reporting periods with the PE's directorate. The focal point would also serve to relay feed-back on the operational results of the PE. However, the focal point should never be cast in the role of big brother overseeing the day-to-day operations of the PE. PEs can only be managed from within, never from without.

In small countries with a handful of PEs, a single focal point may suffice. However, in countries with, say, ten PEs or more, focal points should be distributed among the relevant ministries. Similarly, the auditing function might be distributed among several private sector accounting firms. The concentration of monitoring duties in a single focal point would create serious bottlenecks in the decision-making process and compromise the very dynamism for which PEs were established in the first place.

The establishment of a holding company to supervise the operations of several or all PEs is even less desirable. The rationale of the holding company, put forward by the late Adlith Brown, is that it insulates the PEs from political intervention.

> A holding company is an intermediary between the enterprises it controls and the political directorate and may therefore have the additional function of reconciling, when necessary, the goals of each public enterprise with the public and social goals of government.6

In fact, it creates an additional bureaucratic layer of personnel who, because they are spread so thin, have less understanding of the specific operations than does the management which it seeks to supervise. Ignorance always tends to promote unintelligent meddling, violating the principle of "control without interference". Besides, if competent personnel are not readily found to manage individual PEs, there will hardly be a superfluity to manage the holding company.

In the last resort we cannot have good management of PEs unless we have in place a cadre of highly educated, experienced and disinterested professionals. Such a cadre will insist on operational autonomy, and will either nip in the bud attempts by Ministers to intervene or will resign. If the best managers in the business fail, the others are not likely to do better.

Managerial Issues

(a) Board of Directors

The responsibility of the Board of Directors is to oversee Management in the pursuit of the objectives of the PE, not the political objectives of the Party in power. Indeed, an important function of the Board is to insulate the Management from political influence. The Board should serve as advisor, supporter, friendly critic and, most important, as the conscience of the Management. If things are going badly, it will need to pay closer attention to operations, insist on more frequent reporting, and if necessary, replace the Management. However, it must never seek to abrogate the operational responsibilities of Management. It must be made especially clear whether the Chairman is a full time executive officer, or whether he is a non-executive Chairman of the Board of Directors.

(b) The Chief Executive Officer (CEO)

The CEO, ideally a Managing Director with a non-executive Chairman to help insulate him from politics, is responsible to the Board of Directors for the day-to-day management of the PE towards the achievement of the objectives of the PE. His job is no more political than that of a surgeon. However, the CEO will need to exercise a fine sense of diplomacy so as to reduce the potential abrasion of his insistence on operational autonomy.

The CEO should have the maximum freedom in the choosing of his subordinates. The Board is justified in maintaining a veto on senior appointments. However, it should avoid as far as possible the imposition on the CEO of staff whom he does not wish to employ. Political affiliation should have no weight in the appointment of Management as long as such affiliation does not conflict with the operations of the PE. Indeed, most constitutions in CARICOM guarantee the right of individuals to join the political party of their choice.

(c) Management

Critical to the success of the PE is the continuity of its top level staff. This continuity enables the management to learn how to run the organization. Such learning is reflected in the collective experience of the organization. This is why insulation from politics is so important. It is most injurious to the PE's prospects of success if after each election its top management layer is purged by the incoming administration. This practice damages the morale of the organization as a whole and dampens the ambitions of promising middle layer staff. Fearing the plight of their seniors, the best of them seek the greener pastures of the private sector, leaving the second-raters behind to run the PE.

(d) Incentive System

This brings us to the question of incentives and penalties. The purpose of incentives is to enable the PE to achieve its objectives. Unless government is prepared to offer salaries which can attract staff capable of doing the job, any salaries paid will be wasted. The level of salaries being paid in the Civil Service is not very relevant. If it takes X thousand dollars per year to attract a suitable CEO, it could cost a large multiple of X thousand dollars not to have him. The underpayment of top management staff at a PE is extremely bad economics. Governments must demonstrate considerable firmness in resisting Civil Service pressures to maintain a fixed relationship between Civil Service salaries and salaries in PEs. The relevant criterion is the going market price. By the same token, the job security of civil servants should not be available to the management staff of PEs. In other words, differentials between market-rate and Civil Service salaries should be regarded as the premium paid for limited job security. Management staff of PEs who do not perform should be removed, although with the utmost consideration and humanity. Indeed, the Directorate should also be liable to penalties, in the form of fines, for failure to submit timely financial and operational reports to the Minister.

