Inter-American Development Bank

Governance, Performance, and the Best Reform Practices in State-Owned Enterprises in Latin America and the Caribbean and Korea

Forum Report and Proceedings from the International Symposium held November 5-8, 2013, in Seoul, Korea

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Contact: Katia Rivera, katiar@iadb.org.

GOVERNANCE, PERFORMANCE, AND THE BEST REFORM PRACTICES IN STATE-OWNED ENTERPRISES IN LATIN AMERICA AND THE CARIBBEAN AND KOREA

MINISTRY OF STRATEGY AND FINANCE
REPUBLIC OF KOREA

IDB

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ACRONYMS

CNEP	Consejo Nacional de Empresas Públicas (Paraguay's Council of Public Enterprise)
CoPLAC	Comunidad de Profesionales y Expertos en Latinoamérica y el Caribe (community of professionals and experts in Latin America and the Caribbean)
Ecopetrol	Ecuador's national oil company
FONAFE	Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado de Perú (Peru's national fund for financing the State enterprises activity)
GDP	Gross domestic product
IDB	Inter-American Development Bank
ICE	Instituto Costarricense de Electricidad (Costa Rica's Electricity Institute)
ICAA	Instituto Costarricense De Acueductos Y Alcantarillados (Costa Rica's National Aqueduct and Water Institute)
INS	Instituto Nacional De Seguros (Costa Rica's National Insurance Institute)
KDI	Korean Institute for Development
KiPF	Korean Institute of Public Finances
LAC	Latin America and the Caribbean
LLC	Limited liability company
Mideplan	Ministerio de Planificación Nacional y Política Económica de Costa Rica (Costa Rica's ministry of national planning and economic policy)
Mercosur	Mercado Común del Sur (South America's Free Trade Zone)
MoF	Ministry of Finance
MoSF	Ministry of Strategy and Finance
OECD	Organisation of Economic Co-operation and Development
PPPs	Public–private partnerships
Petrobras	Brazil's National Oil Company
PETROPAR	Petroleras de Paraguay (Paraguay's National Oil Company)
PDVSA	Venezuela's National Oil Company
PEMEX	Mexico's National Oil Company
PRODEV	Program to Implement the External Pilar of the Medium Term Action Plan for Development Effectiveness
RECOPE	Refinadora Costarricense De Petroleo (Costa Rica's National Refineries)
RoA	Return over assets
SAE	Servicio de Administración y Enajenación de Bienes (Mexico's asset management and disposal agency)
SHCP	Secretaría de Hacienda y Crédito Público (Mexico's Finance Ministry)
SENPLADES	Secretaria Nacional de Planificación y Desarrollo (Ecuador's National Secretariat of Planning and Development)
SOEs	State-owned enterprises
SEP	Sistema de Empresas Públicas (Chile's public enterprise system)
SJP	Sistema de Juvilacion y Pensiones (Argentina's Retirement System)

EXECUTIVE SUMMARY

Over the last decade, several countries in the Latin American and the Caribbean (LAC) region have strengthened the management of their state-owned enterprises (SOEs) through a process of reforms. SOEs are productive businesses typically directed by national governments because they have monopolistic tendencies and work in sectors such as energy, transportation, or telecommunications. These industries provide vital services to citizens of their countries. The objective of the recent reforms was to increase their contribution to their local economy by improving performance, increasing transparency of operations, and expanding accountability to citizens.

In this context, the Republic of Korea's Ministry of Strategy and Finance (MoSF) and the Inter-American Development Bank (IDB), organized several international forums to discuss the policies and reforms of SOEs. The first was celebrated at IDB headquarters in Washington, DC, and the second in Lima, Peru, in December 2012. A third event was hosted by the Republic of Korea in November 2013 in order to discuss management issues. This document reports the proceedings of that event.

In an effort to create a south-south exchange and to share best practices related to public enterprise management, the event was planned and coordinated by the IDB's Community of Professionals and Experts in Latin America and the Caribbean (CoPLAC). The south-south exchange for the multilateral investment organizations has proven to increase capacities of participants. In 2005, the IDB signed an agreement to work together with the Government of Korea to host a series of dialogues to share best practices and work to monitor and improve current public policies. Trained international experts, academics, and professionals working in specific areas were brought together to discuss particular fields of public policy. In this case, representatives who work to reform the SOEs presented their work.

Mr. Sang-Kyu Kim, Vice Minister of the MoSF, and Mr. Dong-Suk Oak, President of Korea's Institute of Public Finance (KIPF), hosted the Korean event, which included representatives from 13 countries in Latin America. These public officials work in SOEs for the national government, either working directly for the Office of the President or within the Ministry of Finance (MoF). These representatives seek to improve the quality, production, and management of their work. The event included speakers from Argentina, Brazil, Chile, Costa Rica, the Dominican Republic, Ecuador, Mexico, Paraguay, Peru, and Uruguay. The idea was to share the process of SOE reforms that have taken place in their countries, explain the reasons why they happened, and present current problems and challenges. The conference had five sessions:

Session 1: SOEs and National Development: Contributions and Constraints
Session II: Governance of SOEs: Structure and Oversight
Session III: SOE Performance Monitoring and Management
Session IV: SOE Fiscal Risk and Debt Management
Session V: Privatization and Market Competition: Stategies and Constraints

The community of practice understands that SOE reform provides ways to improve the effectiveness of governments in managing their economies and providing good public services to their citizens. The event sought to shed light on how SOEs can improve their effectiveness.

PROLOGUE

International cooperation is not usually regarded as a core function of the Korean government, except for institutions whose founding objectives are related to one another or, in some cases, where international standards heavily affect major operations. Rather, the Korean government ultimately seeks to increase productivity and improve government efficiency above all else. Therefore, the value of international cooperation is often seen as less appreciated. While there are many different reasons for international cooperation in Korea, we believe it is most meaningful for the Korean people because it pursues diversity and helps share our successes.

First, the term "diversity" has recently become popular in Korea. For much of its history, the country consisted of a homogeneous ethnic group. Only recently has there been a dramatic demographic shift. As a result of a surge of inbound foreign workers, the large number of multicultural families has increased in Korea. Therefore, public campaigns stressing the importance of respecting diversity have begun. In general, the value of diversity is not usually well appreciated in Korea, but a diverse society can help provide clues to overcoming difficulties and potentially help find new ways of operating businesses. We expect that having a diverse workforce can generate creative and innovative solutions to challenges ahead. Overall, we believe that this is the most important reason why the Korean government should continue to work toward international cooperation.

Second, the important role that Korea has in improving its public institutions should be shared globally. In the past four or five decades, Korea has seen SOEs' participation not only lead to better services for citizens, but also in helping to promote industrialization in strategic sectors. The evolution of Korea's government occurred in three distinctive stages: (1) the country's creation, which drove economic development from the 1950s to 1980; (2) privatization of various sectors from the 1980s to 2000; and finally, (3) the incorporation of these public entities since 2000. How this evolution has happened and how the Korean government has made successful transitions demonstrate how effective and important this sector is to our national economy and the global economy.

Until recently, Korea has had little opportunity to cooperate with the LAC countries, the United States or European countries. Particularly because of the geographic distance between Korea and these regions, historically there were relatively few chances to share international exchanges. Even private institutions and public agencies promoting international trade have played limited roles, focusing mostly on energy and mineral resources. But most recently, international trade, investment, and exchanges of human capital have become more active. This is particularly true following Korea's free trade agreements signed with Chile, Peru, and Colombia.

It is timely and meaningful that the topic of state-owned enterprises become of interest to both Korea and the LAC region. We hope this important topic will build closer relationships between the regions and create additional exchanges relating to new ideas, management concerns, and other possible current issues. We hope that this opportunity will lead to sharing of policy experiences regarding SOE management and will enhance economic cooperation in the future. This is of particular concern where state-run energy firms are leading the way in improving the fiscal health of our countries. Besides enhancing the way government is run and operated, these efforts should help provoke improved sustainability and address climate change.

We would like to personally thank Ana Maria Rodriguez and Dong Yeon Kim, who initiated an exchange network between policy managers of SOEs in Korea and LAC. And we would like to share our joy in successfully launching the *1st International SOE Policy Conference* with members of the Research Center for SOEs of the Korea Institute of Public Finance, and Inter-American Development Bank's division of Institutions for Development (IFD) team. And I would like to extend my sincere gratitude again to Roberto Garcia Lopez, Jorge Kaufman, Katia Rivera, and Heidi Smith, who managed the writing, editing, translation, and production of the publication. Finally, I also appreciate the efforts of my colleagues in the Ministry of Strategy and Finance and the Korea Institute of Public Finance, who actively prepared for and participated in the conference in Seoul, November 2013.

BONG-HWAN CHO
Executive Director
Korea Institute of Public Finance

INTRODUCTION

During most of the 20th century, especially until the end of the 1970s, the management and creation of SOEs, particularly in countries in the Organization of Economic Cooperation and Development (OECD), which are considered to be highly developed, was fostered by the notion that State intervention was necessary and essential to fix market failures. This idea is based on the belief that SOEs form monopolies, which needed to be regulated by the State in order to effectively provide efficient public services.

In Latin America and the Caribbean (LAC), the creation of SOEs was more oriented toward articulating State intervention in the economy as a mechanism to promote economic and social development. Governments created state-owned enterprises (SOEs) to carry out productive or service-based activities in sectors such as energy, water, telecommunications, finance, and transport. Several governments promoted specific industries to achieve social and economic development goals. For example, Colombia used its State enterprises to promote the spirit of local production.

In general, LAC's SOEs were renowned for low performance, low-quality services, and high costs that constantly required State intervention. State transfers ensured that SOEs kept operating, which generated significant fiscal deficits in the respective national economies. Unfortunately, this is still true for some SOEs in the region, although today, it is possible to identify strong differences among countries regarding the operation of SOEs.

Through out most of the 1980s, SOEs continued this trend toward low productivity and poor quality of services. Often SOEs employed too many public officials who were delegated to top positions, based on political rather than technical criteria. Today, to be prepared to deal with macroeconomic crises when they occur, states need to achieve fiscal equilibrium and well-managed counter-cyclical reforms. With the introduction of reforms intended to liberalize markets, the management systems of several SOEs were reviewed. The idea was to promote economic development based primarily on private sector participation. Therefore, an intense wave of liquidation and privatization of SOEs was carried out in almost the entire region.

During this process of privatization, government structure and oversight of SOEs lost importance in public debate. Specifically, discussion about how to operate SOEs more effectively faded in many places. Obscured by a framework of institutional weakness, especially at the end of the 1990s and the beginning of the 2000s, SOEs reappeared as a topic in public debate.

The privatization of SOEs did not succeed in some countries because of weak regulatory frameworks in some cases and, in others, the selection of bad strategic partners. Therefore, a process of renationalization occurred, particularly in infrastructure and natural resource businesses. This process was supported by the significant economic growth that the region has experienced in recent years. State-owned enterprises have gone through a pendulum of ownership between the State and the private sector and back again. In this new context of State ownership, today some countries have created progressive reforms to manage these enterprises. Specifically, governments seek to improve efficiency in their performance, while continuing to maintain State ownership.

Today, as we discuss the implementation of public enterprise reforms oriented toward new and better management, it is clear that increasing the quality of efficient public services is not an easy task. Nevertheless, in some cases, these obstacles have been overcome with partial private sector participation, improved professionalization of managers, and international sharing of best practices.

In OECD countries, the importance of SOEs is significant because of the major role they play in economic sectors such as infrastructure. The value and the impact of these enterprises' performance are vital for their economies. Following privatization processes in various OECD countries during the 1980s and 1990s, SOEs have maintained an important role in the public sphere. Citizens have consistently remained interested in improving the performance and quality standards of SOE operations.

Public concerns relating to management of SOEs are valid, especially since these enterprises provide an important segment of production and employment, and they have enormous effects on fiscal accounts on the economies in all countries in which they operate. Because of the public visibility that civil society demands of these enterprises, they must meet high levels of transparency, governance, and respect for environmental norms, among other international standards.

Yet, some SOEs still present institutional weaknesses such as: nondisclosure of technical reports, displacement of State supervision, lack of independence from regulatory agents, and absence of a business culture. All of these factors obviously result in low levels of efficiency and service quality, similar to what several LAC countries experienced in the 1970s.

In an effort to establish priorities in this field, three SOE governance challenges have been identified in LAC:

- How to improve the organization and effectiveness of oversight.
- How to secure monitoring and evaluation based on performance and results.
- How to ensure the professionalism of management.

These three elements are discussed and described in this document. In an effort to enhance surveillance, create better transparency, improve accountability, and adopt a culture of oriented-for-results management in public enterprise in the region, several governments need to prioritize the debate. In the next decade, SOEs could help governments strengthen national fiscal accounts and improve their country's growth and economic opportunities, making the entity more competitive.

This exchange between representatives of LAC and members of the Korean government, who have themselves had a very successful experience with SOEs, will inspire future reforms and new public debate within the region.

ANA MARÍA RODRÍGUEZ
Manager, Institutions for Development Sector
Inter-American Development Bank

SESSION I:
SOEs AND NATIONAL DEVELOPMENT: CONTRIBUTIONS AND CONSTRAINTS

This session will look through the past, the present, and the future roles of SOEs during the economic development of Korea and Latin America and the Caribbean (LAC). It will stress the significant role of Korean SOEs and discuss the possible role of SOEs in LAC during each region's economic development.

Guiding questions:

• How much have SOEs contributed to the economic development in Korea and in LAC?

• What kinds of problems have been incurred by SOEs that have played a significant role during economic development?

SUPERVISION OF SOEs IN PARAGUAY

Elvio Brizuela, Responsible for the General Direction of SOEs, Paraguay

This presentation describes Paraguay's reforms to its SOEs. First, it describes the contribution of SOEs to the nation's development and defines its classification system. Then, it presents a chronology of reforms from problem diagnosis to the creation of the National Council of SOEs, the system of oversight at the national level to manage the effectiveness of SOEs. The Law of the National Council of SOEs created this entity as a way to deal with government-run enterprise. Finally, this presentation examines how Paraguay is dealing with particular issues related to SOEs. In particular, it focuses on how the government deals with the financial risk and indebtedness of SOEs, the promotion of public transparency in SOEs, and methods to encourage business innovation and private sector participation in Paraguay's SOEs.

Contribution and Classifications of SOEs

SOEs contribute to Paraguay's development in several ways. They represent a total of US$2,221 million in income, which represents 8.3 percent of GDP. The sector grew in 2012 by US$150 million, or 9 percent. The cost of human resources for this sector in Paraguay is US$19,193 million, which is equivalent to 7 percent of total public sector employment. Taxes and transfers generated from the sector amount to 9 percent of total revenue collection for the central government. Investment plans for the next three years imply a possible growth as high as US$1,775 million. The profitability of the average net worth over the last three years is 6 percent; and the national budget for 2013 included US$3,625 million for SOEs, which is 25 percent of the National General Budget and 13 percent of GDP.

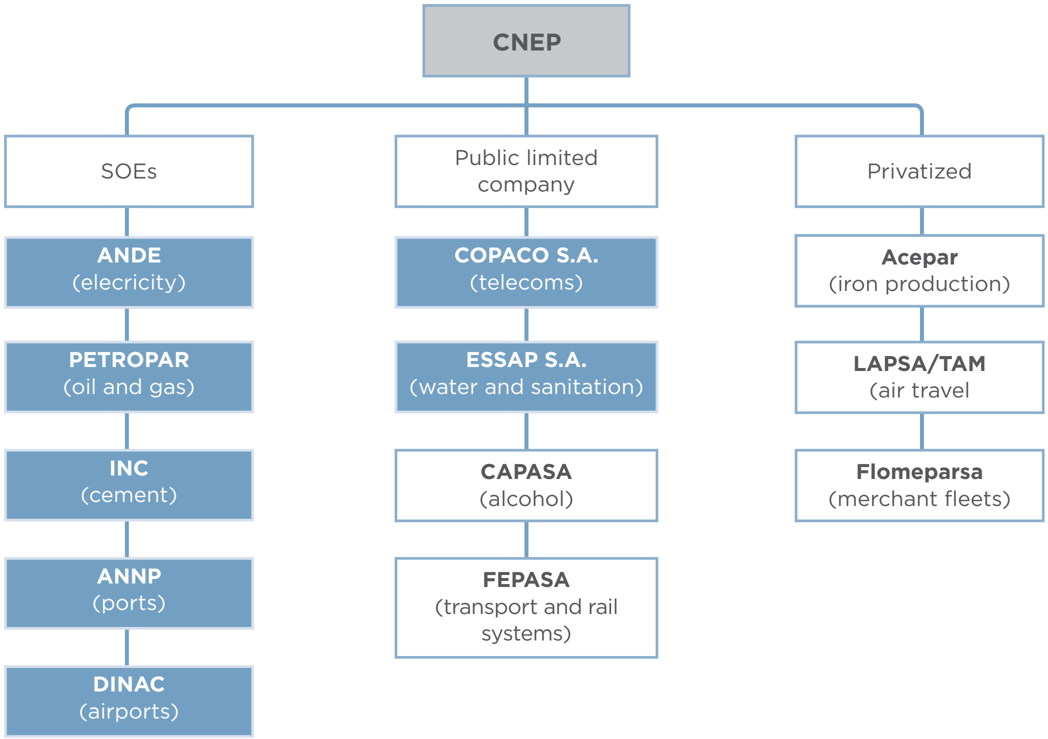
TABLE 1. SOEs in Paraguay (data from December 2012)

Total income	US$2.221 million, *8.3%* in GD
Net value	US$150 million, *9%* above 2011
Human resources	19.193 employees, *7%* of the Public Sector (13.669/2008)
Taxes + transfers	US$306 million, *9%* total revenues
Investment plan	US$1.775 million in approx. 3 years
National patrimony	*6%*, constant for the past 3 years
SOEs 2013 budget	US$3.625 million dollars, 25% of PGN, *13%* of PIB

Source: DGEP Database.

SOEs are classified in two groups: limited liability companies and national administrations. Limited liability companies are private enterprises that sell stocks but are still owned and managed by the State. The second type of enterprise is completely managed and run by the State. These include national industries working in the following sectors: electricity, the Administración Nacional de Electricidad (ANDE); oil, Petroleras Paraguay (PETROPAR); and cement, Industria Nacional del Cemento (INC). Also, the government of Paraguay manages economic activity surrounding marines and ports, Administración Nacional de Navegación y Puertos (ANNP), and civil aviation, Dirección Nacional de Aeronáutica Civil (DINAC). With a different legal status, privatized entities in the following industries could possibly return to the management of the State: steel production and management, Aceros del Paraguay (ACEPAR); air travel, Líneas Aéreas Paraguayas (LAPSA/TAM); merchant fleets, Flota Mercante Paraguay (FLOMEPARSA); and iron production, in which the most well known producer is ACEPARQUE.

FIGURE 1. The Boards' Composition for Major SOEs in Paraguay



Source: Authors' elaboration.

Chronology of Reforms

Reforms began in 1991 with the first issuance of a privatization law, which transferred total or partial control of public entities to the private sector. This included the production of goods and services by private owners of companies. In 1992, a council was created to administer and execute the privatization law. The second time the country tried to privatize began just 10 years later, in 2002, with the creation of the National Secretariat of Reform. Law 1615 was used to reorganize and transfer SOEs to private individuals, but it was later suspended by Law 1932.

In 2006, the Oversight Council for State Enterprises was created, emerging from the need for a public organization to oversee the management of SOEs. Shortly thereafter (in 2008), a Public Enterprise Council was created to manage, coordinate, and execute SOEs' modernization processes. In 2013, the Oversight Council was renamed the National Council of SOEs. It provides the necessary oversight and helps improve SOE programing and strategies. Currently, this council is working to create a legal framework for a body that will be in charge of establishing and coordinating an effective national policy of SOEs.

Diagnosis and Progress of the National Council of SOEs

Before Paraguay changed its laws to create the oversight process, the government conducted a diagnosis and study to evaluate its relations with SOEs. The study reported that SOEs tended to have weak management structures, resulting in low staff productivity and oversized administrative structures. Inadequate information about the operation of these public entities was prevalent. Furthermore, several of them had no effective business plan. Those that did showed low levels of investments, high operating costs, and low productivity; they frequently defaulted on public and private sector loans. Some enterprises had adequate governance structures with supervisory bodies representing experts within the public and private sector.

Since the creation of the National Council of SOEs, the government of Paraguay has attempted to overcome the major obstacles associated with low staff productivity, scarce information about production, and the overall governance structure for each of its SOEs. One major issue for many SOEs was the absence of a business plan. The Council helped foster business plans and develop strategic plans for five SOEs. These efforts have helped lower production costs and decrease the default rate on public and private sector loans for various enterprises. The national budget has established limits for loans, revoking five years of debt held by various SOEs.

The Oversight System

How does the National Council of SOEs work? The Council has a management board with representatives from the following government offices: the Office of the Treasury (acting as the president), the Ministry of Public Works and Communication, the Ministry of Industry and Commerce, and the Republic of Paraguay's Attorney General's Office.

A technical body called the General Directorate of SOEs (NGEP) manages the Council's activities. Through the creation of management contracts, the General Directorate ensures both quality and quantity in production of goods and services. These contracts require higher-level officials to comply with several official mandates. For example, the Council mandates reports from all SOEs. They must also develop strategic guidelines for their governance structures, which allow precautionary and corrective management actions by the Council and contribute to transparency of the SOEs themselves. Furthermore, each public enterprise is required to provide quarterly evaluation reports to the Republic of Paraguay, Office of the President. These management contracts are active for up to three years, and can be renewed. To date, seven out of nine enterprises have signed management contracts.

These SOEs are monitored through a control board, which has created quantitative and qualitative indicators to score each SOE's performance. For example, a score of 65 percent compliance is insufficient, from 65 to 75 percent is acceptable, and above that is satisfactory. Every three months, reports are presented to the National Council of SOEs. If the score is insufficient, the president of the public enterprise is required to present the report to the president, and the score is immediately published in the press, providing the required public scrutiny for an SOE's work.

The Law of the National Council of SOEs

The Law of the Council of Public Enterprise (the Consejo Nacional de Empresas Públicas, or CNEP) was issued on September 20, 2013. This law allowed for the creation of a legislative body in charge of coordinating the national public enterprise boards. The law's objectives were to promote an efficient and effective management system, provide transparency, and ensure that decisions are made under economic criteria.

The law gives certain responsibilities to the Council; for example, the Council must advise the enterprise's executive on policies and management. Also, the Council has the authority to recommend or assign removal of a public enterprise's directors, and the Council has the authority to review a public enterprise's plans to secure compliance with objectives. Along those lines, it may also review and analyze drafts of annual budgets and promote coordination among SOEs for greater effectiveness. Finally, the current law also allows the president to intervene in a public enterprise's affairs when necessary.

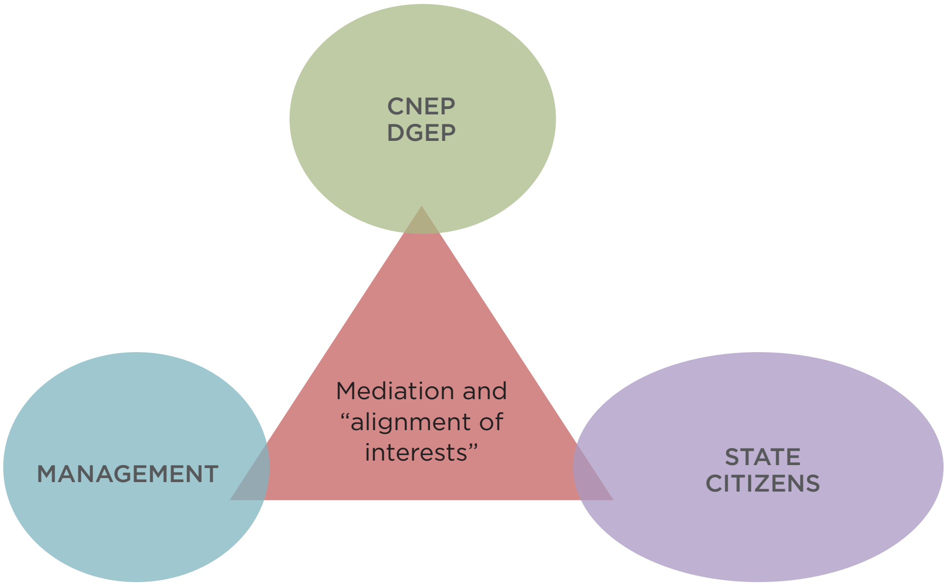
The Relationship between the Government and SOEs

During the privatization process, limited liability companies (LLCs) were created in order for the government to have less involvement in a company's decisions. The privatization process ended when the companies' stocks could not be fully transferred to the private sector. This decision was focused on the issue of debt management. Today, SOEs are 100 percent property of the State, with a Government Charter managed by the president and a specific budget for each according to the national general budget guidelines. In particular, these line items cover electricity, fuel, concrete, and port and aviation services.

The LLCs have the Paraguay State as the majority shareholder. Typically they were created to be governed by social statute and have a president and a directorate, but their budgets are determined in an autonomous way. Examples are telecommunications, water and sanitation, and railway services.

