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FINANCIAL ASPECTS OF MANUFACTURING ENTERPRISES IN THE PUBLIC SECTOR

Report and Proceedings of Interregional Seminar
held in Rome, Italy, 1 - 12 December 1969

Part I REPORT OF THE SEMINAR

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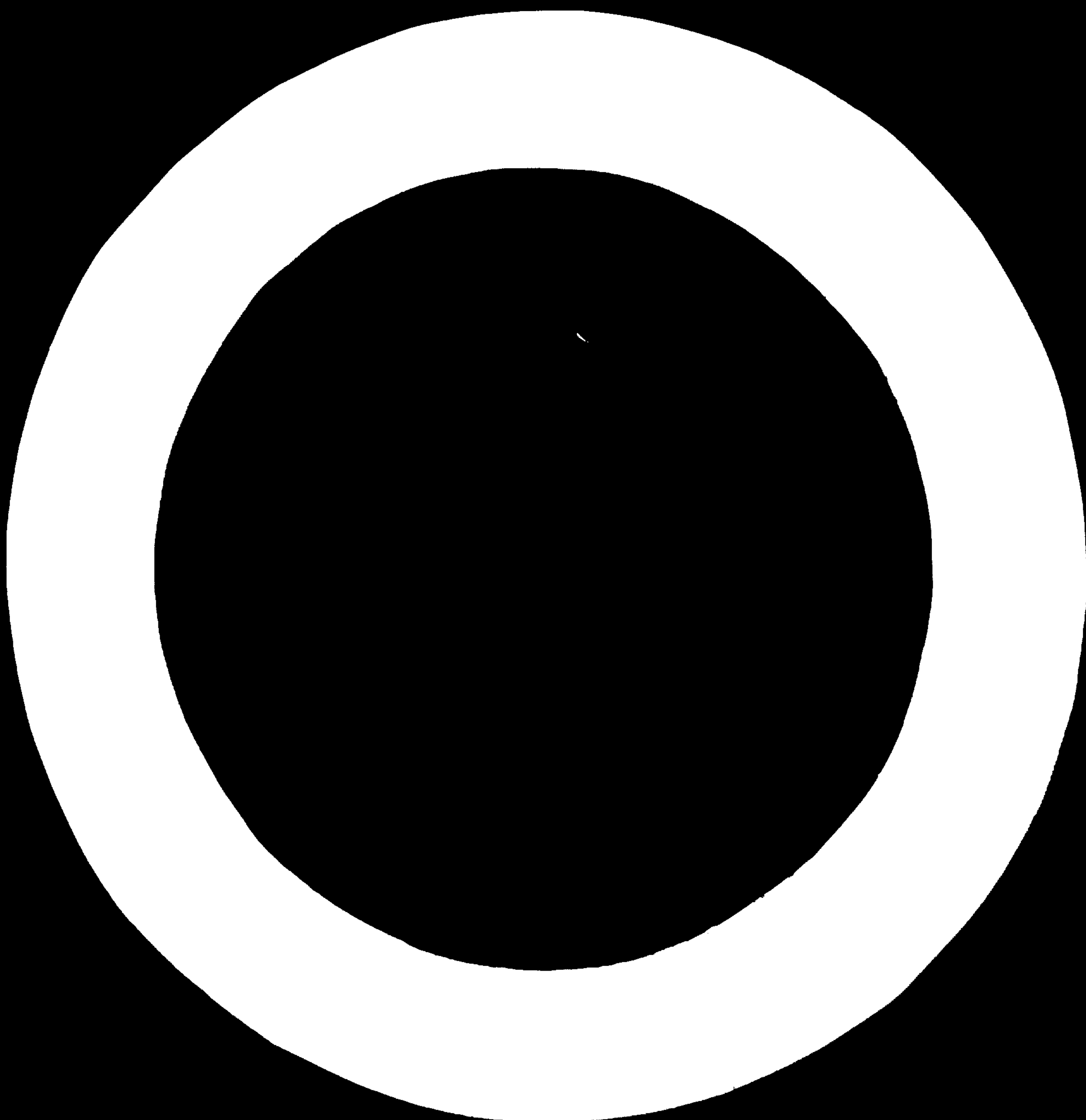
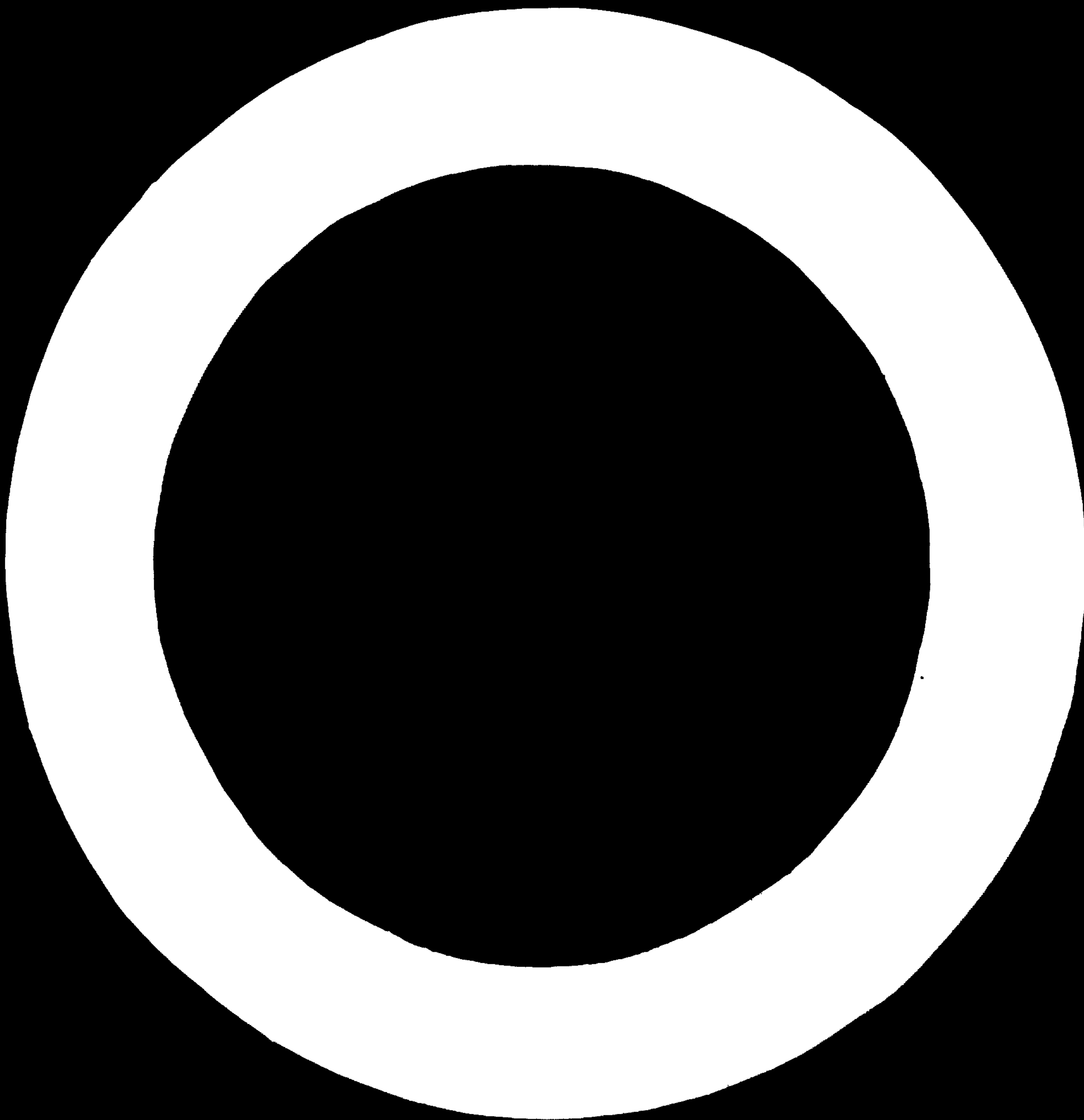
UNITED NATIONS





UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION, VIENNA

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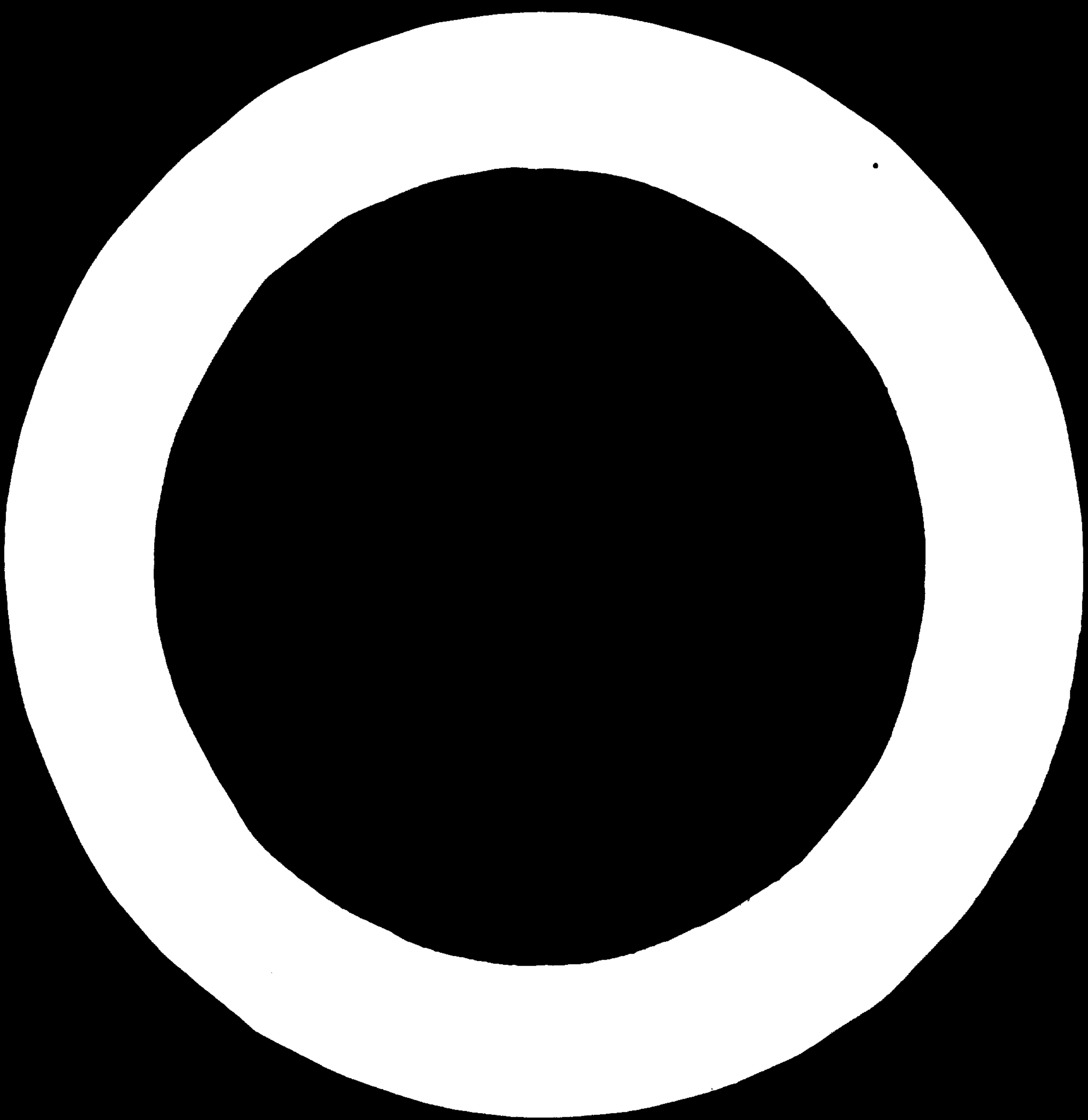


Foreword

1. The organisation of the seminar was preceded by a survey in a number of representative countries with a view to exploring the various sources of industrial financing and the criteria for determining their efficient allocation to the public manufacturing sector, and to identifying some of the basic problems in the effective utilization of these resources at the enterprise level. Analysis of the survey indicated (a) that public manufacturing enterprises form a significant part of the industrial sector in many developing countries, and (b) that the institutional framework for the establishment, operations and control of these enterprises, particularly in their financing aspects, constitutes an important tool of government economic policy both for short-term stabilization and long-term growth.