(e) Information System

A characteristic of a well-functioning organization is the presence of an effective information system. An efficient information system is needed within the organization to ensure that relevant information is fed back to the Management and to the Board. Information on financial operations are, of course, the most critical data. The absence or untimeliness of financial reports is _prime_ _facie_ evidence of mismanagement. Reporting on operational results is also important. PEs should therefore have on board the professional accountants, engineers, and systems analysts needed to prepare the necessary reports. In particular, an effective information system will compile and store in an economic manner those records which the organization needs to remember. If the organization is big enough, it should think of engaging a trained librarian.

(f) Non-Civil Service Management Style

Because PEs usually operate in a dynamic environment, the "management by regulations" which characterizes Civil Service operations is quite unsuitable. Dynamic operations require decision, and the quality of decisions depends upon the skill and judgement of the decision-makers who must also be prepared to accept responsibility for the consequences of their decisions. This does not mean that those making decisions are automatically punished for errors. In fact, trial and error is the only means by which experience can be gained. It means that tasks must be so structured that staff may learn decision-making by trial and error within a context which does not irreversibly compromise the objectives of the organization. To be successful, a PE must attract enough personnel of the type who are wiling to make decisions, accept the consequences of their decisions, and learn from their errors. This kind of personnel will develop into top-class managers in the years ahead.

(g) The Learning Organization

An organization will not develop a capacity to solve its problems and adjust to its environment unless it develops the capacity to think and learn. This capacity is especially useful in the development of strategic plans. To develop this capacity, top management must attract and identify individuals who are reflective and willing to put forward new ideas on both old and new topics. As far as possible, such personnel should be relieved of continuous operational tasks and given an opportunity to explore all aspects of the organization. Such personnel will form the core of the PE's brain.

4. Issues of Liquidation and Divestiture

Privatization has been very much in vogue during the 1980s. The IMF and World Bank, which encouraged public sector investment in the 1970s, now actively promote divestiture. This reflects disillusionment with the performance of PEs in the Third World; it also reflects the ideological influence of the Reagan and Thatcher administrations on these international institutions. Third World governments should therefore make sure that they are privatizing for the right reasons. For example, the U.K. is now planning to privatize water supplies. Indeed, much of the French water works system is privately operated. Third World countries should recognize, however, that family incomes in these wealthy countries, whether from employment or from welfare benefits, are high enough to permit the purchase of water without hardship. In most LDCs, unsubsidized water would be beyond the financial capacity of a large part of the population - and water is an absolute essential of life! Furthermore, since water supply is a natural monopoly, the problem of social control will not go away as it might in the case of other commercial operations.

One obvious reason for the liquidation or privatization of a PE is the accomplishment of its mission or the loss of its strategic purpose. For example, a PE involved in urban development may have been established to develop a certain district. At some point after the completion of the project, it would be no longer necessary to maintain such a large organization. The maintenance function might then be passed on to the Public Works Department or to a cooperative of the occupants of the development project.

A PE might also be liquidated if it has failed to carry out its mission or if it seems unlikely to do so. Sometimes a PE gets off on the wrong foot and is plagued by cost overruns, misappropriation of funds and other scandals. In such circumstances it makes sense to terminate operations and start all over again. Sometimes the original objective of the PE may have been overtaken by events. Even though the project may still have economic value, it might not justify the absorption of scarce national resources. In such cases privatization offers a sensible solution.

At other times it may become clear that, for one reason or another, the efficient management of an operation is beyond the capacity of a PE's management. This may be reflected in low quality outputs which compromise the success of customers who, in turn, suffer substandard profits or heavy losses. If Government is satisfied that the operation might be more efficiently run by private operators, divestiture would represent a considerable saving of national resources which might be more efficiently allocated elsewhere.

Sometimes governments acquire enterprises for good reasons in times of crisis. For example, it might make good sense in a cyclical downturn to rescue hotels, an airline, a bank, or such enterprise critical to the public interest - for the same reason that Britain bailed out British Petroleum and the U.S. bailed out Lockheed and Chrysler. Government may find after many years that it has acquired so many PEs that it simply lacks the technical and administrative capacity to control them. Systematic privatization would then make a lot of sense.