Based on a recently issued law, the work of the National Council of SOEs is expected to expand. For example, representatives of the State and citizenry groups will most likely assist with strategies to improve high-level management performance. The Council of SOEs has the duty of overseeing parliamentary legislative initiatives. Furthermore, investments in SOEs will be channeled through the National Council of SOEs for future investment opportunities. The enterprises give back to the State and the citizenry by providing dividends, growth, quality, and good prices. The State provides good management oversight to ensure satisfied clients.

FIGURE 2. State Relations within Paraguay SOEs



Source: Authors' elaboration.

Fiduciary Risk and SOE Debt Laws

What are the rules for SOEs to take out public loans? The contingent liability estimated in December 2012 is US$733 million. This level of investment will increase in the next three years to become US$1,775 million. Such a level of growth, therefore, justifies creating an investment fund from independent funding sources for SOEs.

Today, SOEs receive funds that are transferred from the central government and included in the 2014 federal budget. A new law aims to be enacted by 2015 in order to channel new investments and finance them through individual projects. The current law is under review by the national parliament and will need approval by the National Council of SOEs. The recently drafted law seeks to create an independent funding source for public investment projects.

Supervision and Transparency System

Since the introduction of reforms and consolidation of the oversight committee model, public enterprise management is based on transparency through several mechanisms. For example, external audits are made in accordance with CNEP standards. The law requires that each public enterprise publish its external audit results on its website and also on the Treasury Ministry's website. Each entity is required to perform quarterly evaluations that must also be linked to any information published in the press. At the same time, the General Directorate of SOEs has carried out an evaluation process with ISO 9001 Certification. All SOEs are required to annually consolidate, certify, or cancel all public debt, and to participate publicly in programming and budget modification.

Business Innovation and Participation of the Private Sector

Today, the Law of Public-Private Partnerships (PPPs) allows partial or full alliances to provide services. The State of Paraguay considers that the following SOEs can be made into PPPs: those involved in waterways; international airports; construction, rehabilitation, and maintenance of roads and highways; construction and maintenance of bridges; and provision of drinking water and sanitation services.

Also, the State can create PPPs to improve sewage through treatment and management; to transmit and distribute electrical energy; to produce goods and provide services; to produce and sell cement; to produce, refine, and commercialize hydrocarbons; and to provide telecommunication services.

Finally, the National Council of SOEs has improved the process by providing support and oversight of SOEs. It has further required corporative governance practices, mainly applying to governance and management systems. In this context, the Law of the National Council of SOEs has set as its main goals implementing improvements in efficiency and competitiveness, transparency, and the management and financing systems used to govern SOEs.

BEST PRACTICES IN REFORM: GOVERNANCE AND EXECUTION

Carla Báez, Director of the National Secretariat of Planning and Development, Ecuador

First, this presentation will describe the origins of SOEs in Ecuador and define the current administrative structure at the national and regional levels. Moreover, current challenges of the National Secretariat of Planning and Development of Ecuador (Secretaria Nacional de Planificación y Desarrollo, or SENPLADES) will also be presented.

Ecuador's SOEs come from a complex history of nationalization and negotiated privatization efforts during previous governments. For example, at the end of the 1970s, the public railway was created. Meanwhile, oil resources had been found in 1972, and a public enterprise was created to manage these strategic resources. Later, the first telecommunications enterprise was founded, and subsequently, the first hydroelectric dam was constructed in Paute, Ecuador.

The petroleum, electricity, and telecommunications industries have negotiated different management models over time. The petroleum industry is the only sector in which all previous governments have encouraged and increased private exploration. As a result, the State oil company was completely eliminated. The electricity market was delegated to have tariff fixation. As a result, each generator had different tariffs, resulting in decreased private investment in hydroelectric projects. In the telecommunications sector, two large State enterprises, Andinatel and PacificTel, formed what is now the National Corporation of Telecommunications. The company has created a solidarity fund to manage surplus earnings.

Ecuador's Public Enterprise Reforms

To understand the current situation of SOEs in Ecuador, it is important to evaluate the situation before and after 2007. Before that year, there were no general normative laws governing SOEs. Thus, no advantages of the economies of scale generally existed, nor was there a public view to reduce costs and improve efficiency. In general, a limited amount of foreign investment was attracted to these SOEs. Overall, an institutional disorder resulted from a lack of regulatory framework to manage Ecuador's SOEs.

Nevertheless, in 2009, the Law of SOEs was issued to provide an exclusive normative and legal framework. The law's intention was to create greater programmatic roles, improve cost optimization, and strengthen the business conduct of SOEs. This action emphasized public enterprise over private sector producers. The law allowed public enterprise to have greater flexibility and management over Ecuador's strategic investments. Also, the legal reforms allowed the participation and promotion of new SOEs as well as allowing them to be associated with other enterprises.

Ecuador's Definition of Legal Framework

First of all, the Constitution establishes that the State can allow SOEs to manage strategic sectors for the provision of public services. Objectives are to manage the sustainable exploitation of natural resources and public goods through the development of business activities, and most importantly, to increase participation in national strategic planning.

Through the National Plan of Good Living, SOEs now have their programmatic goals published and evaluated. Through the National Council of Planning and Development, the National Secretariat approved the current plan from 2013 to 2017. This is a mandatory instrument for that the public must follow.

The president, as part of the national budget, creates the National Plan of Good Living, and also assigns goals relating to policy priorities for the national bureaucracy to follow. Each of these priorities is implemented and later evaluated, using management-for-results criteria.

The Organic Law of Public Companies is the specific legal framework that governs SOEs. This set of rules regulates public companies in all their aspects, including incorporation, internal decision-making processes, mergers, and other related topics. The law determines the structure of the boards of directors in public companies as well as the appointment of the senior officers, the extent of their responsibilities, and the management of human talent. It also proposes associative mechanisms for expansion and strategic alliances and, in general, all the arrangements regarding the decision making, merging and liquidation of SOEs.

The directorate includes mandatory representatives who are assigned by the Ministry of the National Secretariat of Planning and Development or by the president. The programmatic role of the Directorate is very important, given that it allows for the efficient operation of SOEs. This role includes approving strategic plans, establishing business goals, and, in general, managing all programmatic activity of the enterprise.

On the other side of the Directorate is the General Manager who acts as Directorate Secretary. He or she represents an enterprise at the technical and economic levels, and makes most business decisions, taking into account both business plans and plans to expand investment. The General Manager executes the business strategies and administers the public enterprise's budget. The Organic Law of SOEs frames position descriptions for everyone within the Directorate, including the General Manager, for all SOEs.

The Contribution of SOEs to Local and Regional Development

There are 28 SOEs in Ecuador. On one level, they have an ability to improve the local market by developing strategic industries, by regulating markets, by encouraging social responsibility and by leading a productive conversion toward an educated society. These entities are divided into various sectors, such as telecommunications, electricity, oil companies, mining, security, social services, and the generation of productivity and transfer of knowledge and technology.

SOEs at the national level contribute to regional wellbeing through the National Plan of Development of 2013–2017. By generating strategic projects at the national level, these enterprises are driving local demand and providing goods and services, while creating employment. A clear example of this is the Hydroelectric Coca Codo Sinclair, which is a national priority project for Ecuador; it will generate 1,500 megawatts of power.

Another example is a railways enterprise, Ferrocarriles del Ecuador. It is part of the country's effort to drive productive chains of development, and it helps transform the country's productive matrix. This enterprise seeks to develop specific public-private strategic alliances through the popular and solidarity economy system. This economic system requires specific quality criteria in order to achieve success. Through strategic alliances with private sector companies, such SOEs are admired in Ecuador's popular and solidarity economy.

Ferrocarriles del Ecuador is one of the enterprises with operational indicators. Performance of a public enterprise is based on three factors: how advanced its board is, how many beneficiaries it has helped, and the number of operators and public employees it has. Today, SOEs even have an ISO certification, which was unthinkable before. SOEs can contribute at the regional level through:

- incorporating value-added goods aimed at creating technology for Mercosur;
- ensuring technology transfer;
- integrating productive processes;
- creating new capacities and improving existing ones; and
- promoting cooperation, in general, instead of competition.

Examples of these regional actors include Yachay and Tame Airlines. Yachay, an oil enterprise, clearly illustrates how Ecuador is linking with international markets by drilling wells and exporting petroleum. Yachay was built in the Urcuquí camp, a city that is approximately an hour away from Quito. Located near a city planned for investment and technology innovation, it is expected to transfer knowledge through education scholarships and other projects. Yachay has what it needs to promote knowledge, and, in general, to accomplish all of the goals established by the National Plan of Good Living.

Tame Airlines is exploring new markets that are not necessarily the most profitable. However, this strategy has helped it to establish price regulations on newly added routes such as Buenos Aires and São Paulo, which the company began operating last year.

Main Challenges

The strengthening of SOEs requires a matrix that consolidates government policies and leads to social and economic profitability. These enterprises must also drive productive chains of development, locally and regionally.

SESSION II:
GOVERNANCE OF SOES: STRUCTURE AND OVERSIGHT

This session examines current systems of Korea and the LAC countries relating to oversight of their SOEs. It addresses the governance structures of SOEs in Korea and some LAC countries and discusses strong and weak points of both centralized and decentralized governance systems.

Guiding Questions:

- How is the governance structure for oversight of SOEs organized?
- What are advantages and disadvantages of the present governance structure?
- What kinds of efforts are being made to improve the governance structure?
- How is the transparency and accountability of SOEs secured? What kinds of efforts are being made to improve these features?

A CASE STUDY OF PUBLIC SECTOR GOVERNANCE REFORM IN KOREA

Ho Dong Lee, Director of Policy Coordination Division, MOSF, Korea

The Korean experience demonstrates an evolution of reforms to create an effective management system of public institutions. While governance reform in Korea began in 1962, state-owned enterprises (SOEs) were privatized in the 1990s; today, we have a new governance structure to manage these enterprises, and we continue to make adjustments and improvements. This section summarizes the history of improving the performance of Korea's public institutions. In particular, oversight systems seek to make public management autonomous and responsible, while improving governance structure for internal and external auditing controls. This presentation reviews Korea's background of public sector governance reforms, describes the current public sector governance regime, and assesses what the reforms accomplished, with a discussion of future improvements.

History and Performance of Public Institution Governance Structure

Stage One: Government Reforms (August 1962–February 1984)

Since the 1960s, government policies have been based on the economic development plan, which promoted industrial expansion and encouraged new roles for public institutions. Many SOEs were established, and the need for a consistent management system became evident. From August 1962 to February 1984, public institutions were managed under the Government-invested Institution Budget and Accounts Act of 1962 and the Government-invested Institution Management Act of 1973. The legal concept of government-invested institutions was first conceived in the act of 1962, which served to regulate budgets and accounts of public institutions. This arrangement allowed for the agile management of national finances through SOEs. There were 21 institutions, which had more than 50 percent of their capital financed by the government; they were treated as properties returned by the State (under Article 2) and were systematically managed by the government through Bank of Korea financing.

The 1962 act served as a starting point for government oversight of SOEs. It allowed competent ministers to unify and control budget functions with a system designed to be self-supporting, flexible to implement, and transparent. However, the auditing functions prompted an overlap of responsibilities for the line minister and the Economic Planning Board. The act mandated a standard of budget planning by creating general fiduciary rules that standardized income and financial statements. In effect, this process led to the efficient implementation of business practices because SOE heads could redirect funds to different financial statements; however, approvals set by general rules required the line minister to authorize funds and expenses, which limited SOE heads' role.

The 1973 act established management standards to nurture SOEs and their investments. It outlined how to effectively supervise the budget, accounting, and auditing systems, including the legal criteria of audits, public inspections, and annual reviews. This act defined rules of association, the creation of committees, and their operational guidelines. Board members' qualifications, tenure, and appointment processes were also outlined in this act, which laid out the broad legal foundation for large-scale organizations in Korea.

Despite the act of 1973, bilateral conflicts occurred because the role of the line minister was not clear. Under the governance structure, a line ministry's authority was stronger than that of a board of directors. In general, boards deliberated crucial issues and made decisions in accordance with government regulations, but it was the line ministry that controlled overall budgets and operations. The ministers reserved the right to oversee all operational components; for example, they could request status reports and facilities documentation and monitor tasks. In addition, the line minister approved all projects, implementation plans, fund raising efforts, fee decisions, and profit margin targets. However, the MoF and other institutions had to be involved in approvals, so the system of supervision and auditing did not operate well.

Stage Two: Privatization (March 1984–January 1999)

Korea's corporate governance structure was completely revised during Stage Two of reforms, which were enacted from March 1984 to January 1999. The Government-invested Institution Management Act of March 1984 enhanced the autonomy and efficiency of SOEs because they largely affected the national economy. At the same time, the government needed to respond to privatization efforts and unsustainable budget deficits. The reforms encouraged decision making, not only by the line ministry but also by the Economic Planning

Board, the Minister of Finance, and the Board of Audit and Inspection. Management reforms included budget oversight and reorganization authority. The act of 1984 alleviated the overlapping responsibilities between the line ministry and the central government and encouraged autonomous and expert evaluation systems of control.

Privatization and management innovation were first proposed in 1993 and later enacted by the 1997 Act on the Improvement of Managerial Structure and Privatization of SOEs, following an attempt of outright and partial sale of all public institutions by the National Council on Privatization in 1987. The act of 1997 targeted businesses that had more than 50 percent of capital financed by the government. Yet, if a business's autonomy had to be guaranteed or its competitiveness and flexible response to swiftly changing environments was required, that business was exempt from this ruling. Thus, the Korean Broadcasting System and financial institutions listed in the Banking Act were exempt from these laws of 1987 and 1997, respectively. With privatization, the number of SOEs fell from 25 in 1984 to 13 in 1999 and was at 14 in 2007, when this law was abolished.

The act of 1997 expanded an SOE's budget autonomy. Before implementing this act, a six-month gap often occurred between budget approval and execution of budget items, causing aggressive management tampering by the line minister. Consequently, the act ensured that boards of directors decided budget planning and execution according to management targets. A management evaluation committee composed of the board of directors, institutional heads, and executives also set internal management criteria. The board of directors and the management team were separate from one another. While the government appointed the head of an institution, that head appointed a vice-president and a staff to address matters related to appointing external personnel and expanding the autonomy and responsibility of the chief executive officer (CEO).

The chairman of the board and corporate director were appointed by the CEO and by the line minister, respectively. External experts could be appointed as non-standing directors, but the board was composed of public officers from government. In order to prevent redundancy and inconsistency, only the Board of Audit and Inspection could lead any external audits. The ex-ante monitoring system was eliminated and an ex-post management evaluation system was introduced. Despite these changes, overlaps and crashes between systems occurred because the line ministry still had the comprehensive supervisory authority.

Stage Three: Corporate Governance Structure (February 1999–March 2007)

Stage Three reforms occurred from February 1999, when the corporate governance structure was completely revised based on the Framework Act of 1997, and March 2007 with the execution of the "Act on the Management of Public Institutions." These changes consisted of abolishing official government board members; appointing standing directors; creating a management contract system; establishing an executive recommendation committee; and introducing a management information disclosure system. The Act of 1997 was revised to end government control, which largely hampered SOE autonomy. At that time, the government controlled SOEs through excessive intervention, using its regulatory powers. For example, the line ministry and the Economic Planning Board determined workforce size. The Board of Audit and Inspection lacked independent authority, and in effect was managed by the SOE's board of directors.

Responsibilities of the board of directors and methods of appointing auditors were largely changed. Previously, a board of directors had had supreme decision-making authority and was in charge of deliberation and resolution of annual budgets, balancing accounts, planning regulations, and composing job descriptions. The board also had the authority to appoint or dismiss department heads, and could evaluate management contracts and performance evaluations because only non-standing directors attended board of director meetings. For the autonomy of auditing, the president had the authority to appoint auditors after a resolution by the SOE steering committee and a recommendation by the line minister. Under Article 5, the new Act emphasized fair and transparent operation of the board of directors, including external audits conducted according to results of management performance evaluations aimed at enhancing transparency.

Stage Four: Management of Public Institutions (April 2007–Present)

Stage Four of Korea's reforms began with the Management of Public Institutions Act in April 2007; this act helped categorize SOEs into (1) government-invested institutions, (2) government-financed institutions, (3) government-affiliated institutions, and (4) government-contributed institutions. Reforms for internal and external evaluation criteria addressed government's excessive intervention in internal management, which had obscured reckless management in the past. Because the board of directors and audits did not operate effectively, the Act of 2007 sought to regulate the ranges and types of public institutions, improvements in internal and external governance, and fair practices for appointment and dismissal of executives.

Characteristics of the Current Public Sector Governance Regime

Categories of organizations created by the Act of 2007 (Article 3) are still in effect today. Institutions divided into SOEs include those having more than 50 staff members; those with self-generated revenue that accounts for more than 50 percent of gross income; and quasi-governmental institutions that generate less than 50 percent of their own income. SOEs are divided into market-based entities (with self-generated revenue over 85 percent and an asset of more than US$2 trillion won) and quasi-market-based SOEs. Quasi-governmental institutions are further divided into fund-management-based and commission-based institutions. In 2010, there were nearly one hundred SOEs and quasi-governmental institutions combined. As of June 2014, there were 30 public institutions and 87 quasi-governmental institutions.

The head of an institution has the power to reorganize, appoint personnel, and manage budget systems. Also, a steering committee for a public institution operates ex-post evaluations and provides guidelines on budgets, workforce size, remuneration, and financial management. Especially, as is the case with market-based SOEs, the steering committee's function is limited by size of workforce, remuneration, and financial management; and its autonomy in managing its guarantee.

TABLE 2. Institution Types and Criteria

INSTITUTION TYPE	CRITERIA
1) SOEs • Market type • Quasi-market-based	**Self-generated revenue ratio ≥ 50%, or number of employees ≥ 50** • Self-generated revenue ratio ≥ 85%, total assets ≥ KRW 2tn • Self-generating revenue ratio ≥ 50%, or number of employees ≥ 50
2) Quasi-governmental institution • Fund management-based • Commissioned service-based	**Public institutions other than SOEs, number of employees ≥ 50** • Entities managing government funds • Quasi-governmental institutions other than fund management-based ones
3) Other public institutions	**Public institutions other than SOEs and quasi-governmental institutions**

Source: Authors' elaboration.

The institutional strategy for making fair and transparent appointments was strengthened in 2007. The head of an SOE appoints standing directors and steering committee members, who are in charge of appointing and dismissing non-standing directors and requesting audits. As for quasi-governmental institutions, the institution's head oversees these functions. Steering committee members are also in charge of requesting audits. The Executive Recommendation Committee, composed of non-standing directors and outside directors, recommends the SOE executive candidates, but candidates selected to head quasi-governmental institutions are on management contracts. However, the "Management of Public Institutions Act" was revised in December 2009 to reduce the proportion of non-standing directors and, to make composing a board of directors more flexible, to skip the recommendation process by the relevant committee for quasi-governmental institutions that had not applied for the presidential decree.

The authority to appoint standing directors of quasi-governmental institutions was transferred to the line minister, based on a reorganization plan approved in December 2008. However, an amendment to the Act in December 2009 allowed an SOE head to appoint the standing directors, showing the expansion of institutional autonomy. A management evaluation was implemented, including changes that permitted the elimination of consecutive appointments and dismissal of executives. The steering committee also gained the authority to assess non-standing directors and auditors, resulting in dismissal or incentives.

In April 2012, the government mandated public institutions that had more than 2 trillion won (about US$1.9 billion) of assets to submit a medium- and long-term financial plan to the National Assembly. These plans ensured the financial soundness of Korea's SOEs, while monitoring relevant issues. Included are management targets, investment plans, and debt information for five years; the plans are submitted and approved by the line ministry and the MoSF before they are passed to the National Assembly. The government expected that these efforts would help SOEs monitor financial soundness and carry out planned reform on their own.

Internal and external audits were strengthened in the following ways: first, a board of directors was allowed to dismiss institutional heads, and non-standing directors were given the power to request audits and the necessary annexed papers to prevent abuse of power. The changes made in the Management of Public Institutions Act in December 2009 were also applied to quasi-market-oriented SOEs. Second, the internal monitoring system was improved by making audit committee documents compulsory and opening information to the public. Third, audits receiving a low rating generated lower bonuses for the personnel responsible. In the case of substandard audits, the relevant institutions and any third parties involved must pay damages.

Future Improvements and a Way Forward

As of June 2014, 303 institutions were designated as public institutions: 30 SOEs, 87 quasi-governmental institutions, and 186 non-classified institutions, with the classification based on size of workforce and amount of self-generated revenue. The problem is that many institutions are designated as non-classified, a title that exempted them from management evaluation because of vague standards. Therefore, for efficient management, specific classification standards should be set based on proportion of self-generated revenue, total income and assets, and differentiated approaches applied to non-classified institutions. To enhance the professionalism of the selection, executive candidates need to submit qualifications through an objective election process, and the majority of committee members should come from external candidates.

GOVERNANCE CHALLENGES OF STATE-OWNED ENTERPRISES IN LATIN AMERICA AND THE CARIBBEAN

Jorge Kaufmann, Modernization of the State Specialist, IDB

This presentation is dedicated to a discussion of cooperative governance in Latin America's SOEs. It contains three main points regarding SOEs in the region. First, despite the privatization wave of the 1980s and 1990s, SOEs in Latin America and the Caribbean remain very important, existing in key sectors of local economies. They promote economic development by providing society with public goods such as water, sanitation, and electricity; they also work in strategic sectors such as oil, mining, finance, telecommunications, sea transport, and airports.

Second, although we do not know exactly the dimension of these sectors in their economies, SOEs are important to the fiscal equilibrium of a country's macroeconomic policy. Complex methodologies are used to understand the exact value of these enterprises, a value that can be relevant in measuring quantities of production and impacts on local economies, estimated to be about 10 to 15 percent of GDP.

Finally, several countries in the region are currently engaged in reforming the corporate governance structures of SOEs. They are particularly interested in sharing experiences to strengthen the governance structures of these firms in the medium term.

The Evolution of SOEs in Latin America

Over the past century, SOEs in the region have evolved in three distinctive stages: (1) their creation, which drove economic development from the 1930s to the 1980s; (2) the privatization of various sectors during

1980–2000; and (3) the incorporation of these public entities since 2000. This sequence is not so different from Korea's experience in the past four or five decades, in which SOE participation not only provided improved public services to citizens, but it also helped promote industrialization in strategic sectors.

During the last decade, citizen concern about privatizing SOEs has transformed into desire for corporate governance of these entities in order to manage them for results. Because SOE debt in several LAC countries led to steep national fiscal deficits, and because many SOEs provided poor quality services, privatization was suggested to amend the situation. Yet, in the past 10 to 15 years, several countries have been seeking to improve SOE management by installing corporate governance and other reforms.

In a global context, each country has defined sizes and roles of its SOEs, including their duty to contribute to economic growth for the State. There is certain consensus that, at least for the medium term, SOEs will not return to the privatization stage. Today, many governments in the region plan to spend time developing their SOEs, with improved effectiveness and efficiency.

The Composition of Public Enterprise in Latin America

At the national level, there are nearly 500 total SOEs in the region (breakdown shown in Table 3). These do not include the SOEs at the state and provincial levels, nor at the municipal levels. If they were included, this number could reach 1500 to 2000 SOEs, depending on each country—especially large countries like Brazil, Argentina, Venezuela, and Mexico—where SOEs at the subnational level have great relevance.

TABLE 3. Total Number of SOEs in Select Latin American Countries

COUNTRY	NUMBER
Argentina	112
Brazil	147
Chile	30
Colombia	35
Costa Rica	15
Ecuador	28
Mexico	68
Panama	12
Paraguay	8
Peru	35
Uruguay	4
Total of EP	**494**

Source: Authors' elaboration.

SOEs are significant to national development. While economists may analyze SOEs in terms of fiscal accounts and macroeconomic conditions, business owners are concerned with management issues related to transparency. SOEs are clearly a government vehicle to create economic value and provide public goods to citizens. Therefore, citizens should care about SOEs in terms of management, corporate governance, and concepts of standards such as quality, transparency, and accountability. For many countries, on average, 10 to 15 percent of GDP originates with SOEs. But this number can fluctuate from less than 5 percent to as high as 30 percent of GDP (Table 4).

State-owned enterprises are a significant factor for development. While economists may analyze public companies in terms of fiscal accounts and macroeconomic conditions, business owners are more concerned with administrative issues that relate to transparency. For society at large, however, public companies must be evaluated as a whole.

TABLE 4. SOEs by Sector in Select Latin American Countries

	Brazil	Chile	Colombia	Costa Rica	Ecuador	Panama	Paraguay	Peru	Uruguay
Energy and Electricity	19	---	7	2	6	7	1	15	1
Water and Sanitation	---	2	---	1	---	---	1	1	1
Oil and Mining	63	4	1	1	5	1	1	2	1
Telecom	---	---	---	2	2	1	1	---	1
Finances	19	---	7	---	---	---	---	4	---
Transports	3	2	3	1	2	---	3	---	---
Infrastructure in transport	9	10	---	2	1	3	---	5	---
Radio & television	---	1	4	---	1	---	---	---	---
Manufacturing	4	---	---	---	1	---	---	---	---
Services	16	6	7	2	2	---	---	---	---
Research	4	---	---	---	---	---	---	---	---
Other sectors	10	11	1	4	9	---	1	4	---

Source: Authors' elaboration.