2. Following the survey, and as part of its supporting activities of technical assistance, the United Nations Industrial Development Organization (UNIDO) organised a seminar on "Financial Aspects of Manufacturing Enterprises in the Public Sector" which was held in Rome in December 1969.

3. The objectives of the seminar were:

(a) To provide a forum for participants from both developing and developed countries to exchange views and experiences on problems of financing of public sector manufacturing enterprises in their respective countries and to review the various approaches and techniques that have been developed in resolving these problems;

(b) To formulate some general guidelines for the effective mobilization of financial resources, their proper allocation to specific industrial sectors and the efficient management of these resources within the operational scope of public manufacturing enterprises.

4. The seminar was convened in Rome on 1 December 1969, and the opening meeting was addressed by Mr. Giuseppe Jacoangeli, Counsellor of Embassy, Ministry of Foreign Affairs, on behalf of the Government of Italy, which served as host to the seminar. Statements presented at the seminar on behalf

of the Institute of Industrial Reconstruction (IRI) are reproduced in annex 2. The agenda and a list of the documents prepared for the seminar are reproduced in annexes 1 and 4 respectively.

5. The seminar was attended by senior officials from seventeen countries, nominated by their Governments but participating in their personal capacities. Expert consultants and guest speakers were selected by UNIDO from France, Italy, Poland, Sweden and the United Kingdom on the basis of their professional competence and experience. Representatives from the International Labour Organisation and the Economic Development Institute of the International Bank for Reconstruction and Development also attended.1/

6. This report, drafted and reviewed in the closing meetings of the seminar, is herewith published as Volume I, to be followed by a second volume which will contain selected papers presented to the seminar and a report of the preliminary survey.

7. In concluding the meetings, the participants expressed appreciation to UNIDO for the organization of the seminar and to the Government of Italy and the Institute for Industrial Reconstruction (IRI) for the generous provision of facilities and for the arrangement by the IRI of a study tour of industrial establishments in Southern Italy.

1/ A complete list of participants is given in annex 3.

Introduction

8. As an instrument of industrial development policy, public manufacturing enterprises play an important role in the industrialization process in many developing countries. Apart from any ideological predisposition, many developing countries consider that, on purely pragmatic grounds, there is a case for government initiative and direct public intervention in the development of the manufacturing sector of the economy. This initiative may take the form of resource expansion and mobilization, resource allocation to different segments of the manufacturing sector, and resource utilization at the enterprise level. Some developing countries, however, have adopted the catalytic approach whereby government intervention in the development of the manufacturing sector takes the form of indicative planning through which private entrepreneurship is given broad guidelines and necessary incentives for the development of this sector.

9. Whatever the character and method of industrial development in developing countries, the co-ordination role of government, particularly in mobilizing internal and external financial resources and utilizing them effectively, is an essential factor in the industrialization effort of these countries.

10. Some of the general problems of organization and administration of public enterprises have been the subject of a number of United Nations seminars.2/ The seminar covered by this report was an attempt to focus attention on a few financial policy measures and their implications for enhancing the operational efficiency of manufacturing enterprises in the public sector.

2/ United Nations publications: Some Problems in the Organization and Administration of Public Enterprises in the Industrial Field (54.II.H.1); Public Industrial Management in Asia and the Far East (60.II.H.1); Management of Industrial Enterprises in Under-developed Countries (58.II.B.5); Report of the United Nations Seminar on the Organization and Administration of Public Enterprises (67.II.H.2).

11. As the financial aspects of a public industrial enterprise will necessarily vary according to its role in the total national economy, and as different countries have chosen to use such enterprises for different purposes, one must begin by making certain broad functional and structural distinctions. The first of these is between public enterprises which are intended to perform, on a more or less permanent basis, tasks that are elsewhere being performed, also on a more or less permanent basis, by private enterprises, and those that are given, vis-à-vis private enterprise, what might be described as a catalyst role.

12. In the first case, a decision has been taken that the state shall make itself responsible, wholly or partly, for the production of a particular commodity or the provision of a particular service. Such a decision may be made ad hoc or embodied in a general declaration of policy, such as the Indian Industrial Policy Resolution of 1956. This may be described as the substitution of public for private enterprise.

13. Even the most substitution minded of the mixed economy countries, however, also employ to varying extents, the catalytic technique. Essentially, this is the use of public enterprise to stimulate private enterprise. In a sense, of course, catalysis is unavoidable. So long as private entrepreneurship and investment is legally permissible (even though it may not be positively encouraged), it will derive benefit from the investments made in the public sector - unless it is taxed so heavily to pay for them that it has no resources left. Here, however, we are concerned not with this natural stimulus that the private sector may receive, but with deliberate attempts to stimulate it. Even more specifically, we are concerned, not with all attempts to stimulate it (which include a very wide variety of devices, particularly in the fields of fiscal and financial policy) but with the role which public enterprises are called upon to play.

14. There are few countries of mixed economy that have failed to equip themselves with such public enterprises. Prominent among them are industrial finance corporations of various types, created for the purpose of providing private entrepreneurs with credit on terms more favourable than they could obtain from private agencies. Where entrepreneurial energies are being inhibited by shortage of long-term and medium-term loan capital, these public enterprises can play an important role both in stimulating economic development and in steering it. But if private entrepreneurship is extremely weak, it is

unlikely to be significantly stimulated merely by the offer of loan capital, even if this is accompanied by the offer of financial advice and technical services. Under these circumstances it is likely that public development agencies will be able to make a much greater contribution to economic growth than public finance agencies.

15. Indeed, most mixed economy countries have established development corporations of one kind or another. Here we are interested only with those concerned with the development of manufacturing industry. The usual plan is that the development corporation, using capital provided by the government from budgetary sources, shall itself create, manage and bring to maturity manufacturing undertakings of various kinds, either on its own initiative or in accordance with the priorities laid down by the political authorities. If necessary, or if considered preferable, it may use its own funds exclusively, not looking for supplementation elsewhere. Alternatively, and if opportunity offers, it may from the very beginning enter into partnership with the private investor, who may conceivably be attracted by the security offered by government commitment to the development of the undertaking. The operation, however, is not necessarily a catalytic one. That depends on the projected future of the subsidiaries that the development corporation brings into existence. If they are to remain in the public sector, the policy is one of substitution; it is only catalytic if they are to be sold out to the private investor. Whether they actually can be sold out or not largely depends on the availability of private capital and on the prospects of profitability that the new undertakings offer. Whether they are actually sold out will depend partly on the prevalent political ideology.

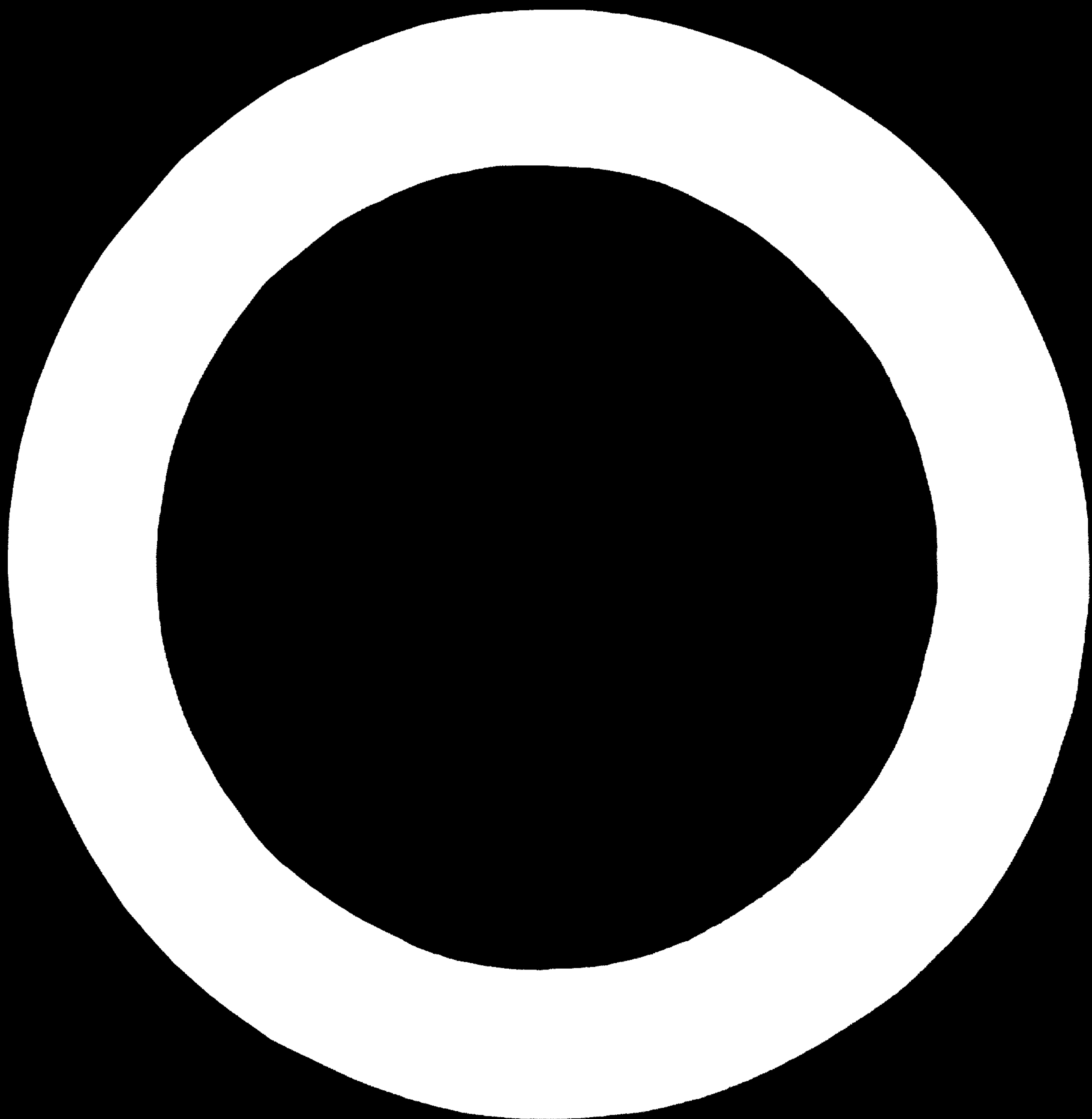
16. In some countries the industrial development corporation does not play a very economic role, as the government prefers to undertake the development of industry in a more direct manner, through setting up a public corporation or state owned company for each separate undertaking or group of undertakings. Elsewhere, the development corporation sometimes becomes a major agency of industrial growth. Both economic and administrative advantages have been claimed for it. Economically, it may have the merit of enabling the government to develop a comparatively large amount of industry with a comparatively small expenditure of public funds, since success in the selling-out operation provides the corporation with revolving capital. Administratively, the responsibilities of the government are kept within limits - at least in the field of economic

administration - since it is concerned, through the development corporation, only with those undertakings that are in their early stages of growth and not with those which, having reached maturity, are taken over by the private investor.

17. One further broad distinction may be made. The development corporation, in general, has a more important part to play in the economies of the developing countries than in those of the developed ones, particularly if it is being used for catalytic purposes; for in the developed countries private industry has comparatively little need of the kind of stimulus that the development corporation exists to provide, whereas in less developed countries such a stimulus may be essential to it.