As suggested above, it is extremely difficult for most developing countries to exercise effective control over more than half a dozen PEs. By control we mean the process of indicating goals, establishing criteria of performance, determining reporting periods, and ensuring that corrective action is taken when feed-back indicates a departure from predetermined performance standards. Indeed, these preconditions for control require a most sophisticated cadre of civil servants quite non-existent in most developing countries. As a result, most PEs are not effectively controlled by government and attract attention only when their inefficiency has reached scandalous proportions. In such instances, it is much better to have such enterprises operated in the private sector and depend on indirect controls to regulate them in the national interest. In most cases, it makes more sense to let them operate on a purely commercial basis and tax their profits for application elsewhere in the economy. In Sacndinavian countries this approach is encapsulated in the principle of private production and public distribution.

In some cases the establishment of PEs have been on the principle of "ownership and control" of indigenous resources and "occupation of the commanding heights of the economy". We have seen from the above analysis that public ownership need not lead to control but may lead to the overload of government control systems and ultimately to pervasive economic disorder. Similarly, the attempt to control the "commanding heights" may prove overambitious and the State may, in fact, find itself mired in the "valleys" with quite unexpected forces, like the IMF or debt-for-equity swappers, in occupation of the "heights". It may frequently be more economical to control through less direct and more economical means. At any rate, control is not properly an end in itself but a means of achieving an end. Does it really matter who owns and controls enterprises as long as they are operated efficiently, or at least more efficiently than government itself could? In these circumstances, isn't privatization a more sensible course? Peter Drucker goes even further:

> We now understand why there are some things government, by its very essence, cannot do. And even for the things government can do, conditions must be right. A government activity can work only if it is a monopoly. It cannot function if there are other ways to do the job, that is, if there is competition. The Post Office in the nineteenth century was a true monopoly. And so were the railroads. There were no other ways of sending information or of moving freight and people over land. But as soon as there are alternative ways to provide the same service, government flounders.
>
> Governments find it very hard to abandon an activity even if it has totally outlived its usefulness. they thus become committed to yesterday, to the obsolete, the no longer productive.7

Normative Principles

The following normative principles can be derived from the theroretical discussion conducted above:

(1) The PE is a legitimate institutional tool in a strategy of economic development.

(2) The establishment of a PE is indicated when the contemplated economic activity is dynamic in nature and does not lend itself to bureaucratic-type operations.

(3) The managerial, technical and professional resources required for the successful operation of a PE are, by definition, scarce in developing countries. The use of the PE should therefore be restricted to strategic purposes.

(4) The number of PEs which a given government in a developing country can effectively control is quite limited.

(5) Government control of PEs is appropriately and most effectively achieved through (i) the enunciation of clear objectives, (ii) the establishment of performance criteria, (iii) performance feedback and (iv) a corrective mechanism; not through ministerial intervention into its operations.

(6) Operational autonomy is a sine qua non of organizational effectiveness.

(7) The legitimate objectives of the PE, rather than party-political considerations, are the appropriate concerns of its Directorate and Management.

(8) The incentive system of the PE should be geared towards the recruitment and maintenance of qualified staff, rather than tied to civil service salary sales.

(9) The PE should develop into a thinking, ~~and~~ learning and teaching organization.

(10) PEs should be privatized or liquidated if:

(i) their original purposes have been achieved;

(ii) the time comes that their services can be provided effectively in the private sector;

(iii) they fail in the achievement of their purpose.

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NOTES

1. World Bank, World Development Report 1983, New York, Oxford University Press, 1983.

2. Rostow, Walt. W., The Theory of Economic Growth, New York Cambridge University Press, 1960.

3. Drucker, Peter, The New Realities, New York, Harper & Row, 1989, p.85.

4. Galbraith, John Kenneth, Economic Development, Boston, Houghton Mifflin, 1964, p.89.

5. World Bank, op. cit. p.78.

6. Brown, Adlith, "Introduction", Studies in Caribbean Public Enterprise, Vol.1: An Overview of Public Enterprise in the Commonwealth Caribbean, Institute of Development Studies, Georgetown, Guyana, and Institute of Social and Economic Research, Mona, Jamaica, 1983, p.9.

7. Drucker, Peter F., op. cit. p.63.