State-owned enterprises work in a wide spectrum of activities and are effectively managed in a sustainable way with a long-term vision of profits and the benefits provided to citizens. SOEs generally do not go bankrupt; instead they must have a long-term mandate to be managed effectively, efficiently, and with transparency. Other roles potentially assigned to SOEs include the following:

- To manage transfers from the national treasury sustainably and not harm fiscal accounts at the national level
- To implement public policies in a socially responsible way, by taking a clear role in supporting medium and small enterprises and microbusinesses
- To support the economy through productive processes that strengthen the country's competitiveness

Overall, SOEs must be globalized and competitive and have good administrative and governance structures to accomplish these very important goals.

Public Enterprise Reforms

Three major movements, which have been introduced through three different channels, aim to reform corporate governance issues in SOEs within the region: including private shareholders, centralizing authority, and reforming corporate governance structures.

As an example of the first movement, Colombia and Brazil have incorporated private shareholders into public companies. This action has improved the companies' administration and overall financial results. These governments have listed their SOEs on the stock market in order to make basic private business standards public. This process, independent of any private property given to private shareholders, has improved financial accounting and made the SOEs more transparent in order to generate new business.

With respect to the second movement, a centralization of public authorities model has been tried in Brazil, Chile, and Peru to improve national supervision of the companies. This centralization of authority has improved the government's business operation alignments and made the businesses more transparent. For example, Peru's National Fund for Financing the State Enterprises Activity (FONAFE), Chile's Public Enterprise System (SEP), and Brazil's Department of Coordination and Governance of State Enterprises (DEST) all have centralized public oversight of companies.

Finally, the third type of movement aims to reform directories and internal governance structures in Chile, Colombia, and Argentina. This process has increased the autonomy of SOEs for improved decision-making authority. For example, Chile's largest public company, CODELCO, undertook major reforms to strengthen performance, in particular regarding board composition and responsibilities; Colombia has reformed some provincial SOEs such as SOEs in Medellín (EPM is its Spanish acronym); and in Argentina, some provincial public health services enterprises have been reformed.

Challenges to these Reforms

Corporate governance reforms have created three major challenges in the management of SOEs.

- *How can an SOE's operations be clearly separated from the State's?* Incorporating ministers to the boards of public companies can often create confusion regarding the roles of public policy makers and the role of the State.
- *How can monitoring and evaluation performance be boosted?* Monitoring should outpace targets and results; that is, to improve a public company's results by strengthening management, oversight must aim at first improving services, coverage, and final products.

- *How can professional management of SOEs be improved?* For example, can a fair and professional executive director be appointed to manage a corporation without political interference and to make the job as professional as possible?

Case Examples

Fortunately, there are several successful experiences from Latin America to learn from. Efforts made in Argentina, Brazil, Chile, Colombia, and Peru have improved their SOEs' governance structures over the past 20 to 30 years.

With regard to improving effectiveness, organization, and oversight, two distinguished cases serve as examples. Finland created a special department to direct enterprises, which assures the transfer of property rights of an SOE. New Zealand was able to transfer responsibility to a single entity that would be managed by the Ministry of the Treasury.

Examples of professional performance monitoring and oversight are New Zealand and the United Kingdom; New Zealand has required self-evaluation of the members of its Directorate, while the UK requires monthly performance reports to be made public. Also, the German government manages a large registry of all public tenures in order to annually report their progress. In Korea monitoring of information is in real time, and it concerns financial goals as much as nonfinancial ones.

Regarding the degree of professionalism of board members and management, the Korean case is exemplary. In addition, in the UK and Australia, board members are chosen through specific guidelines in a transparent process. Sweden has rules that reinforce the independent role of the directorate and require information about operations.

Many more examples demonstrate the professionalization of SOE boards in the past few years (e.g., Poland and Hungary), but there are too many to list here. If a particular LAC country would like information, analysis, or research on how to improve some aspects or specific weaknesses in these areas, there are several cases that the IDB can point out.

Survey Results

A survey was distributed to seminar participants regarding three principal challenges that exist to improve SOEs: (1) efficiency of oversight, (2) monitoring and evaluation, and (3) the professionalization of SOEs. The survey asked participants to rate reform efforts on a 1 to 5 scale, where 1 suggests an accomplished task and 5 is a task that needs work. The results presented in Table 5 were from observations of eight governments: Brazil, Chile, Costa Rica, Ecuador, Jamaica, Paraguay, Peru, and Uruguay.

For each of the three challenges the group responded with an average of 2.5, just the midpoint for each task; therefore, much work remains. The ranges were larger between countries, between 0 and 4. Some countries reported considerable work accomplished, while others said they needed to improve their government's reforms.

TABLE 5. Survey Results of Public Enterprise Reforms in LAC

CHALLENGE IDENTIFIED	AVERAGE SCORE	Mín.-Max.	Mode
Oversight effectiveness	2.5	1 - 4	2 y 3
Performance monitoring and evaluation	2.5	0 - 4	2
Professionalization of SOE management	2.5	1 - 4	3

Source: Authors' elaboration.

The results of the survey indicate that there are pending issues for the region. First, many countries use a dual oversight model, meaning participation of the Ministry of the Treasury or Economy and the Sectorial Ministry within the SOEs. Second, almost all countries have a monitoring system, but these systems tend to be created by certain practices that the ministries of finance or treasury already use to monitor other public sector programs; they are often unplanned in their design. Therefore, specific performance evaluations are needed to measure the progress of a region's SOEs. Third, almost all countries reported that they have official procedures to select an SOE's board of directors, but not one reported the need for an independent board. Finally, with regard to SOEs and governance, the Bank works primarily in these areas: strengthening a company's institutional capacity and regulations or the governance framework within a particular sector (e.g., water, electricity, and telecommunications). Some countries have indicated initiatives within the themes of accountability, transparency, and risk identification, particularly regarding public companies. Third, the bank has worked in all three areas of these challenges: separation of the policymaker from the role of the State, monitoring and evaluation of performance, and professional management of the public company.

GOVERNANCE OF SOEs: STRUCTURE AND INSPECTION MECHANISM IN COSTA RICA

Mayra Calvo, Executive Director of the Budget Unit, Ministry of Economy and Finances, Costa Rica

Three ministries form the Budget Authority in Costa Rica: the Treasury Ministry, the Ministry of National Planning and Economical Policy (Mideplan), and one other ministry, which is designated every presidential period. The Budget Authority determines budget guidelines and compliance with respect to wages, jobs, and debt for approximately 100 public institutions, which includes the country's SOEs.

Four major SOEs were established more than 50 years ago with the foundation of the Second Republic. They form a major part of the Costa Rican society not only as businesses, but also as symbolic institutions created to promote economic and social development in the country. These businesses include the National Costa Rican Electricity Institute (Instituto Costarricense de Electricidad, or ICE); the National Insurance Institute (Instituto Nacional de Seguros, or INS); the National Refineries (Refinadora Costarricense de Petróleo, or RECOPE); and the National Aqueduct and Water Institute (Instituto Costarricense de Acueductos y Alcantarillados, or ICAA).

TABLE 6. Costa Rica's SOEs 2013 Budget (in millions of colones)

Sector	Industry	2013 Budget
Electricity	National Costa Rican Electricity Institute (ICE)	$1.842.819
Insurance	National Insurance Institute (INS)	$865.323.7
Oil	National Refineries (Recope)	$1.759.040
Water	National Aqueduct and Water Institute (ICAA)	$163.055

Source: Contraloría General de la República.

The ICE, created in 1949 to manage the provision of electricity in the country, has its own regulatory and legal framework; it also receives income from public services, established through tariffs. The institution was a monopoly until 2008. In 2000, the company tried to privatize, but there was a civic revolution that paralyzed society with a week of rioting in the streets. The parliament intervened and called off the privatization. The ICE continued to be a monopoly for energy and telecommunications. Until the national debates to join a free trade agreement with the United States, the country decided to dismantle some of its SOEs and institutions, breaking the monopolies.

Since 2008, ICE changes have included creating a public governance structure, as well as modifying the budget control held by the government. Now the board of directors has six members: four from the private sector with specific knowledge of telecommunications and two within the government. Of the latter, one is assigned by Costa Rica's president and must have knowledge about telecommunications and be an expert on the economy and law, among other qualifications. All four of Costa Rica's SOEs are structured the same way, and the president of each company must have knowledge of that sector to be legitimately appointed to the post.

In terms of auditing, the Executive Power must require annual reports from the Governing Council, but two years ago, the government of Costa Rica changed this requirement to every six months. Management must now report biannually and the report must include the following components: (1) environmental impacts, (2) financial reports, and (3) compliance with the National Development Plan.

This report is presented to the Governing Council and sent to the Treasury Minister for review. The minister provides a financial analysis, along with recommendations for one consolidated report for the other ministers to review. The minister then consolidates all suggestions before recommending the report to the Governing Council. The ICE must then follow the report's instructions, for example, to improve its operations.

Finally, Costa Rica's Comptroller General approves the ICE's budget. Costa Rica has a multitude of public budgets, depending on the number of institutions. The national budget includes only the ministries and the executive branches, and the Comptroller General must approve budgets of other autonomous or decentralized institutions.

The ICE is also managed through a regulatory authority of SOEs, which sets fixed tariffs and oversees the quality of the company's services. This authority, for example, established a fiscal rule that states that the ICE can negotiate debts and contract autonomously, but with no more than 45 percent of its assets. If the company wants to increase its debt capacity, it has to go to the Governing Council to make an official request.

Another important institution that has been working for more than 30 years is the National Insurance Institute (INS). Created as an autonomous institution, its job is to administer the insurance monopoly. Before 2008, it was subject to other regulatory guidelines regarding budget ceilings, the general institutional structure, and personnel management.

From 2008, in the context of the Free Trade Agreement discussions, Costa Rica opened segments of the insurance market, which had previously been open to the public sector only for insurance purchases. As the only insurer for the public sector, the INS bought all of the insurance for the institute. In 2008, the INS changed its rules in order to issue consolidating figures, measuring risks of the insurance industry by creating the Insurance Oversight Board (Superintendencia de Seguros) to follow the enterprises and their economic activity in the country. The board has a budget approved by the Comptroller General, as it is an autonomous institution with the same executive structure as the ICE.

The INS is the only public enterprise that could be returned as part of the government. Some 25 percent of its ownership will belong to the government. The law did not foresee the large investments needed to maintain this sector. Yet, because of the high public debt, the public utility companies may return to governed ownership.

Because the INS can become indebted, it may sell corporate bonds to Central America. Other types of financial activities do not have the State guarantee for covering any resulting debt. This rule, which other autonomous institutions like ICE had previously upheld as a way to finance current expenditures with capital investments, was omitted from previous versions of the legislation.

The remaining two SOEs in Costa Rica are the National Refineries (RECOPE) and the Instituto de Acueductos y Alcantarillados (ICAA), which manages the country's water supply. RECOPE is a state monopoly, in charge of all aspects related to fuels (i.e., importing, refining, and distributing); and ICAA manages water and sewage. It was also founded more than 50 years ago and continues to operate under the control of the government.

In terms of supervision, RECOPE is an autonomous institution, subject to the general guidelines of the ICAA, although it is treated differently than a private company. On one hand, the Comptroller General of the Republic must approve its budget, while the Regulatory Authority for Public Services regulates rates and fuel prices; other issues go to the Assembly Legislature for approval. On the other hand, usually only 8 percent of the refinery budget is subject to review—most of the budget is excluded because it is used for raw materials, transportation, and shipping, among similar uses. The refinery business also has a different legal framework with respect to compliance. For example, the regulatory authority must resolve issues within eight days.

Like the refinery, the Institute of Aqueducts and Sewers (ICAA) is subject to auditing by the Comptroller General. In this case, the regulatory authority manages its rates and ensures the quality of the water supply, including drinking water and other products. The ICAA also has a fiscal rule. Since its services are provided at production cost, the company does not make profits and therefore cannot transfer any earnings to the public sector. For this reason, the law requires the State to endorse public loans when an SOE borrows from the capital markets.

These are the four major public industries in Costa Rica. Other much smaller entities might be called public companies because they provide public services in some way, but they are not considered as such in the Constitution. Among these entities, for example, we have the Instituto Costarricense de Ferrocarriles. The railroad was privatized in 1995 after a political discussion. However, in the last two administrations, the State has invested resources to rehabilitate railways by buying some cars and making the industry self-sustaining. However, 98 percent of operating costs are still covered by government transfers.

Another example of a nonpublic entity is the Social Protection Board. It has a monopoly on gambling and lotteries, and it provides instant citizens awards, among other things. Its legal framework allows 8 percent for administrative costs; for other resources the law provides a margin to sign agreements and to distribute benefits. This agency distributes benefits to nursing homes, with costs ranging from operational items to medical assistance payments, such as an ambulance, a mammogram, or a scanner.

In conclusion, except for the four listed here, public companies in Costa Rica have had little development with regard to autonomy and creating their own guidelines, and they lack monitoring and evaluation of management.

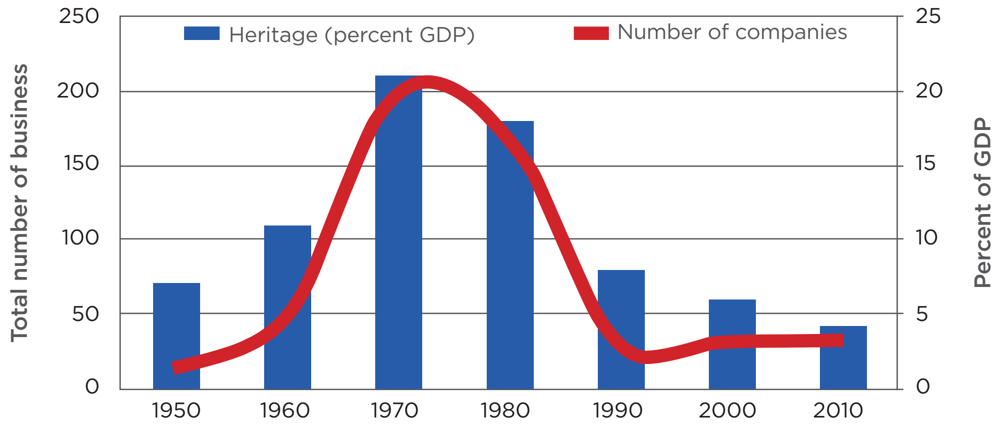
STATE-OWNED ENTERPRISES: THE CASE OF FONAFE

Titto Almora, Director, National Fund for Financing the Enterprise Activity of the State, Peru

This section provides the history, context, and current reforms of Peru's SOEs. Beginning in the 1970s, Peru had more than 270 enterprises dedicated to managing the various economic sectors such as hydrocarbons, electricity, and telecommunications. At that time, SOEs comprised nearly 20 percent of GDP and included 60 percent of the national financing system. But shortly thereafter, as in several other places in Latin America, Peru moved from one extreme to the other. The country encouraged privatization of these companies, especially during the 1990s.

Today, Peru has 35 SOEs, which represent 5 percent of national GDP. These legal entities are limited liability companies. The State can only respond to the liabilities up to the amount of the net equity invested. These enterprises are concentrated in public services such as generation and distribution of electricity, water (including water services in Lima), financial services (basically of second floor), and infrastructure.

FIGURE 3: Peruvian SOEs from 1950 to 2010 by Total Number and Share of GDP, 1950–2010



Source: FitzGerald; for 2000, Diario La República; for 2010, SISTEMA de FONAFE.

SOEs in Peru

For the past 14 years, the National Fund for Financing the Enterprise Activity of the State, (FONAFE is the Spanish acronym), has helped centralize a model used by nearly all of Peru's SOEs. FONAFE owns nearly all of the 35 SOEs, managing almost 100 percent of their stocks. There are only a few cases in which FONAFE is the minority shareholder; in general, it is the majority shareholder.

Members of the FONAFE Directorate represent five State ministries. Board members, many appointed by the President of the Cabinet Council, come from different sectors of the government and include the Minister of Communications and Transport; the Minister of Economy and Finances, who also chairs the Directorate; the Minister of Energy and Mining; or the Minister of Housing, Construction, and Sanitation. Other sectorial ministers can be included, such as heads of air traffic control, port services, the postal service, and some financing institutions. Peru's largest water company is also managed as a public enterprise. Finally, Peru's largest public industry is in the energy and mining sector, which includes power generation and energy distribution.

Created in 1999, FONAFE directs the business activity and administers the earnings generated from these enterprises. It has little dependency on the public sector. The Directorate, not Congress, approves the budget of the organization. Although no particular laws exist to manage FONAFE's budget, the organization is obliged to annually request Congressional approval for its work. FONAFE manages its own funds, and each enterprise must report its earnings and performance to shareholders; consequently, FONAFE receives dividends from SOEs and helps manage their investments. It has an investments portfolio, which is prioritized according to each sector's needs.

FONAFE's Economic Impact

The services provided by SOEs are focused on sanitation and electricity distribution. The main Bank of Peru manages more than US$2 billion in credits for these enterprises. Basic transportation services such as airports and air navigation comprise a somewhat smaller segment, with revenues of approximately US$305million in investments in 2012. FONAFE's work is not only to control these budgets, but also to find new investment opportunities. Public law requires that FONAFE receive positive returns; for example, the sales made by Peru's SOEs represent 5 to 6 percent of GDP. Total assets are US$24 billion. In 2012, the net utility managed US$633million and approximately 24,000 persons benefited from Peru's social security system.

The Institutional Background for SOE Management

The institutional background that supports the management and supervision of SOEs is deeply affected by changes of government. In many countries, the government is changed every four or five years, and each new administration has its own specific plans for SOEs that are different from previous ones. Public companies, however, must continue to operate, provide their services, and meet their goals. The fact that each administration brings in new plans is perfectly understandable in most cases, especially given the current democratic structure of Peru. The real challenge, however, is to get companies to continue to provide quality services to citizens regardless of government changes. The lack of an institutional background makes this a hard goal to achieve, so every five years we find ourselves going back to square one.

The solution is to open new scenarios that allow SOEs to continue operating despite these changes and reduce the impact of the political situation to a minimum. This is certainly not an easy task, but our firm intention is to make it happen.

Corporate Governance

To achieve economies of scale and increase efficiency, FONAFE exercises its purchasing power. This is in fact one of the processes the fund has managed to standardize. The fund takes advantage of its corporate purchasing power and goes out to the market to buy whatever can be bought jointly (e.g., property insurance, vehicles, computer licenses, and electrical parts). The fund has developed this model in recent years and has implemented it through a third party who is responsible for procuring whatever is necessary for the different projects.

In so doing, the fund has met some resistance from the market and even from companies, but it has managed to save quite a lot of money. It seems evident that having great joint purchase power leads to greater negotiation power, which in turn reduces sales margins for vendors.

In this respect, the purpose of FONAFE has been to resort to a centralized model for joint purchases. Even though it has had to face opposition, it has eventually managed to gather companies together around the advantages of joint management. As a majority shareholder, FONAFE enjoys the privilege of making this type of decision. The fund is responsible for conducting negotiations with vendors.

Another issue that is as important as corporate governance is the development of an internal control system. Since 2009, the fund has been working on consolidating an internal control system for public companies, thus contributing to the generation of an institutional background. FONAFE is aware of the importance of developing the corporate sphere and internal control systems to achieve this background. Companies must implement internal mechanisms to help them pinpoint areas where security should be stressed. The fund thus helps create an environment of continual growth.

Pros and Cons of a Centralized System

At this point, it is important to mention the pros and cons of the fund's centralized model. In this respect, public officials working in this field do not consider this model to be the definitive solution, but it does offer some advantages, such as the joint management of all companies for increased buying power or a board of directors made up of state ministers, which helps to make decisions related to other state institutions and company sectors.

In sum, the fund fosters greater coordination among SOEs. Until a few years ago, SOEs were often in conflict with one another due to prices, contracts, services, and other factors. However, the guidelines issued by the fund have made it possible to keep discussions out of court, thus saving large legal fees.

In terms of the cons, including government ministers in the board of directors may pave the way for decisions that have public policies in mind. Since the fund is young (only 14 years), many of the ministries that make up the board have interacted with the fund before, which may be good but also may end up being a political weakness.

Another disadvantage of the centralized public company management model is the fact that there is a significant amount of work to be done and the fund only has 120 employees. As a natural consequence, important decisions are often delayed. Also, since the fund utilizes a centralized approach, public officials working in the fund tend to think that all processes will at some point be standardized, but this is not necessarily true. Although the fund concentrates a great deal of power, it is important to stop and think before making decisions, taking the time to compare proposed solutions to those of other actors to come up with the best possible solution. In view of the 100 percent stake interest, the fund's decision power over companies is significantly strong. As is the case with all companies, public companies have a general shareholders' meeting. Since FONAFE owns all the shares, it has the final say on various matters; therefore, it is essential to create internal balances to prevent this great concentration of power from overextending their involvement.

Transparency and Accountability

The fund also manages transparency and accountability within the companies. In principle, all companies undergo an external audit. An agreement with the Comptroller General establishes that all external auditors must have a solid national and international reputation and work for an independent source that has been duly approved at the federal level. All foreign bond operations require external audits, and thus it is important that auditors enjoy widespread recognition to ensure international credibility around the company's performance. Previously, auditing companies were small local firms that did fully guarantee the accuracy of their reports. For international operations, it is important that the auditor ensures the consistency of financial statements.

The Comptroller General of the Republic has also issued a number of guidelines that control the operation of SOEs. However, the fund considers it essential to advance the development of an internal control system to provide greater assurance.

On another note, transparency is an overarching issue in Peru's public sector. The government enforces specific regulations for the SOEs in this respect and monitors closely their adherence to the legal framework. FONAFE's webpage includes a transparency rating for all companies, which reveals the degree of compliance with these guidelines.

Also, Peru's provisions in terms of corporate governance contribute to the reinforcement of transparency and accountability. The recently approved Code of Corporate Governance is currently in its implementation phase and the Superintendency of Stock Exchange has prepared a code exclusively for Peruvian SOEs, which is already in the market. Finally, it is worth mentioning that the Peruvian State has established a four-year work plan with the IDB through a loan that seeks to strengthen corporate governance in companies under FONAFE.

Future Challenges

Although the work conducted by FONAFE has helped to reinforce company operation, new challenges are emerging. The fund is restructuring its corporate center to address these challenges.

One of the key issues is how boards of directors operate. Even though all SOEs have a board of five to seven directors depending on the sector they serve, having a state minister sitting on the board is both a pro and a con. State ministers appoint directors based on certain profiles, but it is also very important to include directors who are independent from the government and have the capacity to openly discuss what is right and wrong, with an unbiased opinion in corporate matters. As a way to mitigate this limitation, the fund seeks to generate incentives to bring in independent directors. At present this process is conducted verbally, although the idea is to eventually make it a public election process. The issue is certainly complex, but we are working on a solution.

Another challenge is the need to consolidate investment projects through public–private partnerships (PPPs). Even though the fund's budget is US$305.350 billion annually, this is not enough to satisfy

SOE development expectations. To materialize some PPPs, the current board of directors is in the process of approving new guidelines.

Two challenges have been identified in human resources. On the one hand, and specifically regarding the development of senior officer profiles, the plan is to standardize the required capacities and qualities of senior officers in each company. On the other, and with regard to the evaluation of directors, the fund is currently discussing a combination of both self-evaluation and objective evaluation.

The last challenges identified relate to corporate governance and the internal control system. In relation to corporate governance, the Peruvian government has already approved or is in the process of approving a number of provisions targeted at companies, and the fund is developing a standard methodology to evaluate compliance. With regard to the second challenge, the internal control system refers to FONAFE's corporate system.

SOE SYSTEM IN CHILE

Orlando Chacra, Executive Director, SEP, Chile

Chile manages its SOEs through its public enterprise system (Sistema de Empresas Públicas, or SEP), which falls under the leadership of the National Ministry of Economy and Tourism. This section is divided into three parts in order to explain the experience of Chile in reforming its SOEs: a description of the system of governance and corporate leadership of SOEs; an explanation of how the SEP works; and an analysis of its legal framework.

The Chilean economy has been very productive in recent years. Chile has a small population of 16.6 million people with a very high literacy rate and an average life expectancy of 79 years. The GDP per capita is nearly US$20,000. The growth rate is close to 5 to 6 percent, and inflation remains close to 4 percent. The national unemployment rate is very restrained at 6 percent. In the last few years, poverty has fallen from as high as 38 percent in the 1990s to 14 percent today.

The Evolution of Chile's Corporate Governance System

Chile's corporate governance system has evolved since the 1970s. At that time many SOEs, more than 100, were managed with a decentralized model. This approach created a negative experience, which politicized operation of the SOEs and diverted citizens' attention from other public policies.