18. Public industrial enterprise, therefore, may be used either as a substitute for or as a stimulus to private industrial enterprise; and in most countries of mixed economy it operates in both capacities. There is also, however, another possible use for it which deserves at least brief mention. In some countries and at certain times, public industrial enterprise has been used as a "stabilizer" for the national economy. Its potential in this respect was seen as soon as governments, under the influence of Keynesian economic concepts, began to pursue policies aimed at "full employment". It seemed that one of the ways of counteracting a downward swing of the trade cycle was to pump more resources into that sector of the economy over which the government exercised full control. Hence public enterprise should be expanded when there was a down-turn of private economic activity and deflationary tendencies began to make themselves felt. Conversely, an "overheating" of the private sector, with its concomitant inflation and "over-full" employment could be counteracted by a counteraction of public enterprise. There are good reasons, however, for not using public industrial enterprise in this way. First, there is no case for making public enterprise bear the burden of the up-swings and down-swings of the trade cycle, since methods other than the expansion or contraction of public enterprise are available for influencing the general level of economic activity. Second, the pursuit of such a policy imposes unjustifiable distortions on the economic pattern and, over a long period, tends to make the planned and coherent development of public undertakings very difficult if not impossible. Third, it has a very deleterious effect on the morale of both managers and workers, who feel that their enterprise is at the mercy of governmental decisions which have little or no relevance to the interests of the enterprise as such. Unless, therefore, the

use of public enterprise as a stabiliser forms part of an over-all economic strategy which has regard to the correct proportions between the various forms of economic activity, it is to be strongly discouraged. This, of course, does not rule out decisions to take up the slack by initiating or intensifying programmes of public works in periods of economic depression; nor does it mean that public enterprise can be regarded as occupying a privileged position. It does mean, however, that every effort should be made to avoid treating the public sector as something that can be turned on and turned off as general economic conditions deteriorate or improve.



Chapter I CAPITAL STRUCTURE AND FINANCING

19. When a public manufacturing enterprise is being established, one of the most crucial decisions that has to be taken is about the amount of capital with which it shall be endowed, the source of this capital, and the terms on which it shall be provided. The provision of capital may be from internal or from external sources or from both; internally provided capital will be considered first.

Initial capital endowment

20. Except in the case of mixed enterprises, the whole of the initial capital endowment normally comes from the government, either directly or through the intermediary of a development corporation or similar type of body. In theory it may take any one of three forms or any combination of them: (a) a grant; (b) equity investment; or (c) a loan. The distinction between these types of initial capital endowment is, however, by no means always precise. For instance, if a grant is employed, the government will often regard it as a quasi-equity investment entitling the ministry of finance to receive a dividend from the operations of the undertaking as soon as it becomes profitable. In many countries with centrally planned economies, moreover, capital grants, although non-repayable, carry a rate of interest like loans. This rate, which represents a minimum profitability requirement, is analogous to a tax on the enterprise (particularly, of course, when the enterprise is operating under non-competitive conditions). It may take the form of a grant or a loan or a combination of the two. If the grant is employed, the government will often regard it as a quasi-equity investment, entitling the exchequer to receive a dividend from the operations of the undertaking as soon as it becomes profitable. The disadvantage of the loan is that it involves the enterprise in fixed obligations which it may find difficulty in discharging, particularly during the early days of its life, although the difficulty may be, and is frequently, overcome by excusing the enterprise from "service" payments for a number of years, or by

granting it a moratorium for deferment of such payments. The disadvantage of an outright grant is that it imposes no financial discipline on the enterprise. The equity-type investment, by contrast, combines financial discipline with a considerable degree of flexibility. The enterprise is expected to make a yield on its capital, but the amount that it contributes to the government is adjusted to the degree of success that it achieves. Except in the rare case where outright grants are used exclusively the enterprise will ultimately be equipped with both equity-type capital and loan capital.

21. These distinctions apply mainly to public industrial enterprises in countries where the market serves as a regulator of the economy, and where the risk element which equity-type capital is intended to provide can be very high, particularly for enterprises pioneering in new and hitherto untried fields, or which present unfamiliar problems of organization and technique, or which are attempting to break into an international market. In the countries with centrally planned economies, however, the question of the type of capital provided is not usually discussed in comparable terms, as the financial obligations of the public manufacturing enterprise to the state authorities are incorporated in the over-all plan and the risk element arises not from market uncertainties but from bad management (which can be replaced) or bad planning (which can be corrected). In such countries therefore, the precise terms on which capital resources may be provided are considered mainly from the perspective of maximizing incentives to achieve planned coefficients of efficiency.

Proportion of equity to loan capital

22. Elsewhere, the proportion of equity to loan capital varies considerably from country to country and from enterprise to enterprise. This is both inevitable and right, since there are no general principles by which a fixed proportion may be determined. Much depends on the "riskiness" of the enterprise concerned, on the degree of credit-worthiness it may have achieved at a particular stage in its growth, on the source from which capital is currently available, and on the kinds of financial obligation which the governmental authorities consider may be reasonably imposed on its management in the light of long-term and medium-term development plans, current budgetary exigencies and other factors. Loan capital may be "excessive" when it involves interest and repayment obligations which the enterprise is unable to meet, or able to meet only at the expense of the neglect of targets which ought to receive priority. Equity capital may be "excessive" when comparative lack of fixed

obligations tends to undermine managerial incentives to achieve a high level of financial performance.

Rate of interest

23. Some countries with long experience of running public manufacturing enterprises have arrived at a more or less standard equity/loan proportion. Although divergence from this standard may be quite frequent, each is regarded as requiring some special justification. Other countries with less experience have erred on the side of too great a rigidity or too great a flexibility in their methods of financing public industrial enterprises. These opposite errors tend to coincide, respectively, with situations in which capital is extremely scarce and those in which it is relatively abundant (as currently in some of the oil producing countries). The question of the rate of interest on publicly provided loan capital, together with the period of repayments, is also subject to a variety of answers. Normally, the rate of interest should reflect the scarcity of capital resources, and a common rate should apply to all enterprises whether in the public or in the private sector. However, there are many developing countries where, owing to the underdeveloped condition of the capital market, it is difficult to determine the going-rate of interest. Moreover, in countries where it is the intention of the government that the public sector shall play a dominant role in the economy and the private sector no more than a subordinate one, the development of a capital market is not envisaged. In such circumstances the price of capital resources can only be determined by the public authorities themselves in the light of their estimated scarcity in relation to estimated (or planned) demand. Such determination, however, should in no case be neglected since only by setting a realistic price on capital can sound decisions be taken regarding the priorities to be accorded to alternative projects within a given area of planned development. It must never be forgotten that no matter what type of economic system a country is operating, capital always has an "opportunity cost".

24. There is also the possibility that a particular public manufacturing enterprise may be provided with loan capital at a rate lower than that which reflects its scarcity. This may be justified on the ground that the enterprise, which is regarded as of vital importance to the development of the national economy, would incur too heavy a financial burden, particularly during its running-in period, if it were required to service its loan capital on normal

terms. In such a case, measurement of its economic performance demands that a "shadow" rate of interest should be used, reflecting the actual scarcity of loan capital. Alternatively, the enterprise may be granted a moratorium on its interest and repayment obligations, the ultimate effect of which is to prolong the period of loan service beyond the expected life of the assets concerned. In either case, the effect is that of providing the enterprise with a subsidy, which should be clearly recognized as such when calculating the yield on invested resources.

Competitive access to capital

25. Competition between public and private enterprises for access to capital (or between public enterprises themselves) is necessarily limited to circumstances in which there is a free capital market to which enterprises of all kinds are required or permitted to have recourse. In so far as a public enterprise obtains its capital from budgetary sources (either directly, or indirectly through a specialized agency such as a development corporation), there is no effective competition of this kind, since the government, having decided to develop a given industrial enterprise in the public sector, will be thereby committed to providing it with amounts of capital requisite for the performance of its alloted tasks. A mixed enterprise, however, will normally be accorded the right to go to the market for additional capital resources, although if these resources are to be in the form of equities the government will usually wish specifically to authorize the resultant increase in the proportion of private to public capital.

Self-financing

26. The extent to which public enterprises should be self-financing through the ploughing back of their profits, has been variously answered. An initial distinction should be drawn between two kinds of self-financing: (a) in respect of the enterprise itself and (b) in respect of the public enterprise system as a whole. In the first case, the enterprise is authorized to retain and to utilize for purposes of expansion the whole of or a specified part of its profits. In the second case, it yields all or some of its profits to the national treasury, which uses them for investment in such parts of the public enterprise sector as are scheduled for expansion.

27. In either case, the question of self-financing raises the issue of profit making policy. Where free competition prevails the enterprise will be expected to make a normal rate of profit (except to the extent that it may have to meet the cost of social obligations not imposed on its privately owned competitors) and to take decisions comparable to those taken in a private enterprise regarding the proportion between distributed and ploughed back profits. In conditions of monopoly or quasi-monopoly however, profit has a different significance, since it may be equivalent to a tax imposed on the consumer. The retention of such profit by the enterprise, either in whole or in part, is generally regarded as illegitimate. It should either be handed over to the national treasury or used for reducing prices to the consumer.

28. In developing countries these issues may be somewhat academic, since the major problems are (a) to ensure that public industrial enterprises achieve profitability, so that they contribute to the development of national resources and do not impose a drain on them and (b) to use their profits as sources of capital formation. Normally, therefore, public enterprises are given profit targets which are formulated in the light of the programme for the raising of capital resources embodied in the national economic plan. The realization of such profit targets may be equivalent to the imposition of a tax of the consumer - although in conditions of limited or imperfect competition it will be somewhat difficult to estimate the actual extent of the tax element - and it is important to realize that this can result in significant economic distortions. Nevertheless as this form of taxation may well be more practicable and politically acceptable than other forms it clearly cannot be condemned as illegitimate, providing that the dangers inherent in it are fully understood. These issues should be judged in relation to practicable methods of mobilizing resources and the optimum utilization of the resources mobilized.

<u>Public enterprises as means of mobilizing domestic private capital</u>

29. Public industrial enterprises, like public enterprises in general, can be used not only as a means of generating resources for investment in development progress, but also as a means of mobilising domestic private capital. This role is most clearly illustrated by the "mixed" enterprise, where private parties participate in providing the equity and enjoy the right of representation on the board of directors. The mixed enterprise can often attract private capital more successfully than the purely private enterprise because its dependence on the government offers (or is thought to offer) the investor an

extra degree of security. An alternative method of mobilizing private capital is the issue by the enterprise concerned of fixed interest stock, normally carrying with it no rights of participation in control.[3/] The success of this method will depend on the availability of funds for investment on the conditions offered - but again the enterprise's association with the government may provide an additional attraction. The use of either of these methods, it should be noted, has implications for the objectives that the enterprise is required to achieve. The mixed enterprise, to be attractive to the private investor, must necessarily aim at a rate of profit sufficient to permit the declaration of dividends which compare favourably with those obtainable from other forms of investment. The enterprise which is partly financed by fixed interest stock must necessarily give priority to the earning of revenues sufficient to meet the interest charges.

30. Outside the centrally planned economies the mixed enterprise is widely used, with varying degrees of success. In some cases, it is regarded as transitional, since the eventual object of the government is to transfer the entire enterprise to the private sector by selling out the state's share in its capital, either by one single transaction or by a series of transactions whereby public participation is gradually extinguished. The economics of such a disinvestment process need to be carefully studied to ensure that its costs to the national economy do not exceed its benefits. The timing of each disinvestment operation is particularly important. The criteria which ought to govern disinvestment policies have as yet been insufficiently investigated. A study of this subject is under preparation by the United Nations and will be published shortly.

31. The mobilization of private capital through the issue of fixed-interest securities by the enterprises themselves is less frequently adopted, since most governments prefer to attempt to stimulate saving through the issue of their own bonds, the proceeds of which may be made available in the form of loans to public industrial enterprises, where this form of financing is considered appropriate. However, when the two-tier principle has been adopted whereby the enterprise functions as a subsidiary of a development corporation, it is not infrequent for the corporation, as distinct from the enterprise

3/ There were some countries represented in the seminar, however, where private participation in fixed interest stock carried with it the right to attend "general assembly" meetings and thereby, at least in theory, to participate in the control of the enterprise concerned.

itself, to be authorized to raise money directly from the public by the issue of its own bonds or of "participation" shares attached, on the Unit Trust principle, to specified groups of enterprises under its control. If the corporation has developed a favourable reputation as a profit maker, it may be able to attract in this way money which would not otherwise have been mobilizable by the government or by any other governmental agency.

Externally provided capital

32. Externally provided capital for public industrial enterprises may be private or public, direct or indirect. Whereas private capital is invariably directly invested in the enterprise concerned (usually by means of a partnership contract) public capital frequently takes the form of government-to-government grants or loans which (except when specifically project-oriented) are made available to the recipient government for investment in whatever areas of the economy it sees fit. In the latter case the investment is the government's own, and the provision of the external capital to the public industrial enterprise that benefits by it may be described as indirect. Grants and loans provided by multilateral agencies may either be in general assistance of a government's development plan or tied to specific enterprises.

33. When a direct investment of externally provided public funds is made, it generally takes the form of a medium-term or long-term loan, sometimes including a contribution in kind to fixed assets. But in no case, to our knowledge, is the enterprise authorised to acquire foreign public capital on its own responsibility. Invariably, the approval of some higher governmental authority is needed. This is necessary for coherent economic planning and programming, particularly as balance of payment questions may be involved. Moreover it would be unusual for the foreign lender or donor to be prepared to make the funds available in the absence of a governmental guarantee.

34. Major questions involved in the foreign public financing of public enterprises relate to balance of payments, project-tying and political relations between the assisting country and the assisted. Balance of payments considerations, both long-term and short-term, will inevitably influence a government's decision as to whether acceptance of a particular form of aid is economically worth while. The tying of aid to a project may itself cause balance of payments difficulties and perhaps also tend to create a bias in favour of the project in which the foreign aid giver happens to be interested, at the expense of other possible projects which might be more advantageous from the point of

view of over-all economic development. There is a possibility, too, that excessive dependence on the aid provided by a particular country may cause a government to lean more heavily than it would otherwise have done in the direction of a particular pattern of economic development and even to adopt foreign policies which are not, in the long term, in its own best interests.

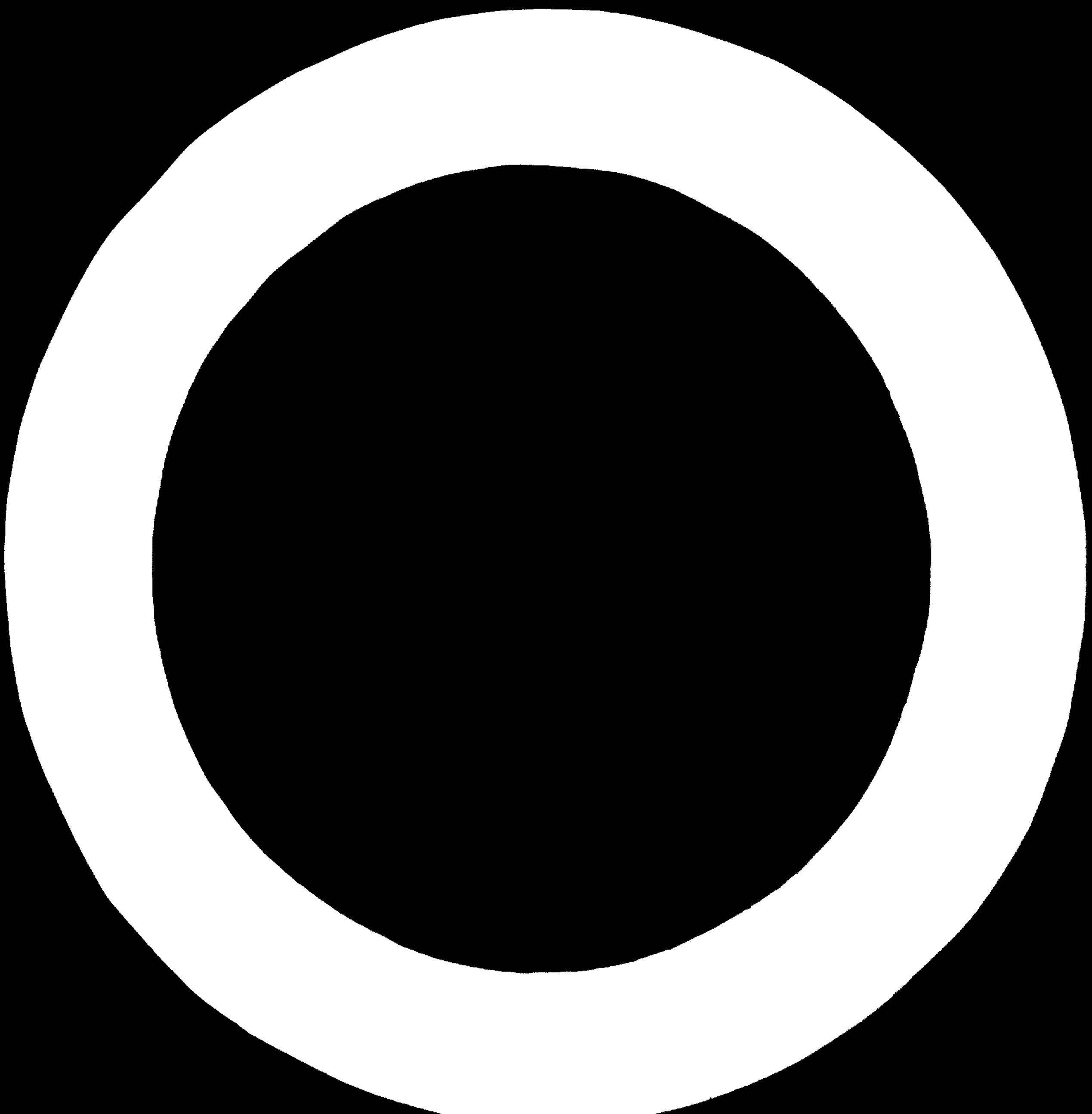
35. When the government enters into a joint venture with foreign capital (whether publicly or privately provided) the state share-holding type of organization usually proves to be the most appropriate. It has also been suggested, with reason, that, in a developing country, the "absorption" of foreign capital is easier when the partnership involves an indigenous public industrial enterprise, as distinct from a private industrial enterprise as there is less risk that the foreign partner will become the dominant one and greater possibilities of ensuring that the national interest will be properly safeguarded, in matters such as the location of the enterprise, provision for training for indigenous personnel and the like.

36. Foreign private loans to public industrial enterprises are not very frequent, except in the form of suppliers' credits. They are also usually more expensive to the recipient country than loans from public sources, since they carry higher interest rates and stricter repayment terms. It is for this reason that many developing countries have relied entirely on government-to-government loans and on those extended by international agencies. As far as publicly provided loan capital is concerned, the centrally planned group of countries tend to offer the most favourable interest rates; the repayment periods they specify, however, are often shorter than those specified by other countries.

37. When a developing country is confronted by a choice between different potential suppliers of loan capital, these are some of the factors that have to be weighed in the balance. Another, and sometimes much more important, factor is the extent to which the loan commits the recipient to purchase the relevant supplies exclusively from the donor country. If these can be obtained only at relatively high cost, or if their suitability to the recipient is comparatively low, a loan made on terms that appear to be favourable may prove, in real terms, unexpectedly costly.

38. Those countries attempting to use privately provided foreign funds in the form of equity investments have to consider carefully what regulations they wish to make about the repatriation of both dividends and capital; for it is

clear that there may be sharp divergence of interest between capital provider and capital recipient in this respect. Many developing countries have passed laws that simultaneously impose certain restrictions on the foreign investor and guarantee him certain rights. Those that are particularly anxious to attract foreign capital, whether to the public or the private sector of the economy, tend to emphasize the guarantees rather than the restrictions.



Chapter II CAPITAL BUDGETING AND ACCOUNTING

Purpose and nature of budgets and accounts

39. One of the reasons public manufacturing enterprises are usually given "autonomous" status (e.g. that of a public corporation or state owned company) is that they use budgeting and accounting systems different from those used by ordinary government departments. Sometimes they are specifically instructed by higher authority to use systems similar to those used by private business; sometimes they are left free to devise whatever systems seem to them most suited to their peculiar needs; but often they are required to frame their budgets and keep their accounts according to a common pattern, essentially commercial in character but including, for the benefit of the various control agencies, information of a kind that would not normally be provided by a private enterprise.

40. Standardised budgeting and accounting systems are invariably used in the centrally planned economies and frequently used in the mixed economy countries. In general standardisation is to be recommended, provided that it does not impose an undue rigidity on enterprises that differ in characteristics and objectives; for without it comparison of performances of public enterprises becomes difficult.

41. Enterprise budgets normally serve two purposes. They provide control information for the benefit of the higher authorities and they constitute an essential tool for the enterprise's own management. In many of the developing countries the budgets, as at present formulated, serve neither purpose as well as it might be served. All too often, a budget consists of little more than a series of headings under which anticipated expenditure and receipts on current and capital account are set out. Such a budget helps neither management nor superior authority to identify the specific areas of activity where things are going wrong and where timely corrective action is required. Only a budget that is based on the identification of specific "cost centres" and the estimation of unit costs can serve as an effective instrument of performance control. In

its most advanced form, such a budget becomes a true performance budget, by means of which responsible persons at all levels, from the divisional or sectoral manager to the relevant minister, may regularly measure, in strict quantitative terms, the degrees of success or failure attending the attempts of the enterprise to discharge its assigned tasks.

42. At the same time, it must be remembered that performance budgeting is a highly sophisticated technique, requiring for its effective operation a corps of appropriately trained accountants and an understanding of its methods and purposes on the part of managerial and technical personnel at all levels. Developing countries therefore, need to think in terms not of the introduction of performance budgeting, but of the progressive modification of their existing budgetary techniques, as appropriately trained people become available, in the direction of the performance principle. This involves a carefully phased programme of training both of accountants and of managers. It is, however, very important that the phasing of the programme should be as far as possible uniform for all the public enterprises concerned; otherwise, the advantages of a standardized budgeting and accounting system, emphasized below, are liable to be lost.

Budgetary review

43. Budgetary review by the high authorities (e.g. the relevant minister, the minister of finance, the planning organization, or such specialized agencies as may be given the task) is one of the most important points at which public control of a public industrial enterprise may be exercised. The danger here, however, is that the enterprise's annual budgets may be treated as a series of isolated exercises, with the result that its long-term developmental needs may be neglected in favour of those current financial exigencies which tend to dominate the minds of ministerial economic policy makers. Ideally, budgetary review should be no more than one stage in a coherent long-term and medium-term planning process, and the purpose of the review to make such modifications to the enterprise's plans as the current economic situation, both of the enterprise itself and of the nation, may demand.

44. This approach to budgetary review is now well established in the more developed mixed economy countries, and is universally adopted in the countries with centrally planned economies. Its necessity, indeed, is everywhere recognized; but many of the less developed countries have not yet succeeded in transcending the familiar "hand-to-mouth" approach, with the result that their

enterprises are inhibited from engaging in effective planning which goes beyond the arbitrary limits set by the annual budget.

Capital budgeting and DCF calculations

45. In no sphere is the adoption of new techniques more urgently required than in that of capital budgeting. One problem here is to devise methods by which the costs and benefits of alternative investment decisions may as far as possible, be objectively measured. Whether the question at issue relates to the establishment of a new plant, the expansion of an existing one, or the replacement of existing capacity, there is, in theory, a "least cost" or economically optimum answer to be discovered. Of the techniques which may be used for this purpose, the most widely employed is that of Discounted Cash Flow (DCF) - a process of calculation whereby the "present value" of a project may be found by the application of a discount rate, or, alternatively, a discount rate may be defined at which internal costs and internal benefits are equalized. The object of the exercise is to rank alternative investment projects in such way that, on the basis of a given time preference, the economically optimum one may be selected.