Chile's decentralized governance model relied heavily on sectorial ministries to execute its public policies. SOEs were separated by function and managed by individual ministries, establishing sector-specific policies, priorities, and regulatory frameworks. Chile's highly human-capital-intensive SOEs were inefficient, and they incited conflicts between management executives and workers. These conflicts often resulted in the interruption of important negotiations and produced negative implications for the SOEs' performance. SOEs competed with private sector enterprises, a competition that was neither fair nor equal, resulting in an uneven playing field.

In the 1980s and 1990s, Chile tried a dual model, giving the MoF and the sectoral ministries equal command over SOEs. The intent of this consolidation was to more effectively manage the enterprises' financial interests.

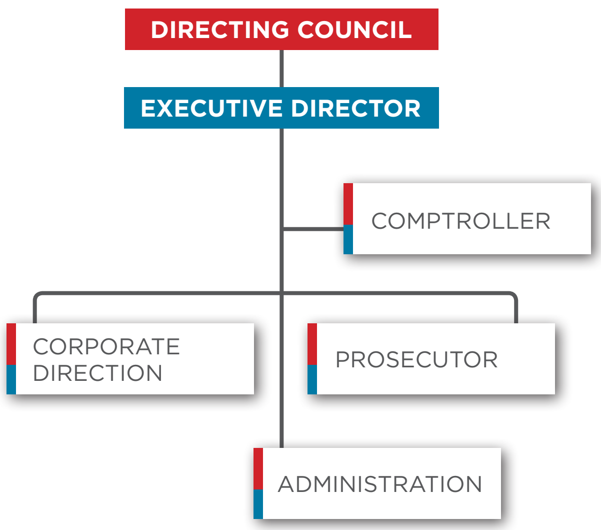
A dual model was produced, with the Minister of the Treasury having a bit more control over the enterprises, together with the sectorial ministry. During this time, a wave of privatizations started in an attempt to control the size of the State's involvement. Privatizations were made in different ways, from public bidding to more complicated ideas such as popular capitalism, in which employees of the enterprises were offered its stock, motivating them to work harder to improve stock prices.

Since 2000, Chile uses a centralized model to manage most of its 30 SOEs, of which approximately 22 belong to the SEP. This centralized model includes a special autonomous agency that reports regularly to the MoF and other ministries. This model offers greater flexibility and allows the application of excellence standards, but it requires high standards of operation.

How Does the SEP Work?

Chile's SOE management system works to comply with the law and ethical standards. It also seeks to increase SOEs' competitiveness without taking too much risk, allowing better profits and higher quality services. The SEP has created corporate guidelines for these enterprises, including 13 guidelines that cover issues such as good practices for their boards. In Chile, business directors control the management boards.

FIGURE 4: The Administrative Structure of Nine SOEs in Chile



Source: Authors' elaboration.

For example, guidelines say that a board president should create committees, manage conflicts of interest, and provide different training tools for board successions and the like. This guideline helps prevent the situation of a manager who has overstayed a term, for example. Auditing committees, internally and externally, receive special attention. Board members must organize special sessions with external auditors, without the presence of the general manager. Internal auditors come from the board of directors to avoid any conflict of interest with the general manager.

The SEP also advocates good practices regarding risks, such as ways to avoid fraud, keep information secure, and manage data. SEP promotes a positive organizational culture through a code of conduct and personnel management systems for different enterprises.

SOEs in Chile

The SEP comprises 22 SOEs, totaling more than 100 directors appointed by the system, 11,000 employees, US$12 billion in assets, and combined sales for US$1.3 billion. Of these companies, 10 correspond to the seaports located along Chile's extensive coastline, from Arica in the north to Punta Arenas in the far south. A special law governs these ports that prevents them from investing directly in new infrastructure. Thus, all new infrastructure investment must come from the private sector through 20- or 30-year concession contracts. During the concession, private agents make the investment while the port acts as port authority, overseeing contracts and day-to-day port operations.

In addition to the 10 ports, the SEP manages the National Railway Company, the Santiago Metro System, and other service companies such as the postal service, the Chilean Mint, and the National Lottery ("Polla Chilena de Beneficencia"), and others. Not all public companies, however, fall within the scope of the SEP, such as the mining giant Codelco and the National Television Network. Congress directly appoints their boards of directors, and thus the system has no influence over these designations.

The mission of the SEP is to act as the owner of SOE shares, and this is the kind of relationship it maintains with company directors. Its main duties are to appoint and evaluate board members, validate the companies' strategic plans, define targets, and support and monitor company management in their daily activities.

To appoint the boards of directors, the SEP utilizes a multidimensional approach based on four main criteria:

- An annual self-evaluation survey for all board members
- A scorecard based on the corporate governance guide
- A review of results compared with annual goals
- Compliance with transparency requirements

The SEP is also responsible for validating the strategic plans and defining the targets of each SOE under its influence. SEP operations are divided into a number of stages throughout the year. First, each SOE proposes an annual strategic plan to the system, which must be limited to the medium term. The SEP must review the plan and make any relevant recommendations. For example, the SEP must point out if the plan is overambitious or not ambitious enough, so as to adjust it as it progresses. Also, the SEP must introduce the process into the budget cycle of the nation led by the MoF. In other words, strategic planning serves as the base for defining the budget of each SOE and then for establishing its targets and parameters. In some companies, these targets are tied to their directors' income and, if the targets deem it appropriate, they may also have an impact on the compensation of company managers and employees. The SEP and MoF closely monitor this process.

The SEP also enters into performance agreements with those companies that apply for government-backed loans. The terms of the agreements determine the manner in which these resources will be utilized and the parameters that will be used to evaluate results. In conjunction with the MoF, investment plans are evaluated from a social and economic perspective to determine which projects should be prioritized.

Once the investment is approved and executed, the SEP's executive board evaluates the projects. The board analyzes the studies, reviews deviations from the targets, and makes recommendations to the companies and their directors. If results are not positive, the boards of directors may be removed, thus terminating the company's management cycle.

Sometimes, specific company requirements call for a more thorough oversight of the support and monitoring of company management. For example, the SEP assists the 10 seaports in working as one to obtain greater purchasing power and negotiate with insurance companies. Insurance is crucial in Chile, given its extreme seismicity. For example, the massive 8.8 earthquake of 2010 nearly destroyed two of the ports, and insurers covered most of the damage.

At the same time, the SEP coordinates the links between government agencies and SOEs. On one hand, there is a strong link between the MoF, which approves annual budgets and investment projects and authorizes company debts, and line ministries with an interest in these companies. For example, seaports and railway companies are closely related to the Ministry of Transportation. On the other, a link exists between institutions such as the General Comptroller of the Republic, which reviews all kinds of transactions to ensure company compliance with the regulation, and the Superintendence of Securities and Insurance, which oversees SOE compliance. The SEP acts as the general coordinator of these companies to guarantee a harmonious relationship among the various sectors.

Finally, among other projects, the SEP has submitted a bill to the Congress of the Republic aiming at its own modernization as well as that of Chilean SOEs. The objective is to update the monitoring process over SOE management based on the recommendations made by the Organisation for Economic Cooperation and Development (OECD) as part of the process that led to the acceptance of Chile as a member country in 2010. These recommendations have three main objectives:

- To provide juridicial support to the SEP, turning it into a public service approved by law, as its current legal validity is only backed by a decree.
- To separate companies' entrepreneurial role from their regulatory role, with the goal of adding transparency to each company to clarify which parts of its business are classified as entrepreneurial and which are more related to the execution of public policies.
- To establish a council that is independent from the current administration. With time, the council may replace its members, although not all at the same time. For example, some members may remain in office to provide continuity to the different activities, while others may be replaced as their mandate comes to an end. At present, the SEP's Council, and consequently the boards of directors of its related companies, changes with every new administration. It would be possible to achieve greater continuity if the Council were independent from the current administration.

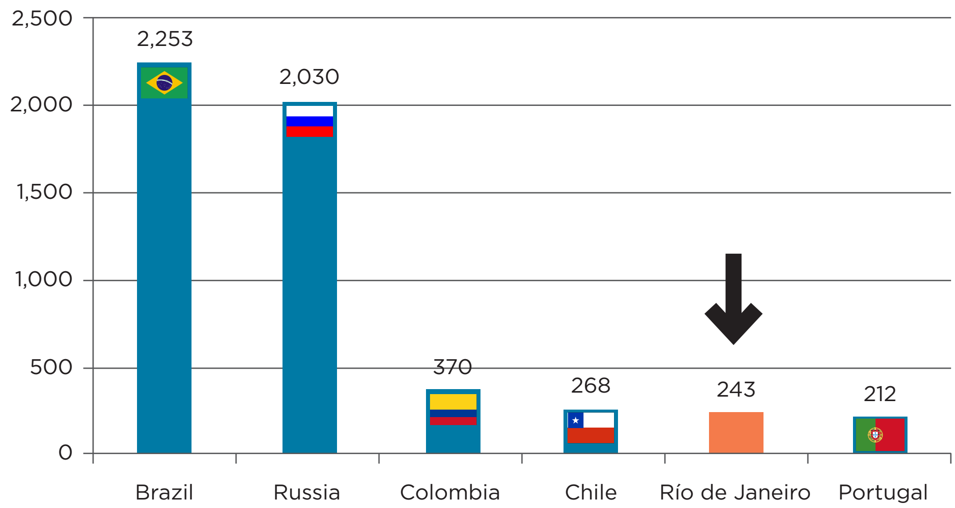
GOVERNANCE AND POSSIBLE FRAMEWORKS IN SOES: CASE OF STATE OF RIO DE JANEIRO, BRAZIL

Francisco Caldas, General Sub-Secretary, Secretariat of Planning and Control, Río de Janeiro, Brazil

This section provides a subnational perspective on the management of SOEs. The case of Brazil is complex because, as a large country, its GDP is around US$2.2 trillion and it has over 200 million inhabitants, so it is closer to the size of China or India than to any LAC country.

The State of Rio de Janeiro is one of 26 States in Brazil. After Sao Paulo, Rio is the second largest State economy, managing about 12 percent of the country's GDP, with an annual budget of US$37–38 billion. As a national comparison, the State of Rio de Janeiro comprises 12 percent of Brazil's GDP. The local economy is based on oil and gas; Rio is now Brazil's largest oil producer. In terms of GDP, Rio is between Portugal and Chile (see Figure 5).

FIGURE 5: Rio de Janeiro's Comparative State GDP



Source: Authors' elaboration.

Rio hosted the World Cup in 2014, and the State created several concessions through public–private partnerships (PPPs). The 2016 Olympics will mark the first time that the Olympic Games will be hosted in Latin America.

The State of Rio had 35 SOEs, but after the 1970–1980 concessions and privatizations, this number was reduced to 15 SOEs plus an investment bank managed by the State. The Treasury manages two of the SOEs. Nearly US$1.8 billion is budgeted for operations, which represents around 4 to 5 percent of the entire State budget.

How the Government Manages SOEs

In spite of State management, Rio's State enterprises need to improve their governance, i.e., how they are administered. Rio's SOEs have already concessioned work in the following sectors: railroads, subways, gas distribution, ferries, and electric power. Today, the SOEs offer better public services than they did in the past. After the State studied the tradeoff between concessions, it privatized several industries, developed several PPPs, and restructured the SOEs; the 15 mentioned above were restructured.

All of the remaining 15 SOEs should aim for fiscal independence. They do not have to be totally independent, but two have become completely independent during the past four years, and most of the others have substantially reduced their fiscal dependence. This means that their businesses are administered independently too.

TABLE 7. Rio de Janeiro's SOEs by Sector

	Public companies	Companies with mixed capital	Total
Financially dependent	3	9	12
Independent	1	1	2
Total	4	10	14

FINANCIALLY DEPENDENT (12)
EMOP - Public Works
EMATER - Technical Assistance and Rural Outreach
PESAGRO - Agricultural and Fertilizer Research
CASERJ - Grain Storage
CEASA - Central Food Reserve
CEHAB - State-owned Housing
CODIN - Industrial Development
IVB - Vital Brasil Inst. - Pharmacological Research
CODERTE - Bus Terminal
CENTRAL - Transportation and Logistics
RIOTRILHOS - Railways
TURISRIO - Tourism

Source: Authors' elaboration.

The State of Rio also manages an index with performance goals for each SOE, operationalized through a management contract. The enterprises receive their budget from the State and must attempt to achieve set levels of goals and indicators.

These SOEs are audited through external contracts in order to avoid problems of internal validity. The State manages guidelines to avoid any conflict of interest related to the Directory's nomination process.

Although Rio has an official nomination process, the court seeks to improve internal and external controls and to increase transparency for its public policy as much as possible. The State requires disclosure statements by public companies to encourage positive ethics and the confidence of workers.

The government of the state of Rio implements these processes in three specific ways. First, it conducts revision and control procedures (over all of the concessioned SOEs and some that are still in the hands of the State). Each SOE must submit reports that demonstrate how the business is supervised, with a formal statute that includes codes of conduct for that business. Secondly, the government manages administrative contracts with goals and indicators to promote budget transparency and risk analysis. Finally, the government manages SOEs by restructuring their Directorates. These are managed through direct supervision of independent members, imposing accountability through internal and external auditing.

Optional Functional Capacity of each Company

The SOEs have a total of nearly 15,000 public employees. Yet, after evaluation, it became clear that some of them operate with less than about 30 percent of their initial functional capacity. For example, a company with 8,000 employees could effectively function with 5,000 or 6,000. Some companies may need to motivate employees to leave, e.g., presenting employees with bonus offers or other benefits if they resign. After one company restructured to optimize its capacity, more than 30 percent of the people agreed with this conclusion.

The State uses management contracts to improve SOE production goals and targets, to manage complaints, and to ensure that budget targets are met. Board restructuring has run into political problems in Brazil. The State of Rio has tried to test several independent board members. For example, the State's water distribution company now has two independent council members. Citizens are strongly demanding the replication of the model of incorporating independent council members. The State of Rio uses a given methodology to evaluate the independence of SOE governance structures from the governance committee. A complementary governance system was advocated for the 15 SOEs, including the investment bank. For example, the organization would have the Brazilian Central Bank provide the Directory and General Auditing conduct different auditing evaluations. The Federal Court would authorize these evaluations for approval from the Federal Budget.

Some SOEs have stocks in the market that are audited by the Brazilian Secure Commission. Governance systems can be managed through rules and laws. Even so, changing government officials every four years without reelection processes may have negative consequences on an SOE's production system. Therefore, the State of Rio government has an eight-year term, and has excellent relations with its SOEs.

SESSION III:
SOE PERFORMANCE MONITORING AND MANAGEMENT

SOEs innately tend to have a principal-agent problem. This session studies the system of monitoring or improving the business performance of SOEs.

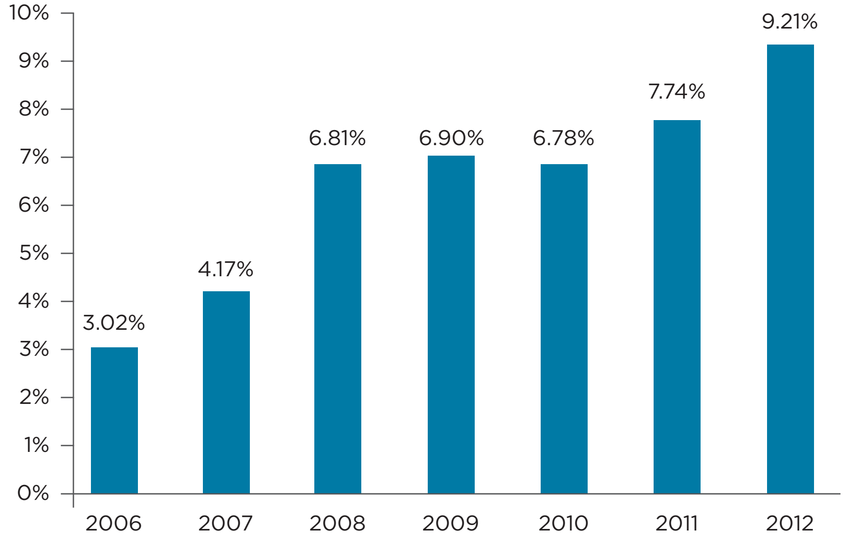
Guiding questions:
- Is there a system for monitoring or evaluating the business performance of SOEs?
- What are the contributions and concerns of the present evaluation system?
- Are there any incentives or penalties for the evaluation results?

IMPROVING PUBLIC GOVERNANCE: ASSESSING ACCESS TO INFORMATION IN SOES IN ARGENTINA

Maria Page, Senior Coordinator, CIPPEC, Argentina

CIPPEC (Center for Implementation of Public Policy to build Equity and Growth) is an independent nonpartisan, nonprofit organization dedicated to applied research in order to improve public policies in Argentina. During the last decade, a significant increase has occurred in SOE expenditures; employment has increased from approximately 5,000 employees to the present number of around 25,000 employees, according to Ministry of Economy figures. SOEs employ new people daily, with one important development: most employees hired before the year 2000 were permanent plant workers, but now a large majority of these workers are hired with temporary contracts.

FIGURE 6. Expenditures of SOEs as Percentage of Public Finances (2006–2012)



Source: Authors' elaboration.

SOEs are businesses that provide public goods and services and are administered by the State. They are either completely or partially property of the State because they typically receive public funding or they are part of the national patrimony of public funds. As opposed to private firms, SOEs are assigned a public policy objective and receive public funds or administer funds for the State.

SOEs should meet transparency laws according to governmental authorities for the legislative power, the control organ (public auditing), and the citizenry, in general. Therefore, SOEs have a duty to be transparent to the public; the decisions of the State, its processes and documents, are subject to public scrutiny and should be open to access by anyone who requests them. Furthermore, the large part of an SOE's work belongs to the State, so any administrator or auditor employed by an SOE must be monitored by the civil society. This access to information enables citizens to monitor SOEs and helps prevent malfunctions, corruption, or deviations from an enterprise's mission.

Although Argentina still does not have access to information law, in 2003 a former president, Nestor Kirchner, passed Executive Order 1172/03, the Access to Information law, which applies only to the executive branch. It does not consider any implementing bodies; it is unspecific with respect to exceptions; it has no formal body to solicit requests; and it lacks specific instructions for exceptions. In practice, in Argentina, access to information is heterogeneous and is managed through distinctive governmental State ministries that do not meet international standards.

Therefore, CIPPEC developed a set of indicators aimed at assessing transparency and the ability to access public information for these businesses and SOEs. The indicators focus on the following 10 dimensions: active transparency, controls and audits, procurement, codes of conduct, conflicts of interest and anticorruption provisions, regulations and enforcement, personnel recruitment and management, data production and disclosure, document management, civil society participation, and integrity agreements. The evaluation tool is intended to provide a diagnostic tool with respect to public access to information produced by SOEs in order to meet international standards.

Approximately 30 SOEs are included in Argentina's national budget. They are of two kinds: enterprises that are property of the State and have no private capital and enterprises that are part of the State, but with a significant portion of their stock in the hands of private owners (limited liability corporations, or LLCs). Also, some SOEs included in the State budget must have public participation and managed public goods; one example is the recently nationalized pensions system, Administradoras de Fondos de Jubilaciones y Pensiones (AFJPs). Another example is the Administración Nacional de la Seguridad Social (ANSES), which is administered through private stock options. Still, no one completely knows the magnitude of the State's asset portfolios; lack of knowledge regarding prices and company growth of SOEs must be rectified.

To gather relevant information on norms, functions, financing, and results for SOEs, CIPPEC selected a sample of 14 enterprises to carry out a study. The enterprises selected are: Administración de Infraestructuras Ferroviarias Sociedad del Estado (ADIFSE)[1]; Administración General de Puertos Sociedad del Estado (AGPSE)[2]; Aerolíneas Argentinas Sociedad Anónima[3]; ARSAT[4]; AYSA[5]; Correo Argentino Sociedad Anónima[6]; Corporación Antiguo Puerto Madero Sociedad Anónima[7]; Educ.ar Sociedad del Estado[8]; ENARSA[9]; Lotería Nacional[10]; Nucleoeléctrica Argentina Sociedad Anónima[11]; Sociedad Operadora Ferroviaria Sociedad del Estado (SOFSE)[12]; Télam Sociedad del Estado[13]; and Yacimientos Petrolíferos Fiscales (YPF) Sociedad Anónima[14]. In 2012, these companies received 85 percent of the resources transferred by the national government to SOEs. Out of the 14 SOEs, 11 receive state transfers and the remaining three are LLCs. In the latter cases, the State is the majority shareholder, as with Argentine Airlines, but the LLCs do not receive transfers from the national budget. The entities in the list above that produce electric energy and transport saw their tariffs increased because of inflation, lower estimated amounts of transfers, and increasing costs for energy and transport. Also, because of this gap, the State increased the amounts of transfers to these firms.

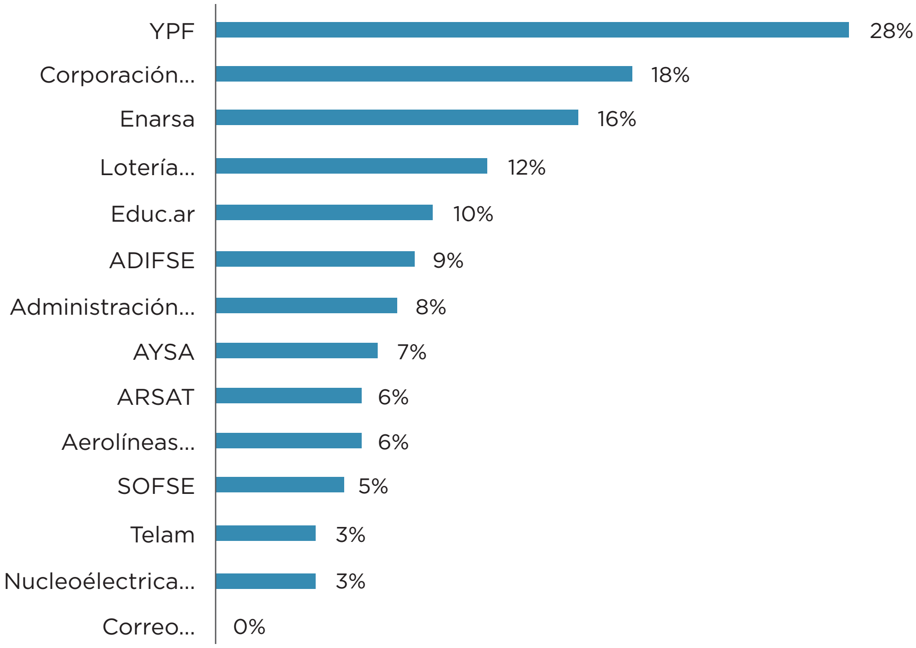
Measuring the transparency of these enterprises was easy. First, CIPPEC analyzed the webpages of these businesses to understand which of the dimensions mentioned above were displayed. Then, a systematic

[1] Develops plans, programs, projects, and construction in three different areas: human development, productive integration of the territory, and railway infrastructure.
[2] Responsible for managing and maintaining areas of the Port of Buenos Aires that have not been put under concession, and for acting as the government's authority in privately-operated terminals.
[3] The flagship airline of Argentina.
[4] Company's mission is to be a strategic participant in the implementation of government policies regarding telecommunications, radio, and Internet and to increase the use of satellite, radio, and telecommunications services for public, private, and government commercial applications.
[5] Nationwide water utility company.
[6] The national postal service.
[7] The urban recovery company that developed the Puerto Madero area and currently participates in several new architectural projects in Argentina and abroad to promote the interaction between the public and private sectors.
[8] Online portal for the development of new technologies applied to education and teacher training.
[9] Company dedicated to the exploration and exploitation of solid, liquid, and gaseous hydrocarbons and to the transportation and distribution of hydrocarbons and natural gas.
[10] Regulates, manages, exploits, and controls gambling to contribute to society in general and generate profits intended for social promotion and assistance.
[11] Dedicated to the development of electric power in Argentina.
[12] Company's mission is to guarantee, maintain, and develop the freight and passenger rail transportation system.
[13] Official news agency.
[14] Dedicated to the exploration, exploitation, distillation, distribution and sale of petroleum and its by-products.

evaluation of governance dimensions was created and distributed to the companies. Each company was also sent information about each dimension in the evaluation tool.

The results revealed new information and each dimension was assigned a value based on the guidelines of the Access to Information Executive Order. To maintain the integrity of the information, a ranking system was built. The first goal was to evaluate active transparency, or the public information already provided by the public enterprise. A case with high levels of active transparency is the State oil company, YPF, which was also recently expropriated to Respsol, a Spanish firm, for which several irregularities exist. The State is still evaluating the compensation package for this case. Although the State appoints the board members and president, that enterprise, which recently was a private enterprise, also has a required public engagement. The company publishes more information on its webpage than the other companies combined. This fact is apparent in the following graphic. The quantity and quality of information published on the webpages was rated from poor to bad.

FIGURE 7. Information Published on SOEs' Websites (2013)



Source: Authors' elaboration.

Figure 8 shows the ranking of SOEs derived from formal requests for information. Many SOEs responded, and many shared norms and internal processes that are used to manage each company. However, accounting information was not provided. The information that was facilitated to CIPPEC came from income statements provided by the State in 2009.

Also, little information was provided regarding employees' earnings and no information pertaining to the income of top officials. Several companies cited the national government's affidavit to protect civil servants' information. The SOEs did not provide performance indicators, adequate information about citizen monitoring, or guidelines used for human resources decisions.