46. This technique may certainly be recommended to developing countries, but only as one of the tools useful for capital budgeting, and with certain important reservations. The general opinion, is that, as yet, DCF is mainly of use in deciding between projects of the same kind which represent alternative methods of achieving a given developmental objective. Even at this level, moreover, the indications that it provides have to be assessed in the light of whatever wider purposes, of a socio-economic kind, the enterprise may be required to serve, e.g. employment creation, regional development, the saving of foreign exchange etc. To the extent that these are regarded as important, "social" cost-benefit calculations of a kind difficult to encompass within the limits of DCF as it is normally used need to be made. *A fortiori* the DCF technique is as yet ill adapted to the taking of strategic decisions about the development of the economy as a whole. For the present, therefore, DCF becomes useful only after decisions have been taken about the over-all rate of economic growth, the broad structure of production and the consequent pattern of investment. Its main utility for a government engaged in the expansion of public industrial enterprise is to provide the basis for an informed choice between alternative kinds of investment within a given field of industry scheduled for development in the public sector.

47. It must be remembered that DCF calculations are only as good as the figures that are built into them, and that these are often highly speculative, particularly in countries with comparatively little experience of industrial development. Cost estimates are particularly fragile, and frequently subject to the over optimism that tends to be characteristic of planners and programmers at all levels. Market estimates can also be wildly inaccurate, while both the anticipation of price changes and the choice of a realistic test discount rate present difficult problems. In general, it can be said that the more experience a country has of bringing industrial projects to maturity, the greater is the likelihood that the estimates it embodies in its DCF calculations will be realistic. These reservations, it should be noted, are not intended to discourage developing countries from attempting to employ DCF for suitable purposes, but merely to advise them that this technique, although full of potentialities, offers no automatic solution to the problem of taking the best investment decisions.

Budgetary plans and economic strategy

48. By whatever methods it may be done, capital budgeting cannot be the responsibility of the enterprise alone. In so far as such budgeting involves making calls on scarce resources, means have to be provided to ensure that the enterprise's budgetary plans are in accordance with the nation's over-all economic strategy. This requires that the capital budget be subject to some kind of external approval, which will normally involve references to the relevant minister, the minister of finance, the planning board or commission and even, in important cases, the council of ministers or the president. In many countries an investment bank of some kind will also be responsible for vetting an enterprise's requests for new capital resources, particularly when these are to take the form of loans. Where foreign exchange is required, there may be a further reference to a specialized committee concerned with the rationing of this scarce commodity. In many developing countries these multiple references involve frustrating delays which, when added to the delays arising from non-availability of essential inputs and services, have the effect of slowing up the realization of the national plan, creating imbalances and increasing costs. It is essential, therefore, that an effort be made to streamline the approval giving process.

49. This is possible only if three conditions are satisfied: (a) that proposals involving demands for new capital resources be thoroughly formulated, at the enterprise level, before submission, (b) that the technical work of vetting such proposals be entrusted to an expert body, informed with a sufficient sense of urgency and (c) that the political authorities confine their intervention to cases where agreement cannot be reached at the administrative level or where political issues of an inescapable kind are clearly involved. It is also of major importance that the proposals coming up from the enterprises be considered, as far as possible, in their totality, and not on a project-by-project basis. Otherwise there is a danger that the requirements of the national development plan will be neglected and that the attempt to execute too many projects at once will stimulate an inflationary situation and place an undue strain on the machinery of administration.

Accounting and auditing

50. Budgeting and accounting are inseparable parts of a single process. It is through the accounts that both manager and supervisory authorities are able to determine the extent to which an enterprise has fulfilled the financial tasks envisaged by its budgetary forecast. It is essential therefore that budget and accounts be in comparable form; the minimum that can be required is that both be "commercial". Although this is now universally recognized, it is still not universally practised. Some countries use procedures originating in the days when enterprises were organized as government departments, and these "normal" departmental accounting procedures, modified to meet special requirements, still prevail. In some cases there is considerable ignorance of commercial accounting practices among the members of the quasi-judicial organs (such as Courts of Accounts and Comptroller- and Auditor-General's Departments) which both audit the accounts and prescribe (either directly or by way of advice to the relevant minister) the form in which they shall be kept. Whatever type of auditing body may be employed, the essential thing is that it (or that part of it which is concerned with the accounts of public enterprises) be staffed by persons who understand the principles of commercial accounting and are given the necessary freedom to apply them. One may add that it should not operate merely as a watchdog - although this may well be its most essential function - but as an aid to management, by pointing out weaknesses in the internal accounting and auditing system, where these exist, and helping the managers of the enterprises to correct them. At the same time, it must sedulously avoid interference in day-to-day financial

operations. The application of any kind of "pre-audit" system to a public enterprise can be deadly. It may conceivably prevent certain minor misapplications or misappropriations of funds, but it inevitably cramps the style of management, slows down the operation of the enterprise to a bureaucratic crawl, and hence results in the waste of far more resources than it saves.

Development of uniform costing and accounting systems

51. On this subject one of the participants in the seminar suggested the following stages by which a group of enterprises might make progress towards the introduction of a unified costing and accounting system equally useful for purposes of internal control and external performance evaluation. In the first stage, all firms should be required to follow a uniform accounting pattern. This would involve the standardization of the coding and classification of accounts and the adoption of common accounting procedures. At the second stage, a uniform system of cost accounting would be introduced, involving uniform methods of evaluation, the identification of cost centres, etc. At the third stage, this pattern would be developed into a fully fledged system of standard costing, enabling the firms concerned to achieve full integration between their financial records and their costing process. Gradual but uniform progress towards this ideal will facilitate efficiency comparisons between the various firms in the group and also the fruitful exchange of information among them. Moreover, the transfer of trained personnel from one firm to another would be made much easier, to the extent that at any one time they are all operating uniform costing and accounting systems.

Chapter III PRICING POLICIES

Pricing under free competition

52. If, in a mixed economy, a public manufacturing enterprise is operating in a fully competitive field, its pricing policies will be dictated to it by the forces of the market. To make a profit or to break even it will have to offer its goods and services to the consumer at prices comparable with those offered by its competitors, quality for quality. If this method of price determination is regarded as a desirable one, the government will need to take positive steps to preserve the freedom of the market, by preventing the formation of monopolies and forbidding price fixing agreements and other restrictive practices. Moreover, it will have to ensure that its public manufacturing enterprises do not enjoy any privileges, such as open or concealed subsidization, that are not available to comparable and competitive enterprises in the private sector. Likewise it must refrain from imposing on its public manufacturing enterprises, without adequate compensation, unremunerative responsibilities from which the private sector is exempt.

53. It must be recognized however that the freedom of the market, even in countries most devoted to this principle, is always to some degree fictitious. In every country there are market imperfections which sometimes arise spontaneously and are sometimes deliberately created by the government to achieve purposes of public policy. The very fact of economic planning implies a recognition that public policy requires that the factors of production be pushed and pulled in various directions. The intervention of the state in the industrial field, through the creation of public enterprises, involves a deliberate disturbance of the pattern of so-called spontaneous economic growth.

Economic regulation through the market

54. This does not mean, however, that market prices cannot be deliberately used as an instrument of economic regulation. All countries in fact rely on them, to a greater or lesser extent, since "administered" prices run into

grave difficulties if they differ too widely from the prices that reflect the actual relationship between demand and supply. The imbalance which results from such divergence becomes rapidly apparent, even in the most closely regulated economy, in the development of a black market. Nor is it possible to argue that public industrial enterprise should necessarily be less subject to the discipline of the market than private industrial enterprise. Indeed, there is one country of socialized economy, Yugoslavia, which firmly believes that planning through the market is the most rational form of planning and leaves all its industrial public enterprises free to engage in price competition. Neither such countries nor other countries which rely on the free market, however, can afford to remain uninterested, either in the general price level or in the relationships between individual prices. All countries now influence the prices of the commodities produced by both their public and private enterprises by means of operations in the field of fiscal and credit policies. This needs to be emphasized because misunderstandings can easily arise from an identification of price policy with price fixation.

Administered prices

55. In other countries which have socialised their means of industrial production, the achievement of price equilibrium is attempted through the centralized fixation of some, although in no cases of all, prices. In these countries, any tension that arises between the fixed price and that which the consumer is ready to pay is taken to indicate the need for changes in the structure of production and supply, to be undertaken on the initiative of the state. In these countries, price-fixation is not used, in principle, as a means of shifting profitability from one sector of the socialized economy to another, since a simple economic model (which can be developed to take account of elasticities of demand) is sufficient to show that price changes are neutral in their effect on over-all profitability. In mixed economy countries, however, they are obviously not neutral as between the public sector and the private, and can be used (provided that their enforcement is possible) to shift profit out of private hands and into public hands, or *vice versa*. Whether they should be used this way, however, is very doubtful, for it is impossible, in the long run, to use administrative methods to disrupt market equilibrium without producing unforeseen and deleterious effects on the structure of the economy. The policy, moreover, is unlikely to be effective in achieving even the immediate results at which it is aimed. On the public

enterprises themselves, its effect is to undermine operational efficiency and with it managerial morale - an effect similar to that produced by any other measure that creates disparity between the public and the private enterprise sectors, such as imposing on public enterprises, without compensation, unnumerative social responsibilities (e.g. the requirement to employ an excessive labour force).

56. Administrative prices, fixed and enforced by state authorities, are employed most frequently (a) where there is a supplier's monopoly or quasi-monopoly and (b) where there is a severe shortage of goods essential for the maintenance of the people's standard of living. In the latter case price control needs to be accompanied by rationing, if it is to have the desired effect. Many countries impose such control, or attempt to do so, on the prices of essential consumer goods, but it is not a form of control which has any special relevance to the problems of public industrial enterprise as such, since the source of origin of the goods concerned is immaterial. In some countries of centrally planned economy prices for producers are administered while prices for consumers of the same commodities are determined by the market. In such cases, divergencies between the two systems of prices are adjusted by the budget, through, for instance, a positive or negative turn-over tax a' anging rates. This arrangement is employed where the impact of market price relations on the behaviour of producers has to be modified by reference to social preferences which are not reflected in market price relations.

<u>The monopoly or quasi-monopoly situation</u>

57. In many developing countries, public industrial enterprises enjoy a sheltered market, sometimes because they are the only manufacturing enterprises in their particular fields, sometimes because the division of the market among the enterprises, both public and private, has in effect been frozen by the operation of an industrial licensing system, sometimes because effective demand so exceeds actual supply that there is a more-or-less permanent seller's market with consequent inflationary pressures. Hence, even though in some cases the enterprises are in theory free to fix their own prices, they must necessarily be guided in doing so by certain rules made for them by higher authority.

58. Many developing countries report that, as a matter of general principle, prices are determined by adding an unspecified margin to average costs. This

may be good enough as a rule-of-thumb, provided that a serious effort is being made to keep costs down and that the margin is decided in the light of some coherent policy governing the contribution that each class of enterprise is expected to make towards its own expansion and general capital formation. Others use important parity as a standard (i.e. the landed price of comparable goods from foreign sources). This makes some sense only if the price of the imported product has not already been raised, by means of import duties, to a level roughly comparable with the cost of the indigenous product (calculated on an average cost plus margin basis). In such cases import parity means little more than the protection of an indigenous industry against foreign competition, which may be justified by the "infant industry" argument, or by considerations of import substitution, balance of payments and saving of foreign exchange. It does not offer a firm and intelligible principle to govern price fixation.

The search for a principle

59. The search for such a principle is being actively pursued in many countries, since price fixing at the ministerial level, often for purposes of purely political advantage and on an *ad hoc* basis, has been productive of serious economic distortions and, in some cases, has had highly deleterious effects on the viability of the enterprises concerned.

60. In one country, the following general criteria have been recommended for the determination of public enterprise prices:

(a) Level of profitability to be aimed at by the enterprise;

(b) Contribution to revenue to be expected from the enterprise and the development reserves to be credited to self-financing;

(c) Manner in which the earnings of the enterprise should make good any losses to government revenue through import substitution;

(d) Level of operational efficiency and the unit costs which should be taken as a guide for price determination;

(e) Comparative levels of market and c.i.f. prices of the imported equivalents of enterprise products; and

(f) Impact of enterprise prices on other sectors of the economy.

61. While the formulation of such principles indicates a desire to achieve rationality and consistency, the principles themselves tend to be too general to have great operational utility. Moreover, it is obvious that they are not necessarily mutually consistent. The essential question is what degree of priority is to be accorded to each.

62. In the last resort, an administered price is a matter of judgement, since a government running a mixed economy has imperfect knowledge of the impact of numerous exogenous factors which should be influencing its decisions. In this respect, it is a very different position from the government of a centrally planned economy particularly if such an economy is relatively self-contained. Ideally, if not always in reality, the latter kind of government has all the factors under its own control. Even when such control is reasonably complete, however, there will remain a conflict of objectives which somehow has to be resolved; for there are very few public enterprises, even in the field of manufacturing industry, which have not been given wider social objectives that have to be taken into consideration when deciding price policies; but the ever-present danger is that these will be used as excuses for bad policies rather than as reasons for good ones. Hence the importance of at least starting the price fixing exercise by the most rigorous application of the best economic principles that are currently available. In the opinion of many economists, these are summed up in the phrase "marginal cost pricing" - although there is still plenty of controversy about the techniques of calculating marginal costs, about the precise circumstances that warrant the application of the short-term as distinct from the long-term marginal cost principle and vice versa, and about modifications that may have to be made, particularly if it is decided that full accounting costs also have to be covered. The use of such pricing policies, as is well known, is impossible unless the right kind of accounting information is available to properly trained accountants. One would therefore hesitate to recommend it for immediate adoption by the less developed of the mixed economy countries. Nevertheless, it should certainly be seriously studied by them, with a view to possible future adoption.

63. While it is impossible to recommend a general principle which should govern the determination of prices charged for the products of public industrial enterprises in all countries and under all circumstances, it is at least possible to make certain recommendations about the machinery for price fixing.

The machinery of price fixing

64. If any coherent and consistent principle is to be applied to pricing policy, it is essential that the policy should be centrally determined. As pricing policy, moreover, is inseparably connected with fiscal, credit, monetary and income policy, it must, in the last resort, be in the hands of an authority with over-all responsibility for economic policy making. This means

the decisions can neither be made on a case-to-case basis nor left to the relevant ministers, but must be taken after proper advice has been enlisted by the minister of finance or minister of economic affairs in consultation with those of his ministerial colleagues to whom responsibility for the different branches of the economy have been confided.

65. To provide them with the advice they need, some kind of expert advisory body should be constituted. The exact location of this body in the administrative system will vary from country to country. It may be attached to the ministry of finance, to the ministry of economy or industry or to the planning board; it may form part of the premier minister's or president's office; or it may be completely independent. Wherever it is located and however constituted, it must recommend the principles that should govern pricing policy and investigate the direct impact of all interventions in this field, actual and proposed, on the development of the economic and social life of the country. A strong case - although not necessarily a universally valid one - can be made for giving publicity to the recommendations of such a body and for requiring the political authorities, when they choose to reject or modify such recommendations, publicly to state their reasons for doing so.

66. One of the major subjects for investigation for a body of this kind is the price policies to be pursued by public industrial enterprises that are aiming at the development of an overseas market for their products. What advantages and disadvantages may accrue from the attempt to break into a new overseas market by offering products at a price lower than the domestic price, and perhaps below cost of production? What justification may there be for the deliberate subsidization of certain exports? Such questions are particularly important for countries with infant industries which require for their ultimate economic viability markets considerably wider than the domestic market. They are equally important for countries faced with serious balance of payments and foreign exchange problems. They raise wide considerations of international economic policy and must be discussed in relation to the rules which the country may have accepted as governing its trading relations with other countries. Clearly, they cannot be discussed in the present context.

Chapter IV PROFITABILITY AND EFFICIENCY

Profit as a measure of efficiency

67. The question of the appropriate profit-making policy to be pursued by a public industrial enterprise, together with that of how the profit should be allocated as among alternative uses, has been dealt with in previous sections of this report. Here we are concerned with profit only as one of many possible criteria for the measurement of efficiency.

68. It is generally agreed that profitability may be taken as a rough-and-ready measure of efficiency only where enterprises are subject to the discipline of free competition. When competitive conditions are non-existent or extremely imperfect, profitability and efficiency are by no means necessarily correlated. As the latter situation, by and large, prevails in the systems of public manufacturing enterprise created in the developing countries, the profitability of these enterprises can play only a very limited role in efficiency measurement. Other criteria of efficiency and other means of stimulating it need to be discovered and applied.

69. The concept of efficiency has meaning only in relation to objectives. The first essential, therefore, is that the objectives of the enterprise should be clearly defined (and periodically re-defined as economic circumstances and national goals undergo change) and that these objectives should be communicated to all concerned with the operation of the enterprise, from the general manager or board of management downward. Efficiency can then be defined as the optimisation of the input-mix for the achievement of stated targets, which will frequently include certain social benefits, accruing to the national economy as a whole rather than to the enterprise itself. It is particularly important that the costs of achieving such targets to the enterprise should as far as possible be quantified. Otherwise the enterprise will be unfavourably and unjustly compared with similar enterprises (whether in the public sector or the private) which are not burdened with such obligations. Only when these

factors have been duly taken into account does the achievement of a specified rate of return on invested capital offer a useful, if partial and preliminary yardstick for efficiency measurement and a meaningful stimulant to managerial entrepreneurship. The meaningfulness of such a yardstick and stimulant will, of course, also be dependent upon its being calculated on the true value of the enterprise's assets, which may be very different from their nominal value.

Other measures of efficiency

70. Another, and most important yardstick is provided by the identification of cost centres for purposes of measuring the movement of costs every time and of comparing costs as between different enterprises producing for the same market or for similar markets. This technique, however, needs to be used with some caution. If costs for instance are shown to be increasing, this does not necessarily indicate that the quality of management is poor; the reason may lie in faulty plan organization, in input prices over which management has no control, in a general inflationary situation or in a host of other possible factors. The important thing is clearly to identify the true reasons for the higher costs, so as to be able to prescribe the appropriate remedial measures.

71. Other efficiency criteria that may be applied are familiar to both public and private enterprises in the more developed countries. How long does the enterprise take to fill orders, and with what degree of reliability does it fill them? What is the size of its inventories in relation to the optimum for an enterprise of its particular size and structure? How does the size of its storage facilities and its utilization of factory space compare with reasonably attainable standards? Has it installed an adequate maintenance schedule for equipment? Is its turnover of personnel above or below the average for similarly situated enterprises? Is the utilization of its inputs of raw materials and components improving or deteriorating? Through the use of these and other criteria it should be possible to construct an efficiency profile for the enterprise, as a base from which to evaluate managerial performance.

72. The application of these criteria is primarily the responsibility of management itself, which should be trained in their use. External measurement, however is also required, if only to ensure (a) that managers are performing their functions to the best of their ability and (b) that the true reasons for less than adequate enterprise performance (which, as stated, may be beyond the reach of managerial skills) can be correctly identified. It is for this reason that many countries have developed, at the level of the central government,

special organs for efficiency measurement comparable in purpose (if not always in organization and in techniques employed) to the French Commission de Vérification des Comptes; for instance, the Prime Minister's High Control Board in Turkey, the State Audit Department in the United Arab Republic, the Bureau of Public Enterprises in India, and the public enterprises section of the State Comptrollor's Department in Israel.[4] The intention behind these organizations is excellent, but the results they achieve is not always commensurate; for in most developing countries the personnel with the necessary qualifications are scarce, and there is a strong tendency for the organization to develop into another bureaucracy sitting on top of the enterprise and to become more of a nuisance than a help to enterprise management. It should be clearly realized, therefore, that the mere establishment of such an organization does not automatically result in the achievement of a higher degree of efficiency; it may conceivably have just the opposite effect.

Training needs

73. In most developing countries, the basic requirements are (a) to train managers in those techniques of efficiency measurement which they themselves may apply within their enterprises and (b) to give both managers and workers adequate incentives to improve the efficiency of their operations. Management training of all kinds is generally taken seriously but the training is often deficient, for reasons that are both identifiable and remediable. Training courses tend to be insufficiently related to the actual problems that the manager is likely to encounter (being over theoretical and based too exclusively on the experience of developed countries). They are also frequently designed for the exclusive benefit of managerial recruits and middle level managers, who find that, on returning to their enterprises, they do not possess the authority to put into practice the lessons they have learned, since their seniors, who have not undergone similar training, remain firmly attached to the old ways. The use of industrial consultants (which, in essence, is another form of managerial training) is often badly organized, since the consultants are too frequently employed by the government as a means of critisizing rather

4/ In certain countries, evaluation of the performance of public enterprises, as distinct from efficiency measurement in the narrowest sense, is undertaken by parliamentary committees, such as the Select Committee on Nationalized Industries in the United Kingdom and the Committee on Public Undertakings in India. In suitable circumstances such bodies are useful as a means of keeping the legislature adequately informed about the progress of public enterprises.

than of helping their managerial clients. Foreign consultants moreover tend to be birds of passage who lack the time (and sometimes the will) to acquaint themselves adequately with problems of industrial organization and managerial roles which are inevitably very different from those with which their experience has familiarized them. One of the major tasks, therefore, is to build up an indigenous body of consultants, who will be welcomed by enterprise managers as helpers and not feared as quasi-inspectors. One should immediately add, however, that at least initially the consultancy service should be kept small, since those who are worth consulting presumably themselves have high managerial capacities, which are in short supply. It is encouraging to note that the development of training and consultancy services is being taken very seriously in most of the developing countries. One may particularly commend schemes whereby indigenous consultants are associated with foreign counterparts. To establish fruitful relationships of this kind is one of the objects of UNIDO. Also to be commended is the use of training, not merely for the introduction of new techniques but for the transformation of current attitudes - which are all too often negative - towards business activities.

Incentives

74. As for incentives to achieve efficiency among managers, this problem is not as serious as it is sometimes presented by those who can see no incentive beyond the profit motive characteristic of private enterprise. Adequate salaries, security of tenure and prospects of promotion for the efficient together with public recognition of meritorious service, should provide incentive enough. The only reason these incentives are often absent is a mistaken determination on the part of the government to treat the public enterprise management service as a mere branch of the bureaucracy. It is the managerial spirit, together with managerial type incentives, that should be introduced into the bureaucracy itself, and not the bureaucratic spirit into public enterprise management. Similar types of incentive should prevail all down the line, to the shop floor itself.

The question of participation

75. When considering incentives, it is necessary to make a brief appraisal of participatory schemes which find fairly wide application in developing countries, and are sometimes written into the laws relating to public industrial enterprises. Participation of personnel in the economic results of the enterprise finds its highest expression in Yugoslavia, where, under the system of

workers' self-management, the enterprise itself is run under the general direction of an elected workers' council and where, subject to certain legal provisions, decisions regarding the disposal of profits are at the discretion of the workers themselves. As Yugoslavia, to a greater extent than any other country, that has socialized its means of production, subjects its enterprises to the discipline of the market, the level of profit constitutes some measure of efficiency and the search for profit provides a real incentive. The Yugoslav experience is unique and cannot be adequately expounded and assessed in a brief and general report. It should be noted, however, that the demand for the participation of the work force in managerial functions by way of representation either on the board of management or on consultative committees would appear to be growing in many countries both developed and developing. Responses to it vary from country to country, and likewise opinions as to the extent to which it offers an incentive to improved performance, by increasing the sense of identification of the workers with the enterprise that provides them with their livelihoods. The value as an incentive of assigning to the management and work force of a portion of the profits of an enterprise, by way of additions to normal salaries and wages, is also controversial. In theory it should be good for morale: in practice it is not always so. When an enterprise enjoys a comparatively sheltered existence, the payment of bonuses out of regularly accruing profits may settle down into a routine and the bonuses come to be expected. Perhaps more serious is the situation where certain enterprises, through no particular effort of their own, are able to pay bonuses, whereas other enterprises, through no fault of their own, are unable to do so. In this case whatever stimulatory effect the bonus-paying regulations have on the first group of enterprises may be offset by the depressant effect on the second group. Similar considerations apply to the use of profits for the provision of services in kind, such as housing and recreational facilities.