FIGURE 8. Compliance with Public Information Requests, 2013

Enterprises	Percent of compliance																				
	0%	5%	10%	15%	20%	25%	30%	35%	40%	45%	50%	55%	60%	65%	70%	75%	80%	85%	90%	95%	100%
Lotería Nacional	0	5	10	15	20	25	30	35	40	45	50	55	60	65							
TELAM	0	5	10	15	20	25	30	35	40	45	50	55	60	65							
Educ.ar	0	5	10	15	20	25	30	35	40	45	50	55	60								
Aerolíneas Argentinas	0	5	10	15	20	25															
ENARSA	0	5	10	15	20	25															
ADIFSE	0	5	10																		
ARSAT	0	5	10																		
Administración Gral. de Puertos	0	5																			
Corp. Antiguo Puerto Madero	0	5																			
Aysa	0																				
Correo Argentino	0																				
Nucleoeléctrica Argentina	0																				
SOFSE	0																				
YPF	0																				

Source: Authors' elaboration.

The research showed that the access-to-information law provided the only public information at the time. There was little compliance in providing public information through the law. For example, information about SOE functionality and management was not provided. Typical arguments for not providing information included: (1) the solicitation did not show a concrete concern (contrary to the rights of the party requesting the information); (2) there are commercial secrets; and (3) the SOE or the participation of the State was considered private and therefore, the access-to-information law did not apply.

On the other hand, CIPPEC requested information from public employees about the access-to-information laws. None of the SOEs in our sample completed all of the answers in the information requests. Almost none of the SOEs provided interviews containing more information.

In conclusion, the principal study sought the following: (1) active participation and the habitual practices of SOEs to provide information regarding public funds; (2) besides a few SOEs that send information under the access-to-information law, the large majority of the firms responded with incomplete answers or responded that they were not allowed to complete, correct, or facilitate information at that time; and finally 3) that the effective implementation of the access-to-information law as a norm will require more time before SOEs consider this process a typical way of doing business in Argentina.

MONITORING AND EVALUATION: METHODOLOGY OF SOEs IN BRAZIL

Murilo Francisco Barella, Director, Department of Coordination and Governance of SOEs, Brazil

After World War II, the State increased its role in economic activities and began to influence the production and provision of goods and services by creating and enhancing different SOEs. In the 1980s and 1990s, the State restricted its activities as a provider of goods and services, resulting in a "wave" of privatization. The Brazilian privatization program in the 1990s was a major undertaking grounded by international standards.

This presentation provides an overview of SOEs in Brazil, including how the State defines its governance role, how SOEs are monitored and evaluated, and future prospects for the sector. Brazil's SOEs include, among many others: the State-owned petroleum company, PetroBras; the electrical energy provider, Eletrobras; financial entities Banco do Brasil group, Caixa Econômica Federal (CEF), Banco do Nordeste (FNE), and Banco da Amazônia (BACA); and a provider of infrastructure and transportation services, the Brazilian Agricultural Research Corporation (EMBRAPA), which is also a tropical agricultural business company.

Today, Brazilians have chosen to keep and maintain several enterprises under State ownership. Today, there are 151 SOEs, although the number can vary throughout the year. The current high number has to do with the creation of several new enterprises by the State. To date, there are 46 SOEs under the government's direct control; the remaining 105 are managed indirectly by the State through the buying and selling of subsidiary companies that the SOEs have created. The numbers that existed as of October 31, 2013, in various industries are presented in Table 8.

TABLE 8. SOEs by Activity

ACTIVITY	NUMBER
Crude oil and gas and derivatives	61
Electrical energy	21
Financial sector	19
Service	19
Infrastructure	9
Transport	3
Research	4
Industry	4
Others	11
TOTAL	**151**

Fuente: DEST/MP.

Brazilian SOEs are arranged mainly in two forms: stock and public companies. The legal status of an entity permits its self-management through administrative, budgetary, and financial autonomy. SOEs are expected to achieve a social function within society as mandated by having corporate legal status. They must comply with the national law of information in Brazil, as well. Their autonomy depends on economic dependence: the more financially independent they are, the greater autonomy they have. This autonomy however does not exclude State and societal control, which is provided through the National Congress (the Federal Court of Accounts); the Ministry of Planning and Budget (the Department of Coordination and Governance of State Enterprises, or DEST); and the Office of the Comptroller General (CGU), as well as through regulatory agencies.

SOEs are governed by the Brazilian Law of Corporations and, in case of public banks, by the applicable laws of the entire financial system, created by the Central Bank of Brazil. The same laws that oversee private enterprises govern SOEs in Brazil; these include rights and obligations covered by commercial, labor (for contracting employees), and tax laws. In addition, public banks are subject to regulations made by institutions such as the Securities and Exchange Commission (CVM), the Brazilian Stock Exchange (BOVESPA), and the Central Bank of Brazil (BACEN). SOEs must also comply with Brazil's general rule of competitiveness, which does not apply to the private sector.

Table 9 shows the number of employees in Brazil's productive and financial sectors, which totals nearly 50,000 people, with nearly half of them in the financial sector. That sector went on strike that year, causing problems for the national economy. Nearly half of the people on strike were from the public sector.

TABLE 9. Number of Employees, Productive and Financial Sectors

PRODUCTIVE SECTOR	EMPLOYEES
Brazilian Post and Telegraph Company	124,470
PETROBRAS Group	86,174
ELETROBRAS Group	25,903
Brazilian Company of Airport Infrastructure (INFRAERO)	13,467
Federal Data Processing Service (SERPRO)	10,701
Others	17,564
TOTAL	**278,279**
FINANCIAL SECTOR	**EMPLOYEES**
Bank of Brazil	115,906
Brazilian Development Bank (BNDES)	2,714
Bank of Amazon	3,181
Bank of Northeast	6,287
Caixa Econômica Federal (CEF)	96,158
Others	1,107
TOTAL	**225,353**

Fuente: DEST/MP.

Asset Management

The equity of Brazilian banks follows the Basel III capitalization index. The financial sector is very strong, partly because the central bank is independent, and because it follows the rules and ensures that solid investment decisions are made. Brazil has increased its public investments in various areas. The country manages a Chinese wall by separating governmental functions for financial transitions. The result is good public governance of the financial system, with the balance and counter balance made distinct from other public sector expenditures. Brazil's federal government has a line ministry that supervises sectorial issues, such as those related to SOEs. For example in the electricity sector, the Ministry of Mines and Energy manages thematic issues, but for financial matters, the MoF shares its expertise with the Minister of Planning and Budget. The MoF oversees federal stockholders in the general plenaries held before Congress, while the Ministry of Planning and Budget focuses on daily SOE operation and management. This division of labor between ministries demonstrates how Brazil's federal government is able to monitor the progress of its SOEs.

The Ministry of Planning changed the name of our department when I arrived. The name was changed, in accordance with a change in the agency's function, from the Department of Coordination and Control to the Department of Coordination and Governance of SOEs. The government wanted to know what must be done to manage SOEs in order to fulfill their societal function. In Brazil, we see that the budget can assist in the area of public investment. The Federal Constitution mandates that SOEs share their investment interests with the public and gives suggestions for spending their resources.

This department works together with the MoF to ensure the social equity of SOE investments, essentially aiming to be fair and treat investments equally. For example, it assembles shareholders to describe the types of bylaws that govern the creation of enterprises.

The aggregate values for assets, shareholder equities, and operating revenues of SOEs are given in Table 10, while investments of SOEs are presented in Table 11.

TABLE 10. Assets, Equities, and Operating Revenues of SOEs (in US$ million)

	ASSETS	EQUITIES	OPERATING REVENUES
PRODUCTIVE SECTOR			
PETROBRAS Group	331,645	167,888	14,073
ELETROBRAS Group	84,265	32,828	1,355
FINANCIAL SECTOR			
Bank of Brazil	562,998	32,051	8,430
Brazilian National Development Bank (BNDES)	350,128	25,529	5,482
Bank of Amazon	5,147	993	143
Bank of Northeast	15,605	1,313	122
CEF (*)	343,960	12,262	2,461

Source: DEST/MP

(*) Federal Financial Institution.

TABLE 11. Investments of SOEs (in US$ million)

PRODUCTIVE SECTOR	2002 (*)	(...)	2010 (*)	2011 (*)	2012 (*)
PETROBRAS Group	963	(...)	3,168	3,012	2,890
ELETROBRAS Group	3,778	(...)	44,744	38,003	42,030
Others	246	(...)	1,009	1,171	1,445
FINANCIAL SECTOR					
Public Banks	353	(...)	1,478	1,178	1,531
TOTAL	**5,340**	**(...)**	**50,400**	**43,964**	**47,896**

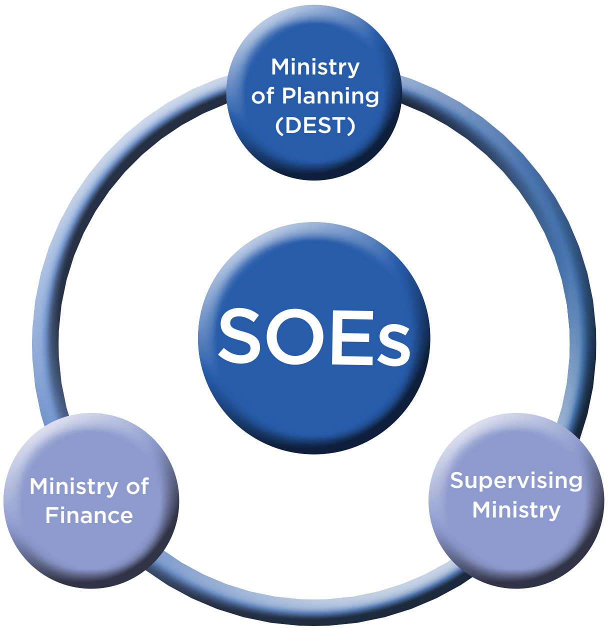
Source: DEST/MP

(*) Exchange rate (2002/12/31): 3,5333 Real/Brazil = 1 USD.

Monitoring and Evaluation

Responsibilities of the various government agencies can be summarized as follows. In general, the Ministry of Planning, Budget, and Management (DEST) works to establish corporate governance guidelines; approve the allocation of income; approve bylaws and capital increases; fix remuneration for board members; and appoint one board member. The MoF's job is to approve financial statements; authorize the issuance of securities and the debt situation; appoint one Fiscal Council member; and represent the State at shareholders' meetings. The Supervising Ministry provides orientation for the investment strategy; sets up the Board of Directors; and helps appoint most of the nonexecutive board and Fiscal Council members. These ministries work to manage SOEs, as shown in Figure 9.

FIGURE 9. State Ownership Function



DEST has the important mission to “Improve the role of the State while a shareholder of State Enterprises, in order to foster the investments of the State for the benefit of the society.” The main attributes of DEST can be summarized as follows: to coordinate SOE budgets (elaboration and monitoring, including fiscal goals and investments); to consolidate and inform SOEs’ economic and financial data; to approve board members’ payments and pension fund policies; to create employee contracts; and to encourage the adoption of best practices in corporate governance.

To monitor and evaluate the SOEs, DEST has a basic filing system for company information and financial statements. It also has a Global Spending Program, which contains important information for determining allocations of resources and investments for an SOE, as well as its capacity to expand its business. This program allows determination of monthly balances, short- and long-term financial liabilities, and indebtedness status for each SOE. The system is governed by the Public Bank´s Loan Policy, which details the level and size (if micro, small, medium or large borrower) of a loan, the origins of funds (whether public or private), the economic sector, and the region.

The Fixed Asset Investment Budget of SOEs is managed annually and monitored monthly through the execution of fixed asset investments. Data containing important indicators for evaluating a company is classified by asset structure, economic outcome, sources and uses of funds, human resources, and fixed asset investment. It is important to mention that in case an SOE fails to comply with information system requirements, the Department will not analyze its process.

For example, an SOE is controlled through its human resource policy. Monitoring and evaluation programs are implemented through the federal government. Brazil has transparency law as part of its constitution; as required by the constitution, each few months, the Department publishes the budget allocations. An SOE lacking a good human resource policy can have significant problems, which can lead to filing of legal actions by employees. The collective agreements are problematic and created several difficult strikes this year.

The Department sponsors the pension funds, focusing on payments from the enterprises for the pension funds. This is important because Brazil tends to have large pension funds, such as PREVI, which is for employees of Banco de Brazil; another is PETROS, a pension fund for PETROBRAS. These large funds are important in our national economy.

Debt Policy

On average, 70 to 80 percent of Brazilian SOEs are self-funded; they are not dependent on the State for loans or for leveraging new funds. Authorities from the central bank monitor credit and loan policies applying to the SOE sector. This policy governs the levels of loans; the size of the borrower (small, medium, or large); the origin of funds (public or private); the economic sector; and the classified region. The destination of the resource is changing in that poorer regions are receiving more credit and more funds to develop their areas, a change that is working in favor of Brazil’s economic development efforts to reduce inequality.

To have quality SOEs, Brazil has invested in support systems and IT systems that help the government manage these entities. Using these systems, a basic profile is produced to register company information and financial statements; this profile is published as a book. It contains important information about the companies that we work with. Each year, the database is evaluated and information is used, for example, to allow an SOE to expand its business. If the focus is on management, cost data are essential.

For example, CEOPE is a system that sets investment budgets for SOEs, as mandated in Brazil's constitution. The Olagrama is a system with important indicators that evaluate enterprises. The IT systems evaluate SOEs based on a clarification system of economic outcomes, sources and uses of funds, and fixed asset investments.

Autonomous SOEs that do not submit indicators to the Ministry of Planning and Budget receive consequences. Typically, their federal budget allocations decrease. If the situation does not improve, and the Ministry does not have updated information, then the Department takes over the SOE.

The Ministry of Planning and Budget uses information from Catomar, a regulatory database, to analyze company performance. The Ministry's work is based on variables for directors and for employees; for example, analysts work with primary data, using human resource information. They can also evaluate operational budgets, financial data, and human resources information. The Department is expanding its databases to provide more flexibility and better utilization. For example, the human resources information (using the same evaluation system that Peru is developing) gives qualitative and quantitative information that allows a combination of reports. Some analyses are developed that apply to an entire group of companies.

Six analysts work in the Department, following given patterns, standards, and indicators. If those change, the Ministry wants to know what happened; in such a case, analysts track the data to develop a business intelligence model. The development of the indicators is a large, but important challenge, because SOEs are not only private, but also public. The resources pay only for the cost of goal fulfillment, which is key to their sustainability.

Monitoring and evaluation processes are very complex. An IT representative generally sits on all of the SOE's boards of directors. Brazil has a mandatory law directing that the Ministry of Planning be present at each council meeting. The Department supports those representatives; it is important as well to show that balance scorecards support the Department's approach.

Concluding Remarks and Future Prospects of SOEs in Brazil

Among the challenges ahead, we have identified partnerships that have agreements with four agencies for access of information. The central bank is neither an enterprise nor an agency, but rather an authority; therefore, information requests are difficult to access.

In terms of monitoring, we are capturing information and need to expand this effort, for example, by creating standards and agreements, producing and standardizing reports, developing enterprise profiles, and the customizing of reports. SOEs need to implement mechanisms to automate the generation of these qualitative and quantitative reports before they can be analyzed statistically. Possible applications are to produce computing systems and to request public companies to archive their own information. It is important to strengthen the relationship between direct and indirect administration by organizing forums, meetings, and administrative boards.

SESSION IV.
SOE FISCAL RISK AND DEBT MANAGEMENT

This session dealt with the current situation of the fiscal stability of SOEs in Korea and LAC. Also, it studied the efforts to strengthen the fiscal stability of SOEs in these countries.

Guiding questions:

- What are the fiscal rules and policy framework governing SOEs?
- Is there a system for monitoring the financial soundness of SOEs?

PERFORMANCE EVALUATION OF SOEs IN KOREA

Joonook Choi[15], Jin Park[16], Jiyoung Kim[17], Kyoungsun Heo[18], Korean Institute of Public Finance

Government cannot evade the financial liabilities of its public institutions because it holds legal ownership and supervisory authority over them. As a large part of public institutions' activities are undertaken on behalf of the government, their liabilities have often originated from lax government policies. Nevertheless, many of these liabilities are excluded from government debt. Even though quasi-governmental institutions are included in the general government category, these are relatively small, accounting for a mere 8.4 percent of all public institutions' liabilities. State-owned enterprises (SOEs), which produce a significant amount of independent revenue, are not included within the general government, but hold 91.6 percent of all public institutional liabilities.

In Korea, the liabilities of public institutions have been managed in a rather relaxed manner, compared with government debt. Each institution or line ministry in charge of Korea's SOEs assumes primary responsibility, because the MoSF has only indirect control over evaluations. The National Finance Act and the Management of Public Institutions Act were revised in 2010 to obligate SOEs to formulate medium- and long-term financial management plans and present them to the government and parliament. The control over public institutions' liabilities, however, is still not tight enough to relieve concerns over accumulative growth. This presentation shows recent trends relating to these liabilities and discusses policy options to

[15] Senior research fellow, Korea Institute of Public Finance (KIPF)
[16] Former director of Research for State-owned Entities of Korea Institute of Public Finance (KIPF), Professor at KDI.
[17] Former Research fellow of KIPF, Professor of Incheon University
[18] Research fellow, KIPF

mitigate them. The next section shows the general trends of public institutions' liabilities, followed by an analysis of six SOEs with the largest liabilities in Korea. Finally, measures to resolve the problem of rising liabilities of public institutions are presented.

Recent Trends and the Current Situation

As the size of SOEs' liabilities may vary, depending on the purpose and standards of statistical compilation, we first clarify standards and terms used. The three most common statistical sources are: Government Finance Statistics (GFS), National Accounts, and standards according to the Management of Public Institutions Act. While the GFS and National Accounts are compiled for statistical purposes, the Act is aimed at managing public institutions. Thus, statistics based on the Act might show a significant difference from those based on finance statistics or national accounts. Controversies over the type of public organization center on the size of the institutions and the total revenue generated, which depend on data sources. The technical problems involved were mostly resolved by 2013, but there are still controversies regarding two issues: (1) whether to count financial liabilities, and (2) whether adding up government debts will show total debt for the public sector. In this paper, we contend that government should not add up the liabilities of financial institutions because the results can be misleading.

The liabilities of financial and nonfinancial institutions differ; they are clearly distinct from one another in terms of forms of financial statement and account titles, as well as in the basic nature of liabilities. For example, the business activities of a financial institution begin with deposit liabilities (money deposited with a financial firm by customers) along with deposits by customers in banks, deposits to securities companies, and insurance policy premiums paid. These are all considered deposit liabilities. Therefore, unlike general companies, financial institutions with a high proportion of liabilities should not simply be viewed as showing poor financial stability. For this reason, there is a limit to discussing this matter based on data obtained by simply compounding the liabilities of financial and nonfinancial institutions; instead, their liabilities need to be examined separately.

Accordingly, the liabilities of public institutions, excluding those of financial institutions, are analyzed here. There are presently 17 classified financial institutions, of which seven were already eliminated due to being classified as pertaining to the general government, and the other 10, including the Korea Housing Guarantee Co., Ltd, are excluded for being financial institutions. Besides financial institutions, pension institutions such as the Korean Teachers Pension were also omitted from consideration. Although excluded from general government liabilities, liabilities for pension schemes are somewhat different in nature and therefore were not included in this study.

Total Liabilities and Changes

Of the 134 Korean public institutions, 26 are SOEs, 30 are quasi-governmental institutions, and 78 are non-classified public institutions. As of 2011, the ratio of public institutional liabilities to GDP, estimated according to the above criteria, was about 28 percent, which is 9.5 points less than the 37.5 percent officially reported through e-National Indicators. We must pay particular attention to the liabilities of public institutions because although they are not classified as part of government debt, they remain as "hidden" liabilities, for which the government is likely to be required to take ultimate responsibility. The 28 percent public institutional liability to GDP ratio estimated in this study is in no sense a small figure—all the more so, given that the South Korean government's debt-to-GDP ratio reached 37.9 percent as of 2011 on an accrual basis.

In general, the liabilities of quasi-governmental institutions and nonclassified public institutions have not undergone significant changes, while those of SOEs have witnessed a progressive increase. While the volume of liabilities and the liability-to-GDP ratio have both increased, the rate of increase has slowed since its 2008 peak. One problem with these changes is that data consistency was undermined by a shift in accounting standards. The data from 2007 to 2010 were calculated based on Korean Generally Accepted Accounting Principles (K-GAAP), but the 2011 data were based on International Financial Reporting Standards (IFRS). For 2010, the data were collected based on both K-GAAP and IFRS. Therefore, the yearly rates of increase for 2011 indicate increase rates as compared to the 2010 data based on IFRS, while the increase rates for the preceding years are those based on K-GAAP.

TABLE 12. Liabilities to GDP Ratio (in percent)

	2007	2008	2009	2010 (K-GAAP)	2010 (IFRS)	2011
TOTAL LIABILITIES	18.0	21.5	24.6	25.6	26.4	28.0
SOEs	15.9	19.3	22.1	23.0	23.9	25.3
Market-based	6.1	7.8	8.3	8.4	9.5	10.5
Quasi-market-based	9.8	11.5	13.8	14.5	14.3	14.9
Quasi-governmental institutions	1.6	1.8	2.0	2.1	2.1	2.2
Fund-management- based	0.1	0.1	0.1	0.1	0.1	0.1
Commissioned-service-based	1.6	1.7	1.9	2.0	2.0	2.1
Non-classified public institutions	0.4	0.4	0.5	0.5	0.5	0.5

A considerable portion of SOE liabilities is concentrated within the selected enterprises. The seven SOEs with the greatest liabilities account for more than 95 percent of the total. Consider the following statements:

- The Korea Land and Housing Corporation is responsible for approximately one half of total SOE liabilities. This suggests a need to thoroughly examine these seven enterprises in future policy responses related to the management of liabilities.
- When examining all quasi-governmental institutions, the Government Employees Pension Service reveals the greatest liabilities, making up about 74 percent of the combined total. It showed a considerable year-on-year increase against 2010 because the amount of liabilities for pension schemes was reflected only from 2011.
- The quasi-governmental institution with the second greatest liabilities is the Korea Deposit Insurance

Corporation, which accounts for 9.3 percent of the total. This corporation also ranked second in terms of magnitude of increase, which was incurred by the risk management process, including rescue aid for failing savings banks.

- Among quasi-governmental institutions outside of those in the general government category and pension and financial institutions, the largest and second largest debtors are the Korea Rail Network Authority and the Korea Rural Community Corporation, respectively contributing 57.6 and 19.7 percent of the total liabilities for the category.

TABLE 13. Liabilities of each SOE by Size (in millions of won and percent)

Ranking	Institution name	2007	Proportion	Cumulative proportion	2011	Proportion	Cumulative proportion
1	Korea Land and Housing Corporation	66,908,862	49.3%	49.3%	130,516,338	46.4%	46.4%
2	Korea Electric Power Corporation	21,611,859	15.9%	65.3%	50,330,593	17.9%	64.3%
3	Korea Gas Corporation	8,743,644	6.4%	71.7%	26,860,898	9.6%	73.9%
4	Korea Expressway Corporation	17,830,249	13.1%	84.9%	24,571,087	8.7%	82.6%
5	Korea Water Resources Corporation	1,575,552	1.2%	86.0%	12,578,289	4.5%	87.1%
6	Korea National Oil Corporation	3,682,981	2.7%	88.7%	12,228,462	4.3%	91.4%
7	Korea Railroad Corporation	5,948,515	4.4%	93.1%	10,806,810	3.8%	95.3%
8	Incheon International Airport Corporation	3,940,229	2.9%	96.0%	2,974,277	1.1%	96.3%
9	Korea District Heating Corporation	1.279,359	0.9%	97.0%	2,797,580	1.0%	97.3%
10	Korea Resources Corporation	434,139	0.3%	97.3%	1,802,456	0.6%	98.0%
11	Busan Port Authority	345,522	0.3%	97.5%	1,430,335	0.5%	98.5%
12	Korea Coal Corporation	1.223,237	0.9%	98.4%	1,429,919	0.5%	99.0%
13	Korea Broadcast Advertising Corporation	726,464	0.5%	99.0%	815,204	0.3%	99.3%
14	Korea Appraisal Board	258,111	0.2%	99.2%	416,919	0.1%	99.4%
15	Jeju Free International City Development Center	64,815	0.0%	99.2%	357,338	0.1%	99.6%
16	Incheon Port Authority	34,418	0.0%	99.2%	314,852	0.1%	99.7%
17	Korea Airports Corporation	242,713	0.2%	99.4%	307,754	0.1%	99.8%
18	Korea Racing Authority	374,946	0.3%	99.7%	263,589	0.1%	99.9%
19	Korea Tourism Organization	310,080	0.2%	99.9%	254,173	0.1%	100.0%
20	Korea Minting and Security Printing Corporation	93,805	0.1%	100.0%	78,081	0.0%	100.0%

Note: The Yeosu Gwangyang Port Authority, which is included in the general government sector, and the Korea Housing Guarantee Co. Ltd, which is a financial institution, were excluded, along with all subsidiaries.