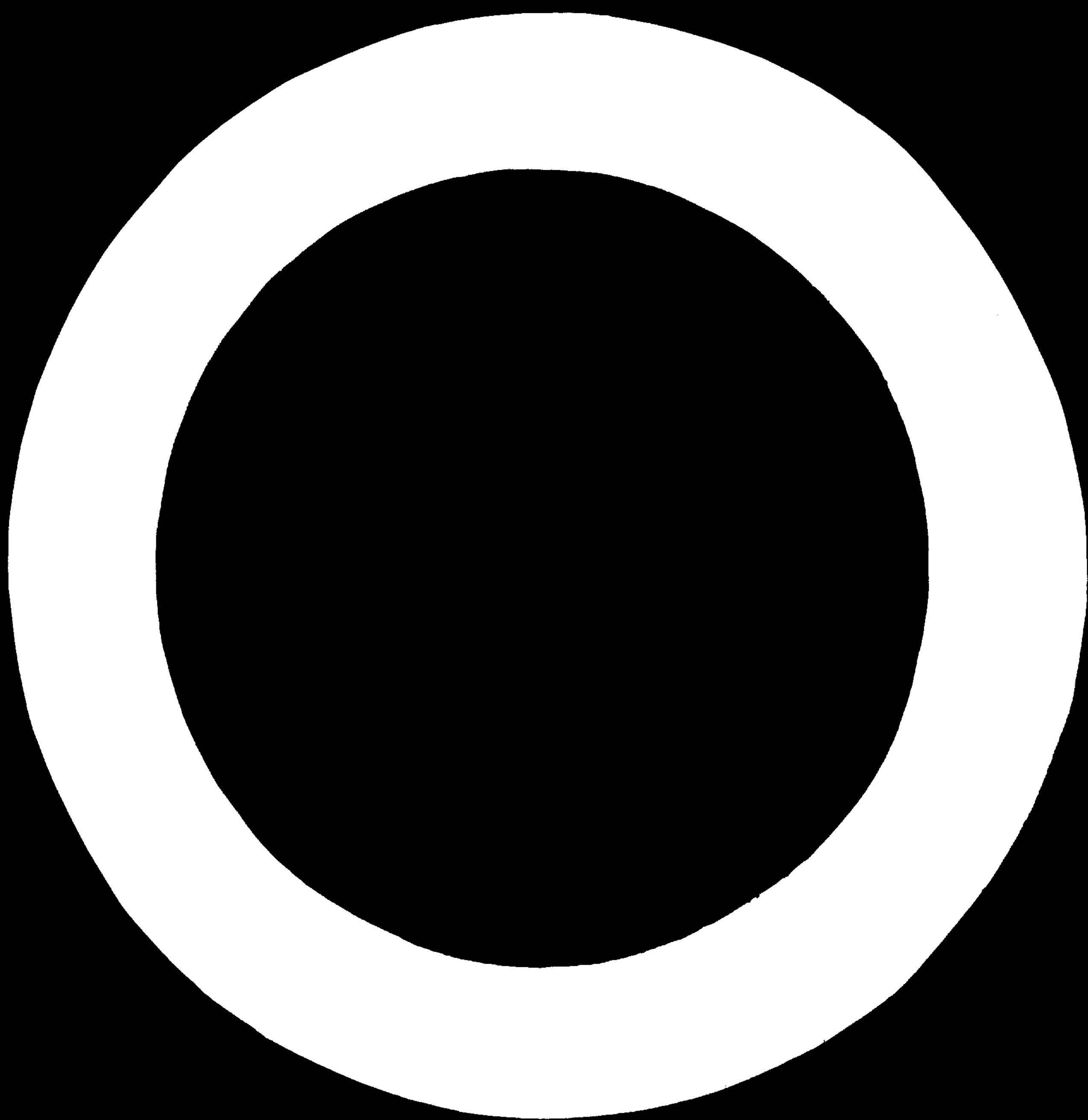
76. Much more useful is the payment of bonuses and provision of services based, not on profitability, but on productivity, both individual and collective; but this requires that there be a reasonably sophisticated means of measuring productivity and of apportioning responsibility for it. So far as workers are concerned, the simplest method is the introduction of piece-work schemes; but whether this is possible depends both upon the nature of the enterprise's operations and the reactions of the workers to this particular

form of remuneration, which differs from country to country and from industry to industry. In some countries, productivity bonuses of various kinds are paid in addition to profit based bonuses. There is plenty of room for fruitful experiment and for interchange of different national experiences in this field.

Annex 1

AGENDA

1. Consolidated report on experiences of selected countries
2. Capital structure and financing
3. Capital budgeting
4. Pricing policies
5. Profitability and efficiency measures
6. Consideration of draft report of seminar



Annex 2

STATEMENTS PRESENTED TO THE SEMINAR

Statement to the seminar by Professor Ronaldo Arena, Central Director for Foreign Service Institute for Industrial Reconstruction (IRI)

Closing address to the seminar by Professor Giuseppe Petrilli, President of the Institute for Industrial Reconstruction

STATEMENT TO THE SEMINAR BY PROFESSOR RONALDO ARENA, CENTRAL DIRECTOR FOR FOREIGN SERVICE INSTITUTE FOR INDUSTRIAL RECONSTRUCTION (IRI)

On behalf of IRI, our President, Mr. G. Petrilli, and the Director General, Mr. Leopoldo Medugno, I have great pleasure in welcoming all participants in this seminar, the UNIDO representatives and organizers, officials of the Ministry for Foreign Affairs, IRI fellowship holders, officials of our enterprises and all those who have done us the honour of attending this meeting.

I do not intend to address you on the subject of your work. This afternoon Mr. Saraceno will make a statement on the role of public manufacturing enterprises in the development of the Italian economy. No one is better placed than he to expound on this subject, for Mr. Saraceno was not only one of the founders of the system of State shareholding in Italy, but was also an early advocate of Italian national planning.

At the end of his statement Mr. Saraceno will be happy to reply to any questions which participants may wish to raise concerning the role of public enterprises in Italy's economic development.

As head of IRI's international relations service, I shall limit myself to a few remarks which may prove useful for your discussions.

In recent years certain countries have witnessed the creation of economic enterprises under public law whose purpose is to participate in national development. In some cases they attempt to further the development of industrial structures by encouraging mergers and technological modernization; in others they try to bring about better co-ordination in particular economic sectors or to accelerate development in certain zones; in yet others, they are concerned with management problems.

In all cases, however, the aim is to bring about solutions of the mixed economy type, in which the future of market economy countries seems to reside. This probably explains why the work of IRI has often been taken as a model. Although based on a market economy, it enables the State to direct its activities towards the economic sectors which are considered crucial.

But before intervening in a particular economic sector, it is essential to consider the training of personnel.

This explains the vital importance of your seminar, which UNIDO has convened to discuss the highly specific and complex subject of the functioning of public manufacturing enterprises. And since there are many representatives of the developing countries among us, I should like to draw their attention to the Pearson report to the World Bank, entitled "Partners in Development".

Reading this report, I was struck by the thoroughness of the investigation, which covers 70 Governments and hundreds of specialists, and the remarkable frankness with which the author discusses the errors made by the advanced and the developing countries.

The report contains numerous criticisms with which I am in full agreement, particularly in connexion with the tendency of technical assistance to develop a life of its own, independently of the activities of both donor and beneficiary countries.

We all agree on the fundamental importance of this type of collaboration; but we have also observed how easily it can degenerate if the donor and the beneficiary are unable to implant it in the heart of the development process. We all know what happens when the technical assistance expert is out of touch with the realities of the country where he works: he becomes a sort of remittance man, enjoying a comfortable and easy life, serving no useful purpose and always able to fall back on the excuse that his ineffectiveness is the result of outside factors over which he has no control.

This is a very dangerous situation since it jeopardizes a most important activity and may even have a negative effect on the relations between aid-giving and aid-receiving countries.

The Pearson report rightly states that technical assistance should form part of any aid programme both at the level of the over-all project and its implementation.

I should like to repeat how much I agree with these criticisms, whose validity all of us have had occasion to note, just as I agree on the need to improve co-ordination in both donor and beneficiary countries.

The Pearson report clearly demonstrates the fundamental importance of technical assistance provided it is well organised and co-ordinated and relates directly to the principal objectives of the beneficiary countries. However, while recognizing its merits, I should like to voice one criticism of the Pearson report. In my opinion, it does not pay sufficient attention to the problem of personnel training in the developing countries. It has long been my belief that the problem of under-development is first and foremost a human problem.

It is a human problem in the sense that the true and decisive shortcomings which place a country in the "under-developed" category is the absence of a sufficient number of senior technical and administrative staff capable of assuming direct responsibility for solving their own problems, making the choices needed to face up to them, and finally of supervising the implementation of projects at the technical and administrative levels.

When discussing training, we should not restrict ourselves to purely educational measures. I am convinced, for instance, that the really basic structures for the training of personnel in the developing countries are the management centres, planning offices and public holdings which have grown up and developed to an increasing extent in recent years. The administrators and personnel who receive training in these centres are the very people on whom we should concentrate attention, since they exert a most profound influence on the life of a country. Through their work they can have a determining effect on the formation of the human infrastructure within their particular fields of activity.

To achieve this fundamental aim, we must avoid giving training programmes a purely educational or scholastic bent. Obviously we must not train personnel who are out of touch with the practical reality of the problems they will be called upon to solve.

Training activities must produce concrete results as rapidly as possible, not only in the form of qualified personnel but also centres of activity and action, testing grounds for experiments which can rapidly become an instrument for practical action.

IRI, which tops the pyramid of the Group and is composed of a small team of directors, has operated along the lines I have just described. It is not only an economic guidance centre but also, in practice, a managerial training centre, with great influence on the economic life of Italy. Its historic, non-ideological origins have greatly facilitated a wide-ranging search for alternative solutions. It has been the scene of a variety of experiments, which have developed side by side in the course of tackling the nation's principal economic problems.

I have drawn attention to this particular aspect of IRI since I believe that the studies to be undertaken by participants in the UNIDO seminar will probably lead to the creation of new activities and economic structures in the countries where they already play a leading role.

And, looking beyond the structures of the new institutions which will be set up, I think we should consider the problems of the men who will be put in charge of them.

On this note, gentlemen, I shall close, wishing you every success in your work.

CLOSING ADDRESS TO THE SEMINAR BY PROFESSOR GIUSEPPE PETRILLI, PRESIDENT OF THE INSTITUTE FOR INDUSTRIAL RECONSTRUCTION

As this seminar draws to a close, I hope you will allow the President of the institution which was privileged to offer you its premises and facilities to say a few words and to wish you every success in the future development of the work begun here. I am the more honoured to greet you here on behalf of IRI since I have closely followed UNIDO's work since its creation and was among the first to welcome the setting up within the United Nations system of a specialized agency dealing with the problems of industrialization in the developing countries. Your Organization has an important part to play in connexion with the ever-increasing volume of exchanges between the industrialized and the developing countries, which span the entire range of technical co-operation from fellowships to refresher courses, from vocational schools to experts, and the financing of studies and projects prepared by consultant firms.

Our interest in this type of co-operation has so far mainly taken the form of a programme of fellowships for technicians from the developing countries and the holding of a series of courses at various enterprises within our Group. We are prompted to this form of action both by our public responsibilities and our entrepreneurial role. Our public responsibilities make us aware of the usefulness of any attempt to bring about a more satisfactory balance in international trade through the diversification of exchanges between the industrialized and the developing countries, while our business sense told us how important it is to take the opportunity of establishing close and friendly relations which might ultimately lead to a strengthening of the various links between the companies in our Group and the home countries of our trainees.

In my view there can be no contesting the need to give priority in any development policy to training. The well known contemporary French economist, Alfred Sauvy, gave a startling illustration of this need by comparing the position of the population of an advanced industrial society obliged to start all over again from scratch after the catastrophic destruction of the material basis of its civilization with that of a primitive people miraculously set down in the midst of a highly advanced technical society abandoned by its creators. It is obvious that in the first instance the civilized community would eventually make up the lost ground thanks to the knowledge it had inherited, whereas the primitive group would be unable to make use of the material structures placed at its disposal because of its inability to master them. Consequently, even from a functional point of view, the problem of development is mainly a cultural problem. Anyone who has studied the regional policies pursued by various countries within a national framework is aware of the fact that the launching of an industrial process in a geographical area whose economy is dominated by agriculture gives rise to all kinds of training problems at every level and calls for the closest attention on the part of the promoters to the adaptation phenomena linked with social evolution. As far as possible the development process must take place in such a way as to avoid breaks or tensions which might prejudice the economic results of the new undertakings.

This is particularly true of international relations, since economic and social imbalances are often the reflection of the age-long historical experience of different countries. A policy designed to promote social progress, which is a prerequisite for any real economic development, must be primarily directed towards awakening people's awareness, thus helping to create a new élite. Technical assistance - in the form of training and refresher courses for technicians from the developing countries, the provision of foreign technicians and co-operation in the implementation of programmes and projects - is essential for supplying the developing countries with the knowledge and skills they need in order to make rational use of their own resources and external financial assistance.

Technical assistance for the industrialization of the developing countries has so far come up against difficulties arising from the lack or shortage of local technical personnel capable of fully briefing international experts on the specific problems of a particular area. For their part, the experts from industrialised countries are usually technicians with a sound knowledge of their own field but accustomed to a background that has nothing in common with the developing countries. They therefore need counterparts who can properly inform them of conditions in the developing countries. This explains the value of the technical co-operation activities which economic groups such as IRI, covering a wide range of different sectors, are alone capable of undertaking and which meet exactly the requirements which led to the establishment of UNIDO.

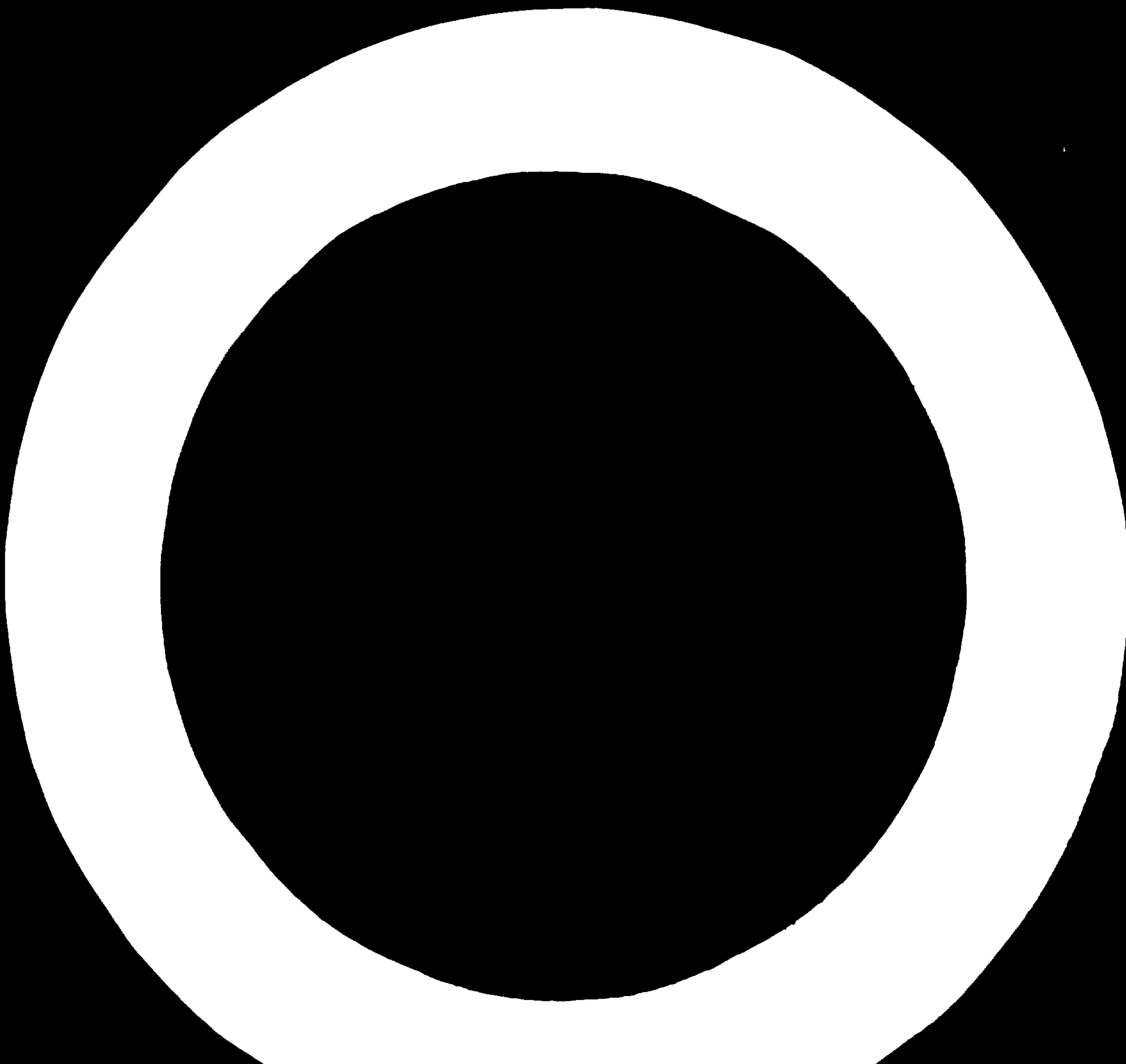
In more general terms I believe that experience with the Italian system of state shareholding - essentially based on IRI - is of special interest for the developing countries, both from the point of view of the role that public enterprises of this kind can play in the industrialization of developing areas and in connexion with the actual techniques of indirect public management of economic enterprises. In this respect it is significant that a seminar devoted to the problems of financing public enterprises should have been held at IRI, with the participation of our own highly qualified experts.

We are well aware of the fact that a solution of this kind is not directly applicable to situations that are entirely different from our own. The expressions of interest we have received from abroad cannot obscure the fact that we began in a completely pragmatic way and do not believe that our experience is necessarily exportable. In fact, the type of public intervention which we represent was ideally suited to a historic situation characterized by shortage of risk capital and the possibility of associating private savings with the financing of activities launched by the public sector. Obviously this situation is not typical of the most economically advanced countries, where a considerable amount of risk capital is available and government action can therefore be limited to fiscal matters and public expenditure. Nor is it typical of the situation in the developing countries, which usually suffer from a very marked lack of savings and a weak private sector. In spite of these basic differences, however, our experience has broader implications because of the world-wide need to find machinery capable of combining the pursuit of aims in the general interest, which is used everywhere as the basic justification for the involvement of the public sector in commercial enterprises, with the need for sound management, which is regarded as the ability to pursue these aims at the lowest possible cost.

As an indication of the importance of the indirect public management of economic activities within the Italian economy, it should be mentioned that our approach is highly suitable for solving the problems connected with ensuring competitiveness at the national and international levels. Nationalization, on the other hand, is better adapted to the special conditions arising in such activities as fiscal monopolies and public utilities, which are characterised by the fixing of prices and rates at a higher or lower level than would result from the normal play of market forces. While nationalization has often been opposed to a market economy and its activities set in a protectionist context, the indirect public management of economic activities has increasingly opened up various sectors to international trade. In the case of IRI, this is particularly true of the Italian iron and steel industry whose present progress is due to the gradual creation of a common coal and steel market within the framework of ECSC.

At the present stage of development of the Italian economy, the outstanding feature of public enterprise is its promotional aspect. This statement must be viewed in the light of the contribution that the system of State shareholding has made to the balanced growth of the Italian economy. The best examples of the work carried out by the public sector for the economic renewal of the southern regions of Italy show that the notion of public intervention has ceased to be too closely linked with the provision of assistance. This notion, which presided in the past over major public endeavours in the south, could only lead to the creation of public works in the traditional sense, i.e. pyramids in the desert, which were incapable of setting in motion a self-sustaining process of development. The main efforts of our enterprises have the merit of closely associating two different kinds of goal. They attempt both to set in motion a true process of development through the establishment of large-scale enterprises and to bring about a lasting solution to certain sectorial problems related to national economic development as a whole. This guiding principle of public intervention has in some respects anticipated the introduction in Italy of a process of economic planning, by closely linking the geographical and sectorial aspects of national economic growth and by ensuring that the industrialization of the south is fully compatible with the increased international competitiveness of the Italian economy.

In concluding my remarks, I should like to add that, while we do not believe that our approach can be exported, we are nevertheless convinced of the value of taking every opportunity to develop a fruitful dialogue based on the broad comparison of different experiences. As businessmen we have attempted in all our technical co-operation activities to develop relations, not as a form of welfare or in a paternalistic spirit, but as a matter of mutual interest. For this purpose we have endeavoured to link the industrialization of our southern regions with the possibility of expanding our overseas trade. In the same spirit, we have tried to create further opportunities for meetings and discussions with all groups interested in the problems of industrialization and its geographical extension. The UNIDO seminar, which we were fortunate enough to host and which has enabled us to welcome so many outstanding foreign specialists in public enterprise, marks an important stage in the development of this friendly collaboration.



Annex 3

LIST OF PARTICIPANTS

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HUNGARY	Zoltan Sztankoczy Head of Industrial Department National Planning Office Budapest
INDIA	Shri R. M. Bhandari Financial Adviser Bureau of Public Enterprises Ministry of Finance Government of India New Delhi
INDONESIA	Sugeng Sundjaswadi Chief, Bureau of Mining and Industry National Development Planning Agency (BAPENNAS) Djakarta
IRAN	Parviz Shargh Head of Investment Department Industrial Credit Bank of Iran and Chairman of the Board of Hekmatan Sugar Company Tehran

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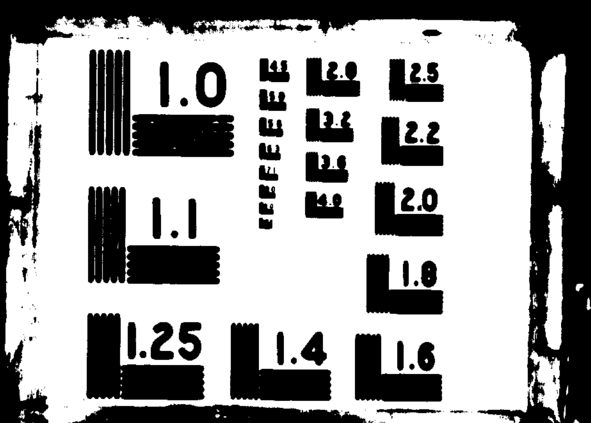

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Tomajuoli Marcello	Marketing Consultant, Olivetti, S.P.A., Rome, Italy

Annex 4

PAPERS PRESENTED TO THE SEMINAR

ID/WG.43/4	Financial aspects of manufacturing enterprises in the public sector
ID/WG.43/5	Determination and control of production costs in public manufacturing enterprises
ID/WG.43/6	The formulation and application of efficiency measures in public manufacturing enterprises
ID/WG.43/7	The price and profits policy of public industrial enterprises
ID/WG.43/8	Financing of manufacturing companies in a state shareholding system
ID/WG.43/9	Financing of state industrial enterprises in the USSR
ID/WG.43/10	Financing of self-governing socialist enterprises in Yugoslavia
ID/WG.43/11	Industrial financing of manufacturing enterprises in Hungary
ID/WG.43/12	Financing of public manufacturing enterprises in Poland
ID/WG.43/13	Pricing policies of public manufacturing enterprises: The experience of centrally planned economies
ID/WG.43/14	The financing of industrial enterprises in the public sector in Syria
ID/WG.43/15	Financing of public industrial enterprises in Tunisia
ID/WG.43/16	Industrial financing of public manufacturing enterprises in Indonesia
ID/WG.43/17	Industrial financing of public manufacturing enterprises in the United Arab Republic
ID/WG.43/18	Industrial financing of public manufacturing enterprises in Tanzania
ID/WG.43/19	Industrial financing of public manufacturing enterprises in Colombia
ID/WG.43/20	Financing of public enterprises in Mexico

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