Analysis of Causes of Liabilities

Korea Land and Housing Corporation

The Korea Land and Housing Corporation (LH) government exceeded 13.05 billion won (US$12.5 million) as of 2011, the single largest indebted institution among Korean public institutions. This figure corresponds to 28 percent of total liabilities born by all public institutions, and 41 percent of the combined debt of all SOEs. The corporation has carried out large-scale governmental programs in a short time, but it financed the bulk of them with liabilities. Major policy programs undertaken by LH since the Kim Dae-jung government include: national rental housing (64.6 trillion won), new-town development (92.2 trillion won), and the Bogeumjari affordable housing program (105 trillion won); the latter is scheduled for completion by 2030. The combined expense of these programs approaches 323 trillion won (US$309 billion). Financial assistance from the government stands at 33.9 trillion won (US$32.5 million), or a mere 10.5 percent of the entire program expenditure. Losses come from various places: first, rental housing programs have vicious revenue structures as the programs progress; second, a series of massive policy programs, in which large-scale new investments were made, have increased LH's liabilities. LH's profitability tends to be further reduced because it is disallowed from reflecting the increasing costs of construction or of an expansion of the green space ratio in housing land development that is demanded by local authorities. Unsold homes at the time of a real estate market slump made the situation worse.

Korea Electric Power Corporation

Korea Electric Power Corporation (KEPCO) is in charge of the process of supplying electrical power, including generation, transmission, and distribution. Its liabilities are 82.7 trillion won (US$79.3 billion), the second largest debt among all public institutions. Liabilities began to increase sharply when its profitability began to deteriorate in 2008. In addition, a shift in the application of new accounting standards, involving the adoption of IFRS in 2010, has produced a considerable change in the size of the corporation's liabilities. The largest contributor to the debt increase is the imbalance between the rising cost of producing electricity and electricity tariffs. While the unit cost of producing electricity rose sharply with a surge in the cost of fuel, electricity tariffs, which were curbed by the government's control policy, fell short of covering the escalation in fuel costs. Since 2007, electricity fees have been raised every year, but the increase does not sufficiently reflect the increases in costs, due to the government's price fixing. The cost recovery rate of electricity stood close to 100 percent from 2001 to 2005, declined to a low of 78 percent in 2008, and then climbed back to 87.4 percent in 2011. Electricity in South Korea is mainly produced from other sources of energy, such as oil and natural gas, but electricity price-restriction policies keep prices at lower levels than those for other fuels. These policies, therefore, lead to an increase in annual electricity consumption. In order to meet demand, facilities necessary to generate electricity are continuously being expanded.

Korea Gas Corporation

By the end of 2011, total liabilities for the Korea Gas Corporation (KOGAS) were reported to be 26.7 trillion won. The largest portion of these liabilities consists of capital expenditures at home and abroad and the working capital required for financing increased capital investment. The table below breaks down the total liabilities of KOGAS on an accrual basis. The liabilities resulting from domestic capital investment and overseas resources development amount to 8.7 trillion won (US$7.9 billion) and 3.2 trillion won (US$3 billion), respectively, indicating that approximately 44.6 percent (11.9 trillion won) of the total liabilities (26.7 trillion won) relate to domestic and foreign capital expenditures. Total investment by KOGAS began to soar in 2010, presumably due to the expansion of foreign investment.

TABLE 14. Causes of Liabilities of KOGAS

CLASSIFICATION	AMOUNT
Accounts receivable	4.4 trillion won
Domestic capital investment	8.7 trillion won
Overseas resources development	3.2 trillion won
Financial lease liabilities	3.1 trillion won
Working capital	7.5 trillion won
Total	**26.7 trillion won**

Source: Korea Gas Corporation.

Korea Railroad Corporation

The total liabilities of the Korean Railroad Corporation (KORAIL) stood at 13.5 trillion won in 2011. Liabilities have risen continuously, and the debt-to-equity ratio also climbed sharply from 69 percent in 2006, to 154 percent in 2011.

TABLE 15. Sizes of Assets, Liabilities, and Capital, late 2011 (in 100 million won)

	2006	2007	2008	2009	2010	2010 (IFRS)	2011 (IFRS)
Assets	137,646	142,137	160,075	186,110	198,123	210,473	221,792
Liabilities	56,157	59,485	67,963	87,547	96,580	126,236	134,562
Capital	81,489	82,652	92,112	98,563	101,543	84,237	87,230

Source: ALIO.

Unlike EX and KOGAS, whose liabilities were accumulated through construction investments, KORAIL accumulated its debt through operating losses. The causes of the deficit in the operating balance can be explored through the dual aspects of costs and revenue. On the revenue side, debt accumulation is largely attributable to low profits stemming from the operation of railroad lines at a deficit. As the decision to operate a particular railroad line is made by the Ministry of Land, Infrastructure, and Transport, it becomes difficult to generate revenue from unprofitable lines, the operation of which is provided as a public service in pursuit of civic purpose. Personnel expenses account for a very large proportion of the sales cost of KORAIL. Labor productivity at KORAIL is remarkably low because of excessive personnel expenses, compared with all other public institutions.

Korea Expressway Corporation

The total liabilities of the Korea Expressway Corporation (EX) amounted to 24.6 trillion won in 2011. In the past, the company maintained a low level of total liabilities, compared to total assets, but the liability amount has recently climbed to a level approaching that of total assets. The liability growth rate from 2005 to 2009 was around 8 percent on average, with a peak growth rate of 13.34 percent, recorded in 2008. Although the liability growth rate has gradually slowed since 2010, it still remains around 3 to 4 percent. Mainly responsible for road construction and management, EX is among the group of SOEs with copious liabilities related to large-scale construction investments. The share of government subsidies has also been declining, but this is not a source of liabilities *per se*. If newly constructed expressways are sufficiently profitable, it is highly likely that the construction investment will be recovered, even when the share of government subsidy is low. Recently, highly profitable expressway segments have tended to be constructed using private capital. EX is more often relegated to the construction of roadway segments that are components of less lucrative policy projects, and the consequent decline in profitability has served as a crucial factor in liability accumulation. Tolls were raised every other year from 2002 to 2006, but have since remained stable. Traffic volume tends to grow in proportion to an increase in road extensions. However, in contrast to the increased traffic volume, toll revenue per vehicle has decreased, with a particularly sharp drop in 2007 when a toll freeze began to be implemented.

Korea Water Resources Corporation

Korea Water Resources Corporation (K-water) can be largely divided between water services, operation and management of dams, industrial complex projects, and development of water resources. K-water, once characterized by a remarkably stable financial structure, has now come to incur liabilities exceeding equity capital through an enormous expansion of business and investments. The volume of financial liabilities grew from 10 trillion won in 2006 to 11 trillion won in 2011, showing that the majority of liabilities resulted from increased expenditures. Therefore, the ratio of financial liabilities soared to 90.5 percent in 2011 from 60 percent in 2006, a sharp increase of 30 points.

The major reason for the steep rise in K-water's liabilities, which since 2009 relate to massive national projects, is that both assets and liabilities expanded significantly. For example, bonds funded the total cost of the Four Major Rivers Restoration Project. The bulk of expenses incurred on the project–related to the Gyeong-In Ara Waterway—were met by borrowing funds from financial institutions, swelling the financial liabilities from one trillion won in 2007 to 11.3 trillion won in 201. The Four Major Rivers Restoration Project accounted for 51 percent, or 6.4 trillion won, followed by 23 percent, or 2.8 trillion won for industrial complex projects, and 19 percent, or 2.4 trillion for the Gyeong-In Ara Waterway Project. These projects comprise 93 percent of K-water's total liabilities.

In the meantime, just like other public utility charges, the rates for wholesale water are basically set at a uniform price nationwide. The current costing system is set from the multipurpose dams, and is based on pricing discounted by expenses and offset by capital expenses. Wholesale water rates were frozen from 2007 until January 2013 by government policies regarding public utilities. Even though the average rates rose by 4.9 percent, they still fall short of the full cost by approximately 17 percent, serving as another factor that undermines K-water's financial structure.

Main Causes of Increased Liabilities

It is possible to summarize the main causes of increased liabilities into three factors: pursuit of policy programs, effects of regulations on charges, and inefficiencies in managing public institutions. Almost all SOEs with substantial liabilities share the first two causes. Programs propagated by governmental institutions, regardless of SOE-related intentions, are therefore government's primary responsibility. Government similarly imposes price controls. Most of the liabilities assumed by SOEs are related to government policies and should be funded through government finance. Also, SOE programs that help maintain the government's fiscal stability must be managed separately. Liabilities triggered by tariff regulation are created because a portion of the payment due is assumed by SOEs under the objective of stabilizing price levels. In sum, SOE liabilities are generated mostly when SOEs allow government and the public to establish pricing.

TABLE 16. Main Causes of Liabilities

	Public projects		Rate regulation		External economic factors		Interest burden	New investments		Productivity	
KEC	O	Construction investment	O	Toll rates regulated			◊				
KOGAS			O	Cost-linked price system	O	Oil prices and exchange rates		O O	Equipment investments at home Desarrollo de recursos en el exterior		
KORAIL	O	Facility investment, rail lines running deficits	◊	Railroad fares			◊			O	Labor cost
KEPCO			O	Electricity rates regulated	Δ	Fuel costs driven up by oil price hikes		Δ	Increasing investments overseas		
LH	O	Bogeumjari, Public Rental Housing, Innovation Cities	Δ	Land and house prices regulated	Δ	Sluggish property market	◊	Δ	Large-scale, short-term investments with slow cost recovery potentials		
K-water	O	Four Major River Restoration, Ara Waterway, Industrial Complex Development	Δ	Price freeze on dam water supplies and metropolitan water supplies							

Source: Authors' elaboration.

Note: Major factor O, minor factor ◊, additional info Δ.

The liabilities of LH, KOGAS, EX, and K-water are caused by a distinct pattern of programs in combination with price regulation. The major factors behind the liabilities of LH are found in programs such as the Bogeumjari housing, rental housing, and innovation cities, as well as restrictions on sales prices of houses. Massive policy projects such as the Four Major Rivers Restoration and Gyeong-In Ara Waterway were main causes of the rise of K-water liabilities. EX's liabilities mounted rapidly in the wake of the government's decision to fund the construction of highways with low projected profits through the corporation's liabilities, especially in combination with the fixed rate of highway tolls. The liabilities of KOGAS can mostly be explained primarily by its investments in domestic and foreign facilities, in particular, its expansion of foreign investments, but rate regulation has played a role as well.

Policy Options and Directions

There are several liability-reducing options, which can be categorized based on who bears the burden. The first category is rationalization of management based on institutions, which is ascribable to a variety of factors. The second includes policies that reduce certain unprofitable projects; in these cases, the beneficiaries of the project and the public institution that would lose a portion of its organization share the burden. The third option is an increase in interest rates; in this case the customers bear the burden. The fourth category is expanding the support of government, such as through investments, contributions, and subsides, which will ultimately shift the burden onto taxpayers.

TABLE 17. Options to Reduce Liabilities

<table>
<tr><th colspan="5">PRIVATIZATION</th></tr>
<tr><td>Partial privatization</td><td rowspan="5">Immediate improvement of the financial structure</td><td rowspan="2">Recapitalization (and repayment)</td><td colspan="2">Expansion of private capital</td></tr>
<tr><td rowspan="11">Remaining in the public sector</td><td colspan="2">Expansion of public sector investment</td></tr>
<tr><td rowspan="3">Asset sales</td><td colspan="2">Sales of idle assets</td></tr>
<tr><td rowspan="2">Sales of business assets</td><td>Reduction of projects</td></tr>
<tr><td>Utilization of lease</td></tr>
<tr><td rowspan="7">Gradual improvement of the financial structure</td><td rowspan="4">Reduction of expenditures</td><td colspan="2">Reduction in business expenditures</td></tr>
<tr><td rowspan="3">Reduction in personnel, operation costs, and other expenses</td><td>Reduction in personnel</td></tr>
<tr><td>Reduction in payment and welfare benefits</td></tr>
<tr><td>Reduction in operating expense and other expenses</td></tr>
<tr><td rowspan="3">Expansion of earnings</td><td rowspan="2">Expansion of its own incomes (reduced deficit)</td><td>Price increases</td></tr>
<tr><td>Adjustment of sales[a]</td></tr>
<tr><td colspan="2">Expanded governmental assistance</td></tr>
</table>

Source: Authors' elaboration.

[a] In a case where profitability is secured, sales are expanded. In the case of deficits, sales are reduced.

Enhancing the Managerial Efficiency of SOEs

How much debt can we reduce by enhancing the managerial efficiency of SOEs? Unlike private enterprises and similar to what occurs with cost reductions, significant limits exist with regard to the expansion of sales. First, as with reducing personnel expenses (even setting aside social and institutional aspects such as stability of labor), public institutions would have difficulty improving managers' efficiency without downsizing their businesses. As seen above, among the six major Korean SOEs, only KORAIL's increased liabilities can be ascribed to management efficiency improvements, including personnel expenses. Efforts to enhance management efficiency are especially important in the sense that it would be difficult to secure the political support necessary for the implementation of other policy measures, such as a raise in rates or expansion of government assistance. Yet, improved management efficiency alone is insufficient to curb public institutions' mounting liabilities.

Enhancement of Transparency and Accounting Separation

Improved management reforms would be difficult to secure the political support necessary for the implementation of other policy measures, such as securing rainy-day accounts. It appears that separate programs would help manage the liabilities assumed by LH, K-water, and EX. In the case of LH, undertaking too many programs without considering the corporation's financial condition rapidly aggravates its finances. Therefore, by separately managing program expense, the corporation becomes more open and transparent in reporting its liabilities; yet, government support measures must be formulated with the goal of removing excessive liabilities. To this end, it is necessary to consider program budgeting.

For policy-based services, the government should consider raising the allowable size of liabilities or increasing the proportion of the national treasury subsidy for construction costs. An SOE should receive appropriate compensation for any public services it carries out. Based on the results of economic and non-economic analyses in a preliminary feasibility study, one measure that could be considered would be to define as for-profit programs those with a benefit-cost ratio that exceeds one while considering the others as policy programs. As for KEPCO and KOGAS, however, it is believed that the necessity of separating accounts for the purpose of identifying policy programs is relatively low.

Toward Fair Prices

One major source of increased liability arises from capping the rates charged for public services at low levels. In such a case, reasonably adjusting rates should be first considered and reviewed as a counterbalance to an SOE's liabilities. For example, consider the cases of KEPCO and KOGAS. The former's liabilities expanded largely because of exacerbated estimates of profitability and the greatest influence on profitability stemmed from the rate controls imposed in 2008 and 2009. KOGAS, on the other hand, was largely impacted by regulations on rates despite an increase in the firm's costs since 2008. This rate control also played a part in the increased liabilities assumed by EX and other SOEs.

When policy programs are expanded with no guarantee of profitability, the first option to be considered is increased governmental support. In the case of LH, its liabilities snowballed as it launched massive simultaneous policy programs without detailed plans to secure the requisite financial resources. On the other hand, K-water once managed its liabilities in a stable manner relative to other SOEs, but its liabilities have recently increased due to its implementation of policy programs, including the Four Major Rivers Restoration Project and the Gyeong-In Ara Waterway Project. As for EX, policy programs with low economic feasibility, which do not guarantee profit but play a role in a corporation's liability accumulation, have been implemented out of national need. Part of KORAIL's liability is attributed to a similar factor.

Public utility fees with a low proportion of cost recovery generally have resulted in SOE liabilities, which are being passed along to future generations. In addition, from the perspective of income distribution, it is not convincing to charge equally low public utility rates to all people. It is more appropriate to set rates at proper levels and then strengthen programs targeting low-income groups. Along with the increase in rates, additional policy measures could also be considered.

Expansion of Government Support

Implementing policy programs through public institutions instead of by directly spending government funds can undermine fiscal transparency and weaken oversight by the National Assembly and the public. Of course, most of these issues have improved recently. Policies have shifted toward making liabilities open and transparent, even those institutional liabilities that are not considered national ones. These shifts have helped develop a foundation for allowing the indirect influence of popular opinion. In addition, a framework was created for reporting liabilities to the National Assembly through medium- and long-term financial plans. However, people tend to place relatively less significance on public institutions' liabilities than on national liabilities. While the National Assembly maintains direct control over the general budget and national liabilities, its oversight of public institutions' liabilities is loosely conducted. Taking that into consideration, it would be desirable to financially support such programs through the government budget when public institutions' liabilities are specifically related to public programs and when insufficient means exist to cover them through public institutions' own revenues or other sources.

Conclusions

Any effort to resolve the financial difficulties of SOEs through public institutions instead of through the direct use of government funds can undermine fiscal transparency and weaken oversight by the National Assembly and the public. Of course, most of these issues are expanded with the sale of assets. There are other measures, such as enhanced management efficiency, that could gradually reduce liabilities. Institutional schemes to shelter SOE liabilities from further increases could also help. An example might be gradually expanding government funding for such liabilities. Many liabilities result from a structure that allows the government to enjoy the programs' benefits without being responsible for its expenses. When the government pursues implementing public programs, it should pay for related expenses. This requirement would restrain overly ambitious attempts to govern policy programs; to institutionalize restraint, SOEs should incorporate a separate accounting system.

SOEs are not reluctant to expand business because such expansion leads to increased budgets, augmented programing, and promotions. The general public likes new programs because people either directly or indirectly benefit from them. Secondly, the government maintains lower subsidized utility rates for electricity, gas, water, and transportation, compared with rates related to production costs, and individuals are pleased by lower rates. SOEs accept low public service rates under pressure from the government, taking solace in the fact that as long as rates remain low, there is no possibility of privatization. The core of SOEs' liability problems is the fact that the government and citizens enjoy benefits without paying. The collusion among the government, SOEs, and the general public produces enormous liabilities for SOEs. Addressing these liabilities must be undertaken not only by the government and SOEs, but also by the general public.

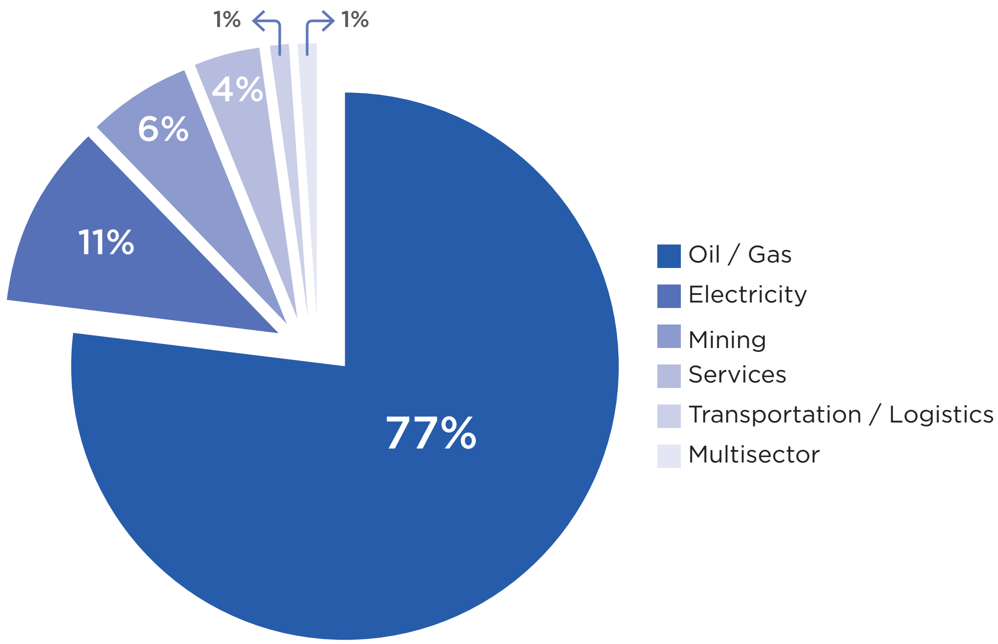
STATE-OWNED ENTERPRISES IN LATIN AMERICA AND THE CARIBBEAN: OVERVIEW AND FISCAL RISKS

Roberto García López, Executive Secretary, CoPLAC-GpRD, IDB

The fiscal impact produced by SOEs is often a consequence of the deficit inherent in these companies. This is certainly not a new topic in the Latin American and Caribbean (LAC) region, but it is an important factor for SOE operation and for medium-term fiscal sustainability.

This presentation will describe the important roles of the SOEs in the energy sector, with a special focus on nonrenewable resources. Figure 10 illustrates the relative proportion of SOEs in a number of energy-related sectors in the region. The first realization is that only five enterprises account for 77 percent of all sales, and that all of them belong to the oil and energy sector.

FIGURE 10. Distribution of the Main SOEs in LAC by Sector, 2011 (percent of sales)



Source: América Economía.

Notes: In 2011, only five enterprises concentrated 70 percent of all sales made by SOEs in the region, all of them in the oil/gas sector (Petrobras, PDVSA, PEMEX, Petrobras Distribución and Ecopetrol).

Causes and Factors of Fiscal Risk and Debt

My experience as Budget Director of the Republic of Argentina in the early 1980s showed me that most SOEs presented fiscal deficits. In those days, the Budget Office hosted monthly meetings to discuss what resources would be transferred to alleviate SOE deficits. The evaluation system used at the time was not very elaborate and consisted of assessing whether SOEs had expanded the coverage of the services provided.

Discussions, however, did not consider whether they had reduced costs, become more efficient, improved their investment, or fulfilled their projects. The only significant evaluation indicator was whether there was a need for fiscal transfers or not. Some SOEs did not require any, while others had to struggle with structural deficits and therefore were always in need of additional resources. Today, many of the SOEs in Latin America and the Caribbean (LAC) present fiscal deficits.

SOE deficits put pressure on the national treasuries across the region, both in terms of the permanent deficit and potential contingent liabilities. The causes of deficit vary, but they seem to stem from political interference with the management of SOEs. Sometimes this interference takes the form of implicit subsidies such as the fuel subsidy. For example, despite high oil prices, oil companies continue to be a source of deficit, as oil and gas prices are fully subsidized to the consumer. Mexico, for instance, subsidizes the oil sold to electricity companies. In this scenario, oil companies can hardly be asked to generate profits. Even if prices are adjusted, they do not follow the inflation pattern but are managed in such a way as to lessen their inflationary impact. When public companies generate deficits, debt for investment inevitably translates into transfers or guarantees from the central government.

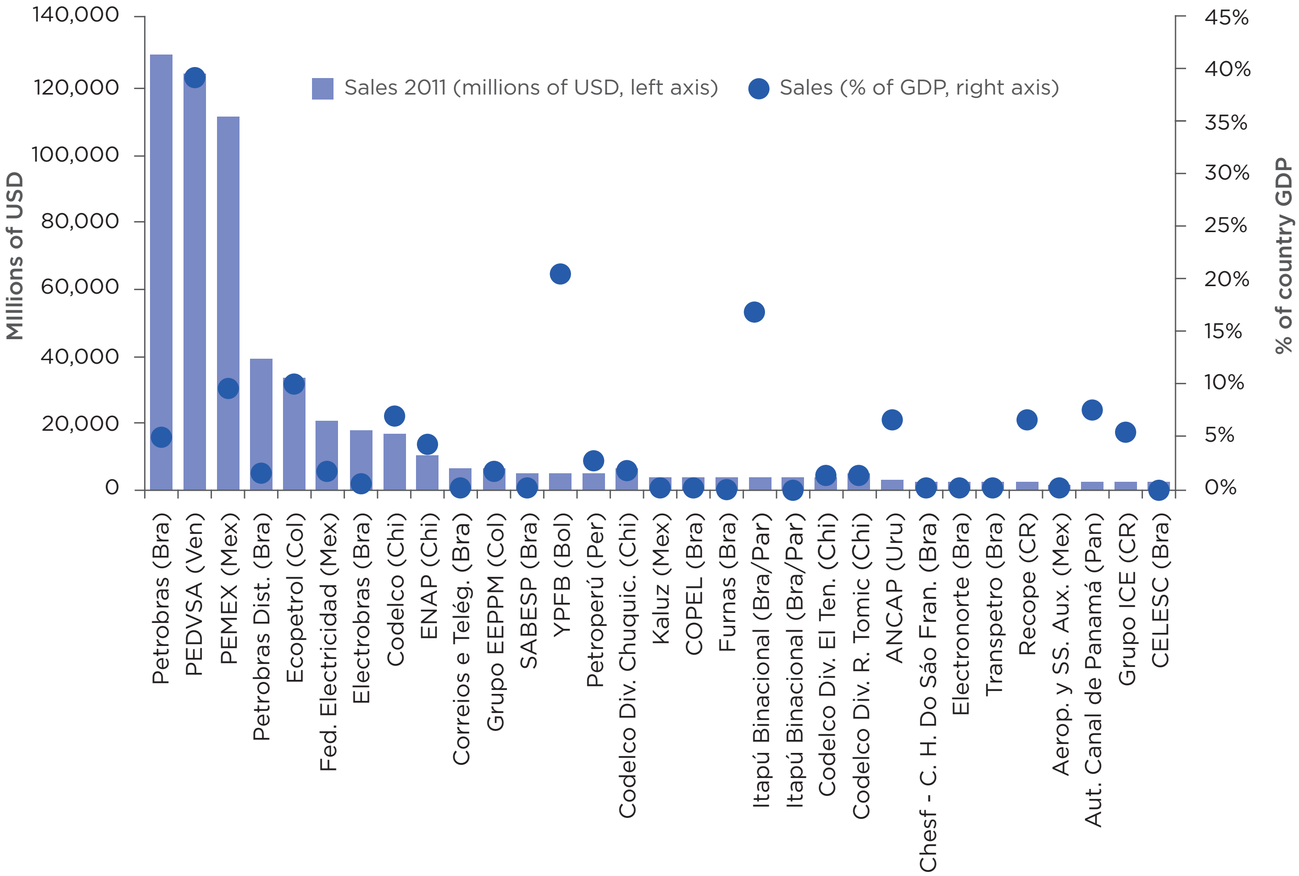
Other factors have also contributed to the increase in SOE fiscal risks and debt. One of them was the economic crisis of the 1980s, which eventually led to the wave of privatizations that swept the region during the 1990s. The process had some major flaws, one of them being the regulatory frameworks that governed privatized companies in some countries. These frameworks were not solid enough, however, and resulted in significant deviation of funds toward these companies, which did not meet the goals of reducing their deficits and increasing investment. Another problem arose in the selection of strategic partners, which, in many cases, were inappropriate and the process had to be reverted by nationalizing these companies.

In the present analysis, it is important to consider subnational SOEs. This type of enterprise, which normally provides basic social services, such as potable water, gas, transportation, and housing, is found in most provinces and states, as well as in some municipalities. Even though the extent of their operation is not as large as that of national companies, there is still a problem of subsidized tariffs. Again, the issue is the deficits generated through these subsidies, which pose potential fiscal risks for subnational governments. This may have a direct impact on intermediate jurisdictions such as provinces and states, as well as on the central government.

Another characteristic of SOEs with fiscal risk and debt is their liabilities-to-net equity ratio. At one end of the spectrum are PEMEX or the national enterprises in Paraguay, where liabilities are considerably high compared to their net equity. At the other end are companies with a ratio that is more rational from a business point of view. This type of behavior generates a fiscal impact, and when a company engages in this sort of behavior, it is never too long before somebody asks for additional resources.

One indicator that throws light on the issue of fiscal risks and public company debt is a healthy return on assets (ROA). This means that if profitability over an asset is very low, then the company may have a limited capacity to generate profits and therefore cause an impact on the treasury. Some may think that the number of such LAC companies is indeed limited, but, as Figure 11 illustrates, most SOEs are under 8 percent. Only a handful of companies have an ROA that is sufficiently important.

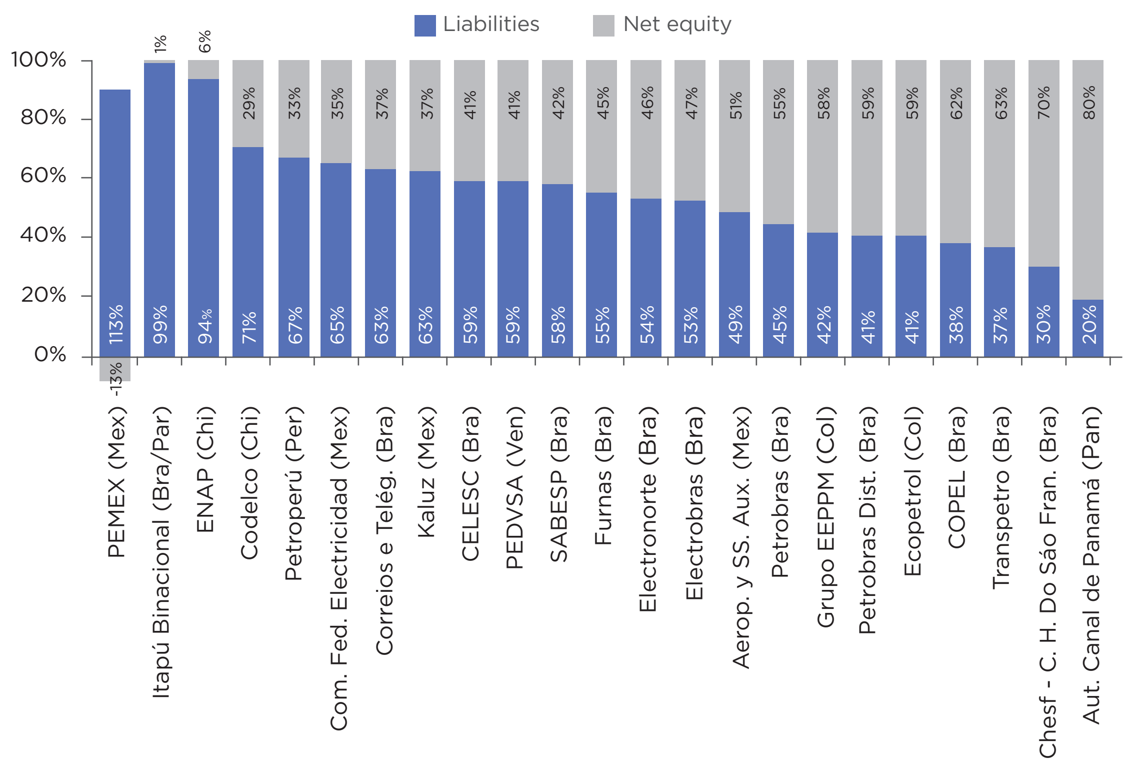
FIGURE 11. Main Public Enterprises in LAC



Source: América Economía.

Information is crucial in preventing fiscal risks and debt. Broadly speaking, the LAC region has advanced toward greater transparency, although it may be some time before the level of transparency increases for reporting SOE financial results. If figures are to be consolidated, information must be published in a timely basis. Only a few countries in the region, however, are timely in publishing their information. Furthermore, in some countries, SOEs do not publish their balances nor provide aggregate information. In general, fiscal figures tend to be more consolidated in large and medium countries, thus allowing a clearer picture of their total debt.

FIGURE 12. Liabilities and Net Equity of the Main Public Enterprises in the LAC Region (in percent of assets)

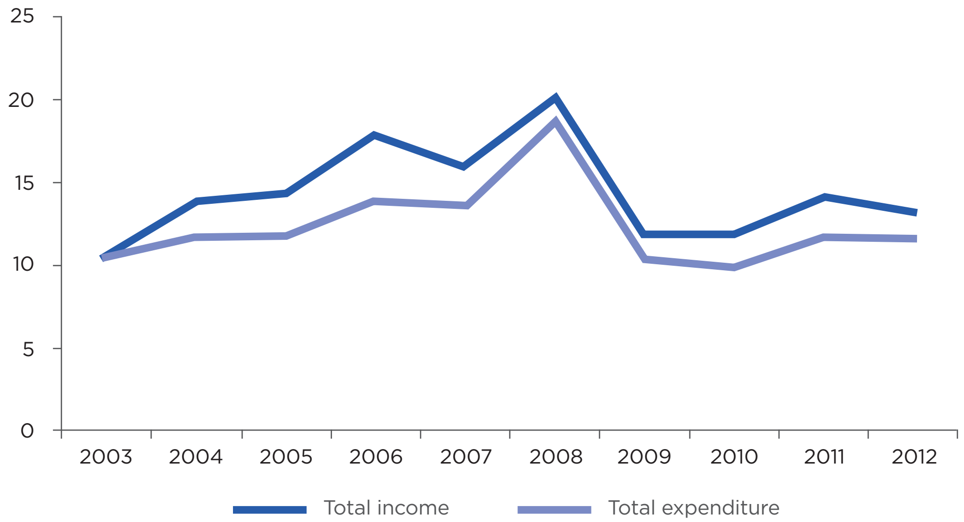


Source: América Economía.

When there is a lack of information, SOE economic and financial performance is often distorted, and once the actual figures are published, it is already too late to take corrective action and the treasury must assume the losses. In this sense, public companies with an exporting capacity are much better placed than those exclusively focused on the domestic market. Therefore, when making an aggregate analysis, companies with exporting capacity can distort indicators such as ROA or the income-to-net assets ratio.

Another factor to consider is the general assumption that public utility companies normally have very low yields compared to their equity and assets. At the country level, this is reflected by considering the fiscal balance of all public companies, which indicates that all SOEs are close to 0 or 1 percent of GDP. In some countries, such as Chile, the revenues of SOEs have been consistently higher than their total expenses. In such cases, the demand for resources from the treasury and the impact on deficit is much lower or even nonexistent (Figure 13).

FIGURE 13. Chile: SOE Income and Expenditure (percentage of GDP)



Source: Central Bank, Ministry of Finance, IMF.

In other countries, the situation is somewhat different. For example, in mid-2008 and before the 2008–09 crisis, Mexico had very interesting results. After the financial crisis, however, prices and expenses were practically the same. Ecuador is almost in a fiscal deficit situation, and Peru has also had a cyclic performance, as it greatly depends upon the prices of international markets and raw materials. In recent years, however, it has had a small surplus. In Bolivia, the situation is best explained by the surge in income and expenditure and by the fact that for 2012, income and expenditure were roughly the same. The reason for this, however, is the nationalization of the hydrocarbon and mining industries.

In conclusion, SOEs fall into fiscal risks for different reasons. First, the fact that natural resources are state-owned may not be the best incentive for managing them properly. In general, there is a widespread agreement that natural resources are a country's property, hence the discussion on what the best way to exploit them should be. In some countries, the private companies exploit and produce these resources, while in others the prevailing idea is that public companies should produce them, with the welfare of future generations in mind. In this analysis, what matters most is to decide whether SOEs should exploit these resources and, if so, ensure that they do it properly. For example, until five or six years ago, the international energy balance in Argentina was approximately US$2–2.5 billion. At that time, the imports-to-exports ratio was favorable and showed a surplus. Today, however, the country faces an energy deficit of US$10–11 billion. What happened, especially considering that oil prices are, in principle, favorable? First, the SOEs performed poorly in terms of investment, growth, and exploration, and now Argentina needs to import gas, oil, and other products that it could otherwise be exporting. Second, SOEs play a dual role. They are enterprises, but at the same time they provide services to citizens, many of which are of a social nature. In other words, they are expected to generate profits but they must also provide public goods and services at subsidized tariffs. That only adds confusion as to what their main role should be. On the other hand, as mentioned, the ROA and return on equity is very low and there is a bias toward those companies that export raw materials, especially nonrenewable resources. In the case of service providers, however, and precisely as a consequence of the subsidy scheme, the investment required is barely sufficient, thus generating a fiscal impact. As a result of their inability to count on fiscal resources because of the bleak fiscal conditions, SOEs may fall behind on their investment programs, become obsolete, or simply lack the technology and productivity required.

So, what are the big problems associated with the main fiscal risks and where do they stem from? One of them is the manner in which the external impacts on raw material prices are managed. Quite obviously, none of the countries in the region can, for its production volume alone, control the international prices of raw materials. Therefore, these enterprises find themselves at the mercy of the fluctuations of international prices. Right now, we are on the upward side of the curve, as prices for most raw materials have been favorable. However, the situation has caused many SOEs to stop making risk analyses, and if the situation changes, they will have lost the opportunity to stock up on reserves. There are, however, a few exceptions, such as Chile's Codelco and Mexico's Pemex, both of which provide a price compensation fund to mitigate the risks of external price changes. The ministries of finance rather than the SOEs manage these funds.

A second cause of fiscal risk is the way subsidies are managed. LAC countries have implemented explicit subsidy schemes as well as price and tariff control. These schemes are, however, politics driven. During the years before an election, tariffs tend to decrease, only to be adjusted after the election has passed. When sustained in time, these fluctuations bring about severe problems to SOEs. In other words, when prices are maintained below the profitability line for a long time, the company's capacity becomes significantly affected.

Another issue has to do with human resources. SOEs may control their fiscal risks by employing personnel who are qualified, trained, and appropriate in number. Therefore, the staffing of these companies should not be changed for political reasons. However, in Argentina, for example, 14 enterprises went from 5,000 employees to 50,000 in just 10 years. This augmentation is disproportionate and inefficient, as production did not expand in the same measure. On the contrary, the quality and quantity of services decreased significantly.

SOEs also need to manage their operations efficiently. Deficiencies affect productivity and the fiscal risks they entail will impact the country's economy. Moreover, SOEs often fail to calculate or estimate other contingent liabilities, such as pensions or medical services, among others. These are minor costs, however. When SOEs begin to discuss these kinds of liabilities alone, it will mean that they have taken significant steps towards operational efficiency.

Finally, another area of opportunity to control fiscal risks is to strengthen governance and oversight. A lack in this area puts significant strain on deficits and financing.

MECHANISMS AND FISCAL RISKS INVOLVED WITH SOEs IN URUGUAY

Fernanda Díaz, Advisor, Ministry of Economy and Financing, Uruguay

This presentation focuses on four main points: a description of SOEs in Uruguay and their impacts on the economy; explanation of how the government incorporates SOE actions into the National Development Plan; description of the rules, legislation and policies that govern them; and discussion of the political framework the government uses to mitigate large fiscal risks associated with SOEs.

SOEs in Uruguay

In Uruguay, SOEs are defined as public entities producing goods and services of a commercial, industrial, or financing character. Goods may be sold in the open market; SOE management generally functions autonomously, with independent financing. Their legal status is different from the State's, but the State maintains oversight and control over their operations directly by holding a majority of an SOE's capital or other instruments.

According to the Constitution, there are different types of SOEs in Uruguay. First, there are autonomous entities with inclusive capital and decentralized services. "Inclusive capital" means that these enterprises are under the supervision of the Ministry of Economy's Office of Planning and Budget. A second type of SOE is an autonomous entity that has mixed capital and decentralized services; the capital includes funds from both State and non-State entities. Limited liability companies (LLCs) are under exclusive State control and invest in certain types of business. These companies are not managed directly by the Ministry of Economy, but rather by public capital investments.

Uruguay has seven SOEs. The four main ones are the oil producers (ANPAC), the telecoms (ANTEL), the electricity service company (UTE), and a monopoly that manages water and sanitation (OSE). ANPAC manages all business related to oil and its derivatives, including importing and refining oil, distributing fuel, and producing alcohol. ANTEL has a monopoly on telephone landlines, but is open to competition related to cell phone lines and data transmission. UTE has a monopoly in electrical energy transmission and distribution, but competition is developing for electrical generation. OSE is the monopoly in sanitation and water supply. The remaining three enterprises are monopolies in ports and railways and the National Housing Agency.

Table 18 measures the importance of SOEs in the fiscal results of Uruguay's public sector. To better grasp these figures, it is important to mention that in 2008 the public sector carried a fiscal deficit equivalent to 1.6 percent of the GDP, with SOEs accounting for 0.8 percent of that deficit. As can be appreciated, SOEs have a significant weight on public accounts, although with changing intensity. For example, while in 2008 SOEs posted the deficit mentioned above, in 2010 they posted a surplus equivalent to 0.3 percent of GDP. Given their impact on the results of the public sector, it is crucial that SOEs make strong commitments that are compatible with government plans.

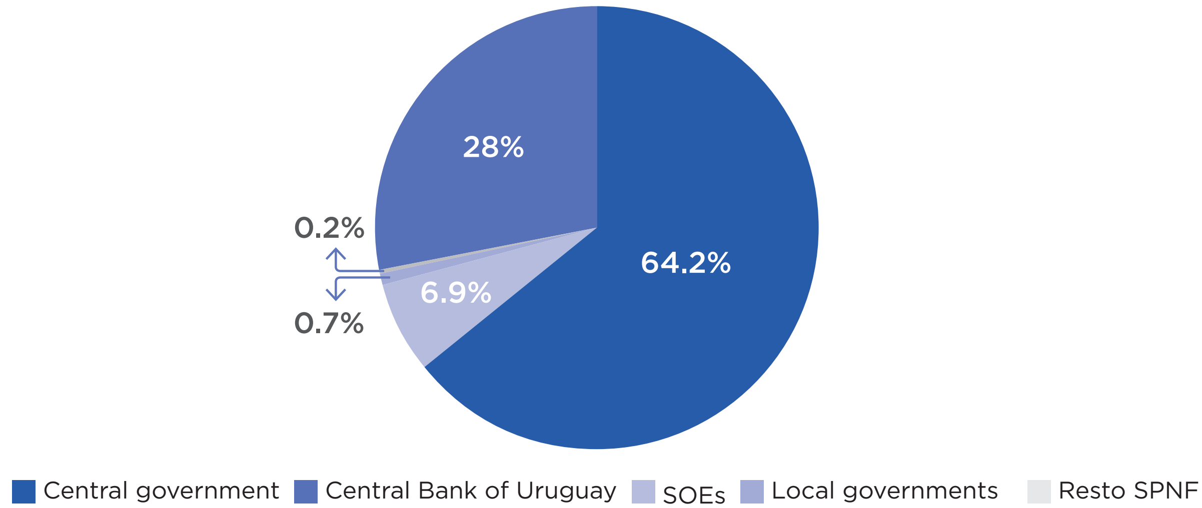
TABLE 18. Impacts of the Public Sector on the Uruguayan Economy (2008–12)

	2008	2009	2010	2011	2012
Central government's operations	-1.1%	-1.6%	-1.2%	-0.6%	-2.1%
SOEs	-0.8%	-0.6%	0.3%	-0.2%	-0.6%
The Central Bank of Uruguay	-0.2%	-0.1%	-0.7%	-0.6%	-0.3%
Local governments	0.1%	0.3%	0.0%	0.1%	-0.1%
The State Insurance Bank	0.3%	0.3%	0.5%	0.3%	0.4%
Consolidated public sector	-1.6%	-1.7%	-1.1%	-0.9%	-2.8%

Source: Ministry of Economy and Finances, Uruguay.

The share of SOE debt in Uruguay's total gross public debt is very limited. The country's total gross public debt is approximately 62 percent of GDP, while the total net public debt is 26 percent of GDP. The debt of SOEs is barely 5 percent of the gross debt, which means that until now their debt has been managed in an orderly way. Their debt is primarily with international institutions, private banks, and companies that have issued negotiable debt obligations.

FIGURE 14. Uruguay: Net Total Debt by Public Entity in 2013 (percent of total)



Source: Central Bank of Uruguay.

Policies and Rules that Govern SOEs

The programs for SOEs are part of the government's plans. Every five years, the newly elected administration designs its government plan, which includes sectoral and social policies, among others. Based on this plan, the Ministry of Economy and Finance and the Planning and Budget Office define the global financial program for the public sector. Together they forecast global macroeconomic scenarios and predict fiscal revenue according to the expected behavior of the GDP and other macroeconomic variables and set public debt targets. For example, the government may establish that the gross debt should fall to 40 percent of GDP in five years and that the new figure will be used as a benchmark to set fiscal results for the public sector, which includes SOEs, in order to make them consistent with that particular public debt target. The global financial program sets guidelines for SOEs in the areas of investment level, current expenditure, and transfers to general revenue, among others.

The Ministry of Economy and Finance sets rules based on the needs of each SOE in terms of resources to be invested in each company so that it can meet the fiscal result expected. The Ministry does not intrude in the definition of SOE investment projects, but it does require them to submit an economic and financial assessment of the investment project they plan to undertake to ensure their economic and financial viability.

The Ministry also provides instructions regarding SOE expenses and wage policies. Some of the instructions include the hiring process or topics related to organizational culture. For example, Uruguay is introducing a variable compensation system to tie wages to performance. For some time, a portion of public employee wages has been determined by productivity, although this productivity has not been properly measured, so in practice it has become one more component of the salary. With the new system, this productivity component is determined by institutional performance goals, the goals set for the sector, and individual performance goals.

The Ministry's guidelines also provide specific measures for SOE transfers and subsidies, depending on whether enterprises are profitable or not. Until now, this has been a weakness, as the rules concerning transfers are not clear and have only been set in fixed amounts. With regard to subsidies for SOEs with fiscal deficit, although still in the initial stages, a mechanism is being arranged to tie the approval of subsidies to management commitments.

The guidelines provide the base for SOEs to define their long-term plans and, from those, their annual operational plans. These plans are the starting point to create budgets and financial programs, which constitute the qualitative expression of annual operational plans. Long-term strategic plans and annual budgets are reviewed, adjusted if necessary and approved by the Ministry of Economy and Finance, the Planning and Budget Office, and the ministry that governs SOE operation.

The Ministry of Economy and Finance and the Planning and Budget Office conduct monthly meetings with SOE management to monitor the execution of the financial programs defined. In these meetings, they make all relevant analyses and, if necessary, establish corrective measures. Those resources that are not used are reallocated.

A law mandates that the Executive analyze and approve all SOE debt over a certain amount in terms of the execution of the public sector financial program. For example, if an SOE requests financing for an investment that is not included in the annual financial program, the additional financing is denied. The Ministry's Debt Office reviews and approves conditions for financing.

Fiscal Risk Mitigation Mechanisms Implemented in Uruguay

The impact of SOEs on Uruguay's public finance is varied. Of all SOEs, the electricity enterprise UTE shows the most dissimilar results. This generates a greater impact and larger variations in the fiscal results of the public sector. The electrical enterprise produces power from hydraulic and thermal sources. If there is a drought and hydraulic plants cannot operate at their maximum levels, the company is forced to resort to its thermal plants at a much greater cost than its hydraulic systems (Uruguay is an oil importer). This strongly affects fiscal results, and produces deviations from the goals established.

To avoid the impact of this enterprise on the government's fiscal result, the Energy Stabilization Fund was created in 2001. Its objective is to reduce the negative impact of water deficits on UTE's financial situation and on public finances in general. The National Corporation for Development holds and administers this fund outside the public sector.

According to the regulation that governs the Stabilization Fund, the enterprise makes a minimum annual contribution to the Fund regardless of whether the climate is favorable or not. In years of higher rainfall, the enterprise increases its variable contribution. Therefore, at the beginning of the year the generation of hydraulic power projected for the year is determined in megawatts. If hydraulic generation for the year exceeds the estimate, the enterprise will make additional contributions to the Stabilization Fund. Conversely, the enterprise may use these resources when conditions become unfavorable—for example, when hydraulic generation does not meet the estimate.

SESSION V.
PRIVATIZATION AND MARKET COMPETITION: STATEGIES AND CONSTRAINTS

This session studies the restructuring and privatization processes of Korean SOEs, stressing the significance of adjusting their role in market development.

Guiding questions:
- How have privatization policies been changing?
- What are the major strides in privatization?

PRIVATIZATION STRATEGY FOR DEVELOPING COUNTRIES

Jin Park, Executive Director, Research Center for SOEs, Korea Institute of Public Finance (KIPF)

The Benefits of Privatization

Although there are contrasting views on the benefits of privatization, the Korean experience supports arguments in favor of privatization. Directly after the economic crisis of 1998–2002, privatization was driven under the direction of the Kim Dae-Jung administration. This action introduced an additional US$15 billion of revenue into the Korean economy, generating a higher country rating that significantly helped Korea overcome the crisis. In addition to these macro-economic effects, privatization had several micro-level benefits.

Since 2000, the following companies have benefited from privatization: POSCO (formerly Pohang Iron and Steel Company, a multinational steel-making company), National Textbook Corporation, Korea Technology Finance, Korea Oil Pipeline, and Korea Heavy Corporation. Micro-benefits after privatization included lower prices, better business strategies, improved services, increased profit margins, and better financial standings of the companies. POSCO and National Textbook Corporation are examples of these improvements. Korea Oil Pipeline has maintained a higher market share after privatization. National Textbook was also better received in terms of overall consumer satisfaction.

Furthermore, the companies' profit margins have increased with more active marketing activities and cost cutting measures. Four of the privatized companies went from a negative bottom line to positive profits; although POSCO could not quite achieve positive profits, it reduced its deficits significantly. (Its main competitors in the United States and Japan face ongoing deficits.) Finally, all five privatized companies showed a more sound financial standing after privatization. It is not surprising that their stock prices have, on average, doubled, reflecting better performance in various aspects. This presentation describes why countries should privatize, using the Korean experience as an example.

Arguments against Privatization

The strongest argument against privatization is that it may produce higher prices and less quality for SOE goods or services. Lower prices for public services may actually benefit the economy. Typically, a lower price is applied regardless of income level. Although the pricing scheme has a progressive nature, both rich and poor enjoy low electricity prices, while heavy users are not subsidized. Unfortunately, low prices explain why many SOEs have heavy debt loads, which create issues of intergenerational equity. However, lower prices can also be achieved through privatization. A privatized company can reduce input costs and increase revenue with more active marketing. If lower prices are still desired after privatization, it is possible for government to maintain the price reductions.

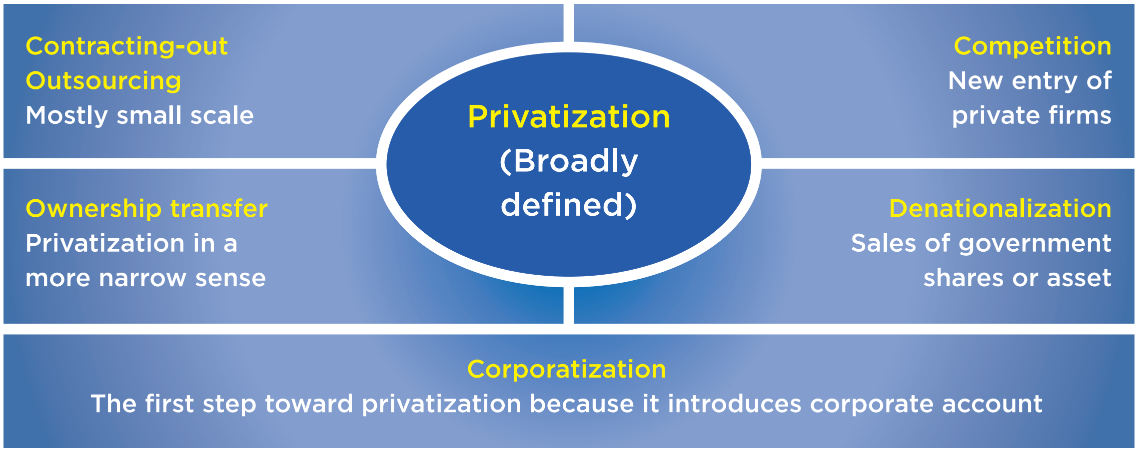
Others argue that a profit-driven company may neglect the needy. In principle, however, protections for the needy should be provided by governmental social welfare policies, not by SOEs. For example, if a private Korea Railroad owns a remote train station with only 20 customers, the station will likely be shut down. For the government, it is much more efficient to offer a bus service than to maintain the train station. Protecting the needy is an important policy goal, but it is the role of social policy, not of SOEs.

Turning SOEs over to the hands of foreign capital may create economic dependency. This worry is not groundless, especially when it comes to key industries such as electricity. Therefore, regulation for foreign capitals, such as ceilings, imposed limits on foreign ownership in some industries. The United States imposes such restrictions on foreign capital in its nuclear industry. Of course, more restrictions will make private corporations less attractive to foreign investors.

In reality, only a big company can afford to buy SOEs. Others argue that privatization will widen the gap between companies by making some of them even bigger. Because the public tends to believe that a buyer of an SOE receives special favors from the government, the State may consider mass privatization: shareholding by many individuals without making a dominant shareholder. However, such mass privatization without a dominant owner can create a private company that is very inefficient. Therefore, the issue of economic concentration and favoritism does not challenge privatization itself, but privatization methods.

Downsizing is the main reason why labor unions are against privatization. Some argue that SOEs need to alleviate unemployment, which is true in the short run. In the long run, however, if the public sector absorbs eligible human resources, which can be very scarce in developing countries, overemployment by SOEs will undermine the private sector's growth. The magnitude of employment adjustment will vary depending on the nature of each industry. For financial institutions, privatization will entail significant employment cuts since personnel costs are a dominant part of input. However, infrastructure or telecom industries may not need such a large downsizing. For such industries, facility-running costs are relatively more important, and they may have higher demands induced by active marketing and diverse price schemes after privatization. Many private companies guarantee employment for three years. SOEs to be privatized may consider these types of bargaining chips when they negotiate with labor unions.

FIGURE 15. Four types of Privatization (broad sense)



Source: Authors' elaboration.

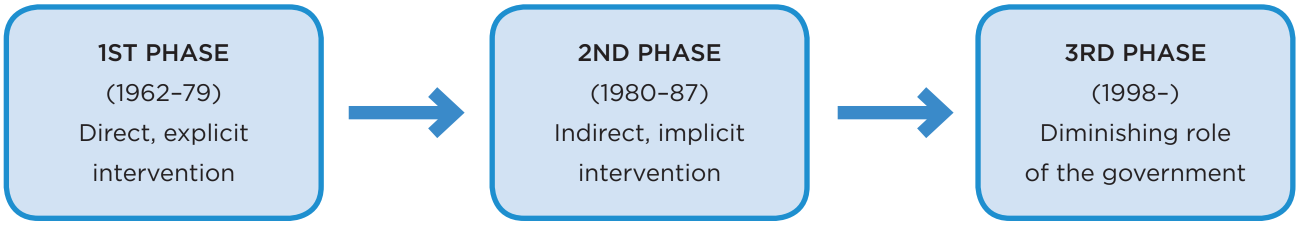
Historical Overview of Korea's Privatization

During the past 50 years of economic development in Korea, the government's role has been taken up by the private sector. In the first phase (1963–79), the State led development, either by orchestrating private companies or by owning SOEs. This government-led development was very effective in mobilizing labor and capital. The government picked not only leading industries, but also winning companies through allocation of financial resources.

In the second phase (1980–97), the style of government intervention changed. Excessive government intervention in the promotion of heavy and chemical industries raised a question about the State's role. As a result, governmental control became rather indirect and implicit, rather than explicit. The change was more in style than in the scope or depth of intervention. The private sector, on the other hand, rapidly grew in size and diversity, creating many business activities not subject to governmental controls, especially in the financial sector.

The third phase of this history (1998–today) brought about a real change in the State's role. After the 1997 economic crisis, Korea actively started reducing the government's role, based on a hard-earned lesson that government failure could be more dangerous than market failure. The reform is still in progress, and more changes need to be made.

FIGURE 16. The Changing Government Role



Source: Authors' elaboration.

Throughout the development process, the source of growth has changed from labor and capital inputs to productivity increases. When resource mobilization was important during the 1960s-1970s, the government's involvement was essential, but its role was replaced by the private sector because companies are the main players in productivity improvement, not the government. Markets are growing, even in fields where SOEs used to be the sole supplier. Aligned with this trend, privatization has continued since the late 1960s, although not all of those efforts were successful. The most important privatization drive in the recent years was made under President Kim Dae-Jung (1998–2003), right after the economic crisis of 1997. President Roh (2003–2008), however, stopped many reform measures that had been planned under his predecessor. The privatization plans relating to electricity, gas, heating, and the railroad were stopped or postponed under President Roh. President Lee (2008–2013) revived many of President Kim's plans, and has been very active in privatization. But many of his initial ambitious privatization plans were toned down after a public demonstration resulting from the government's hasty decision to import beef from the United States.

TABLE 1. Privatization Efforts in Korea

PHASE	WHAT HAS BEEN DONE	MAIN OBJECTIVE AND EVALUATION
1st Phase (1968–1973)	• Privatization of 11 SOEs Korea Machinery Korea Transportation Korea Shipping Korea Ship-building Incheon Heavy Manufacturing Korea Steel / Korea Airline Korea Mining Refinery Korea Saltern / Commercial Bank Korea Fishery Development	• Birth of private companies ⟶ market economy • Successful privatization
2nd Phase (1978–1983)	• Privatization of 7 SOEs Daehan(Korea) Reinsurance Daehan(Korea) Oil Daehan(Korea) Dredging Corp. Hanil Bank / Jale(First) Bank Seoul Trust Bank / Choheung Bank	• Financial market promotion • Since government's intervention did not stop, the objective of the privatization was not fulfilled.
3rd Phase (1987)	• Privatization of Korea Stock Exchange • Reducing government share in SOEs KEPCO (Korea electricity Corp.) POSCO (Pohang Steel Corp.)	• Maintains government influence even up to now • Redistribution policy: Sale of government share to individuals rather than companies • It was not a privatization.

4th Phase (1993–1997)	• Privatization Daehan (Korea) Tungsten Kookmin Bank / Housing Bank Other 7 subsidiaries of SOEs • Reduce government share of 22 SOEs	• Original target: privatization of 58 SOEs except some infrastructure-related SOEs such as telecom, electricity etc. • Only partially successful (Conglomerate's dominance was an issue.)
5th Phase (1998–2002)	• Privatization of 8 SOEs (original plan was 12 SOEs) • Privatization of 67 subsidiaries of SOEs (original plan was 77) • Restructuring and downsizing	• Extensive privatization plan to reduce public sector after the economic crisis ('97) • 4 network industries are not privatized yet. • (Electricity, Gas, Railroad, Heating)
6th Phase (2008–2010)	• Privatization of many subsidiaries • Privatization of functions	• Still in progress

Source: Ministry of Strategy and Finance, 2008.8.11 (modified).

Recommendations for Developing Countries

Privatization strategy

Among the arguments opposing privatization, transfer of ownership to foreign capitals is a more serious problem in developing countries. In general, infrastructure-related industries and telecom network industries should not be privatized. If these industries are to be privatized, foreign capital's dominance in the economy will be much more serious. For developing countries, encouraging domestic capital accumulation is an essential policy objective. Privatizing either infrastructure or network industries will benefit the economy in many ways. Even when there seems to be no such domestic buyer, and when foreign capital is the only viable option left, countries still need to privatize SOEs because the benefits of higher efficiency outweigh the costs of transferring ownership to foreign capital.

For privatization to be successful, the most important factor is political commitment. It is better not to consider privatization without strong political determination. If political will exists, here are some of the strategies that developing countries may want to apply:

1. The most serious resistance against privatization comes from trade union concerns about job security. Temporary guarantee of employment for two to three years after privatization can be a compromise between the labor union and government. However, without some flexibility in reducing employment, prospective buyers will not be interested.
2. Utilize the audit office in finding inefficient management cases so that the general public understands the need for a strong reform, including privatization. The investigation of the audit office should be widely publicized through news media.
3. A temporary team should be formed that consists of both civil servants and experts from the private

sector, under SOE governance. SOE reforms should be a responsibility of the SOE governance body, not that of line ministries nor of the MoF. When the team formulates a privatization plan, let the team talk with the line ministries, but make it clear that the final decision should be made in SOE Governance Council (SGC), not by the line ministries. It is therefore very important to staff the temporary team with reformative experts from the private sector.

4. The plan may take a phased approach, but the final step should be completed within the current president's term. Each proposed step should have a clear deadline and measures to judge the completion of each step. It is a good idea to clearly state privatization of a certain SOE in a law.
5. Create a driving force within a relevant line ministry, making that person or entity accountable to the SOE governance body. The government should be ready to punish the line ministry for any delay. Providing an incentive for the line ministry is a good strategy; for example, a new policy department might be established within the line ministry after privatization.
6. If it is impossible to privatize an entire SOE, privatize each of its functions. When an SOE has both market and public functions, it argues that it should remain an SOE to serve the public function. Privatization of such an SOE as a whole is not feasible; it should be privatized function by function.
7. EBO (employment buyout) or MBO (management buyout) is not an ideal way of privatization because these methods make restructuring after privatization difficult. When a labor union wants EBO, communicate the risks involved after privatization.
8. Try to create tangible effects as quickly as possible after privatization, and share them with the public. A quick win is always important. Publicize these effects widely to gain public support for privatization.
9. Not only an SOE, but also a government body, can be privatized using corporatization as a stepping stone. Some government branches can better serve their functions if they are turned into SOEs. For instance, Korea Railroad Corp. used to be a government agency under the Ministry of Transportation, but it was converted into a SOE in 2005. The privatization plan for Korea Railroad was postponed by the Roh administration (2003–08). It is expected that the privatization process will be resumed soon. KT&G (Korea Tobacco and Ginseng Corporation), once a government agency, later became an SOE and was privatized. KT (Korea Telecom) followed the same path.

Driving Force for Privatization

It is advisable to establish an SGC with a wide-ranging authority to produce reforms. Here are some of the features that a reform driver needs to have. First, privatization should be led by an organization without incentives to not privatize SOEs. Before 1997, privatization was driven by the co-work between relevant line ministries and MoF, which was in charge of managing national assets. The MOF had little incentive to privatize SOEs because they believed that privatization would reduce national assets. The line ministries had no incentive to privatize SOEs under their umbrella because it would mean loss of their policy tools and employment opportunities after retirement. For these and other reasons, privatization was slow in Korea during the 1980s and 1990s.

In this respect, it is recommended to focus entirely on reforms. In the history of privatization in Korea, the Planning and Budget Commission (PBC) under President Kim was the most powerful and effective driving force. Directly managed under the President, the PBC's mission was to formulate fiscal planning and government reform.

As a fiscal planning function, reforms could be more easily implemented. Since the PBC was free from day-to-day issues, it could concentrate on government reform. Second, there should be an SOE governance council that consists of members from line ministries and the private sector to form a final arena for significant decision making. Since privatization was trans-ministerial work, the PBC established an SOE Privatization Committee (SPC) chaired by the Minister of PBC. As a face-saving gesture, the vice chairmanship was given to the Vice-Minister of the MoF. Members of the SPC were Vice-Ministers of relevant ministries, and also served as advisors to the President. Two experts in the private sector were also invited as members in order to provide a more neutral view. Since the SPC was fully empowered by President Kim, it made the controversial consensus-building process much easier. Though labor unions were not happy with this swift process, social pressures following the economic crisis of 1997 made them relatively silent through the process. Finally, privatization alone does not lead the way to a more efficient operation of SOEs. Introduction of competition should precede privatization or be coupled with it. Since such processes are very political, a firm commitment by the government with well-planned strategies for implementation is mandatory for success.

OBJECTIVES AND FUNCTIONS OF THE MEXICAN ASSET MANAGEMENT AND DISPOSITION AGENCY (SAE)

Rodrigo Garza, Corporate Director of Institutional Relations, Asset Management and Disposition Service, Mexico

Mexico has a large growth potential, although this potential has not materialized as expected. According to the current administration, various obstacles have prevented its development. One of the goals included in Mexico's National Development Plan for the next six years is to overcome these obstacles. A main objective of this plan is to achieve prosperity. To that end, several other objectives have been set, among them the disincorporation of parastatal companies from the federal government, as the new economic environment provides no room for them. To achieve this goal, the government relies on the Asset Management and Disposition Service (Servicio de Administración y Enajenación de Bienes, or SAE).

In its Objective 4.1, Strategy 4.1.1, the National Development Plan defines the goals and the mission of SAE: Divest the Federal Government parastatals that no longer meet the purpose for which they were created or where this purpose can be addressed more efficiently by other entities.

The SAE was established after the wave of privatizations and liquidations of SOEs that left a number of assets and pending liabilities without management. Thus, there was a need for an entity to manage them. The SAE was instituted through a decree with the force of a law in the year 2003.

In general, this organization addresses two main areas. First, it receives transfers of public assets for management, sale, donation, or disposition as mandated by the law that created the SAE, although in certain cases these tasks may be complicated. Second, it receives information to disincorporate or liquidate certain SOEs. This includes managing insolvency procedures and liabilities related to insolvent SOEs.

To carry out these tasks in a way that is consistent with good corporate governance practices, it is crucial to make a distinction between objectives and instruments. The SAE should be understood as an instrument of the federal government's policies, in particular the objectives of public policies. This allows the organization to be clear about its institutional objectives, as well as its duties and resources. The following paragraphs will deal with the operation of the SAE as the entity charged with the task of liquidating SOEs in the country. It discusses, as an example, the liquidation of one of Mexico's emblematic enterprises that provided a highly sensitive public service.

Structure and Operation of the SAE

When the SAE was created in 2003, the Executive gave it the specific task of liquidating SOEs that had been privatized. The government assumed this would be a brief process, and that once these obligations ended, the SAE could concentrate primarily on public auctions.

Instead, as a consequence of the specialized work and the results obtained, the SAE has developed a capability to liquidate and sell off almost any government entities. The SAE is part of the Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público, SHCP). In conjunction with the National Commission of Banking and Stocks and the Institute for the Protection of Bank Savings, the SAE collaborates with the Central Bank of Mexico, which is an autonomous entity, to achieve the goals of a balanced budget and healthy public finances with macroeconomic stability.

The Minister of Finance chairs the SAE Board of Directors, with representation from the Central Bank, the Treasury, and the National Commission of Banking and Stocks. These authorities participate in the entity's management and provide instructions as to how it should be managed in accordance with the current legislation.

The SAE provides for 12 delegations across the country and its tasks are organized through 29 internal committees. These administrative units support the Board of Directors. The Investment Committee is distinct, as it relies on independent external advice for managing a large volume of financial resources. In this area, the SAE seems to have introduced the best corporate governance practices. Its clients are transferor entities, some of which are obligated to transfer their assets, while others are not.

There is a wide range of assets voluntarily transferred to the SAE. In early 2013, an Austerity Decree was promulgated, which mandates that goods no longer useful for the entities of the federal government should be transferred to the SAE for disposition. The question is who decides what is preferable? A logical answer would be the federal government, but in this case "preferable" refers to the entities that will transfer those assets. If the transferor can be sold in the market, then the agency that owns it will dispose of it. If the chances for selling it are low, however, the transferor should be sold to the SAE for disposition. The question is preferably for whom? The logical answer should be for the federal government, but in this case "preferably" refers to the entities that will transfer those assets. If the transferor can be sold in the market, then the agency that owns it will dispose of it. If the chances for selling it are low, however, the transferor should be sold to the SAE for disposition.

In the case of entities obligated to transfer assets, the SAE receives their goods by virtue of the law that created it. This arrangement resolves the problem of self-selection and adverse selection described above. The goods that the SAE sells are attractive for most consumers. Used cars are a good examples. Mandated transferor entities transfer their cars to the SAE not because they are in poor condition, but because the government has expropriated them, making this a good opportunity for the general public to buy a good car from the SAE. This kind of situation, together with the large number of entities that need to be served, influences the SAE's performance.

In terms of management and liquidation, the SAE has managed up to 100 enterprises simultaneously, ranging from soccer teams to medical laboratories to nightclubs. To understand the pendulum of privatizations and re-privatizations, however, a distinction must be made between the public property of the State and the public nature of an enterprise. In other words, it is important to understand that SAEs and public service entities differ in economical terms. For example, some enterprises have yields above a certain level, regardless of whether they are public or private. The enterprises can be categorized as follows:

- SAEs that are part of the government
- Private enterprises in the public sector
- SAEs that have been privatized and may be rescued or renationalized
- Private enterprises in the hands of the government, which are the easiest to privatize

Mexico has reduced its number of SAEs from over 2,000 to close to 200. Many were actually private enterprises in the hands of the government for political or similar reasons. SAE-managed enterprises pose a different type of risk, as they may be temporarily transferred to the SAE as a result of their owners being prosecuted and the task of organizing them must guarantee that property rights will be maintained and restored to the owner if the court determines its innocence.

For this reason, the SAE manages different kinds of enterprises. In the case of soccer teams or nightclubs, for example, the press usually shows great interest. It is important to have a serious government entity that applies a uniform and rigorous methodology when managing these enterprises. To define the target and indicators that will be used for monitoring and evaluating the attainment of its objectives, the SAE has had to maintain a clear vision of its clients. For years, the notion persisted that the SAE customers were those who attend auctions to buy the goods the SAE puts up for sale. As mentioned, however, SAE customers are actually government institutions that transfer assets for sale, donation, or disposal. This vision transforms SAE's operation and the method of delivering information to the government.

When evaluating the agency's progress, it would seem reasonable to use an income-generation metric, but the SAE does not consider this to be a good option. This kind of metric has been around for many years. The agency has realized transferor entities sell assets by themselves, however, often selecting those entities from their inventories that may be more attractive for the market while accumulating low-value assets that are too expensive to maintain.

These metrics also include the use of control boards. The SAE prefers to use project-based tools such as a critical path because its work is project-based, not process-based. Although process guidelines are used to manage SAE's obligations, they are not associated with the completion of an assignment. In this sense, the agency is evaluated by its effectiveness eliminating parastatals in a given amount of time. The methodology used is known as "Person Option", which seeks to establish a certain goal and the time needed to achieve it in order to ascertain which measures need to be taken. Conversely, that specific moment in time is used to program the work back to the present.

Another lesson is the sequence with which things need to be done. In other words, a diagnosis system is established to produce a strategic plan, then an action plan and finally an execution plan. And using this methodology has yielded very good results. Having a standardized methodology published as law has helped the agency to solve the problem of government intervention in public enterprise management. If a case is presented that seeks to impact public policies but this means that the SAE should engage in actions not allowed by the relevant norm or logic, then the decision is rebuffed as inconsistent with the legal framework.

A Practical Case of Liquidation

In order to illustrate SAE's work in the practice, the following section discusses the liquidation of a parastatal that provided an essential public service. Were it not for the SAE, eliminating it would have been practically unthinkable. The company's union was older than the Mexican Revolution itself and perhaps one of the oldest and strongest political groups in the country.

The enterprise delivered its service in the central part of Mexico, where a third of the GDP is produced. In this context the SAE knew that eliminating this company might mean interrupting the service in this area with catastrophic costs for the State.

Nevertheless, a Presidential Decree forced the SAE to immediately liquidate 45,000 workers, of which 22,000 were mandatorily retired, and to guarantee the continuation of the service. The SAE was notified only one week before the decree went public. The decree established the immediate allocation of MXN 30 million and the obligation to submit a plan.

In situations like this, it is important to rely on a methodology. In this particular case, the plan came after the execution. Therefore, the existence of published rules mandating that before liquidating a company a plan had to be in place prior to its execution was essential to carry out this operation without entering into conflict with oversight institutions.

Also, citizen participation during the liquidation of this particular enterprise was significantly high, and the SAE had to deal with great scrutiny.

In one day the SAE had to face 45,000 workers who wanted to know whether they would be liquidated or not and 22,000 retirees who wanted their pensions. Only one case of discontent at the bank's teller window would mean a wave of media coverage and would set off the alarm on the execution of the plan. There was also the social oversight from millions of citizens at home who would know whether or not they would receive the public service. This has been the most transparent and supervised case the Service has had to face.

One of the key factors that contributed to the success of this case was the ample power the President vested on the SAE through the liquidation decree. The directive established that any order, good or asset could be used to achieve the goal. However, in the very short time the agency had to react, it came to the conclusion that the decision to grant such great powers had to be reversed, as it went against efficient work.

This helped to keep union protesters away from SAE offices. Instead they made their demonstrations outside the ministry that had the power to resolve demands different from the ones contained in the decree. The lesson from this practical case is that any institutional arrangement should offer incentives that are compatible for all participants, including the public servants responsible for its execution. Also, efforts should be made to avoid strategic actions by other stakeholders that are inconsistent with the objectives of the public sector.

EXPERIENCES OF SOEs AND THEIR PRIVATIZATION IN THE DOMINICAN REPUBLIC

Isidoro Santana, Advisor, Office of the President, Dominican Republic

The Dominican Republic is located in The Caribbean Archipelago, in the central area of the American continent. It shares an island with Haiti, which has a total of 78,000 km squared with 21 million inhabitants. The Dominican Republic has 10.3 million people and a GDP of US$59 billion, producing an average income of US$5,760 per inhabitant. Its main economic activities are tourism, light industry, mining (gold and nickel), agriculture, and services. My job is not precisely in SOE management; rather I represent the Office of the President. For that reason, some of the numbers presented below should be taken as an order of magnitude.

This presentation describes the management of the Dominican Republic's SOEs with an historic perspective. Similar to the Korean case, a great part of the SOEs in this country are a legacy, not a colonial one but the legacy of a dictatorship. I should also warn, for the benefit of the Koreans present, that as reported for many LAC countries, in the Dominican Republic, processes related to managing SOEs have been marked by institutional weaknesses. Application of the law is very flexible, which creates a persistent political culture that is not always transparent. This lack of transparency brings many problems to SOE management and to reprivatization efforts.

The SOE sector is a direct result of our political legacy. The Dominican State turned into a big-state business after the assassination of the Dictator, Rafael Leónidas Trujillo, in 1961. Trujillo had owned nearly all of the important economic activities of the country. His family controlled almost all agricultural, mining, industrial, real estate, and financial services from 1930 until his death. Yet, in the 1960s, his properties were confiscated and privatized.

For example, Trujillo's sugar mills made up 70 percent of the country's production of sugar, the basic crop of the Dominican economy at that time. He owned the only airline, all industrial cement production, paints, steel, paper, glass, and the major part of cooking oil production. Furthermore, he owned the production of fabrics, shoes, carpets, tobacco, and the biggest insurance company in the country, as well as the main agricultural estates and livestock farms that produced food locally. After his death, his legacy, which included many enterprises that directly affected the national economy, was transitioned to the State.

The State also managed the generation, transmission, and distribution of all electricity. The central bank was the property of the State. Trujillo's interference with the State was so great that the State resembled a private entity. When Trujillo died, his family opened the vault and took all of the money, leaving the State with practically nothing.

Private individuals appropriated much of the country's agricultural and real estate. Industrial and service enterprises began serving political and private interests, while their losses and decapitalization augmented significantly. In the end, instead of generating revenue for the State, enterprises became a source of losses. The State was forced to subsidize them to keep them functioning, and that was the situation for almost four decades.

The Assets Fund of Reformed Enterprises was created in 2001 to manage the State's interest in SOEs, to oversee contract compliance, and to use the gains received in public works and social programs. Unfortunately, the management of the fund has not been transparent: In practice, funds have been used to keep political groups satisfied, just like old SOEs did.

By 1997, when most of LAC was experiencing "privatization fever," a Law of SOEs Capitalization was approved in the Dominican Republic. This law promoted the partial privatization of SOEs, not by selling them, but by allowing the enterprise to be capitalized with private investment. The State did not receive income from the sale; rather, private investments were used for the capitalization of these firms. The State maintained 50 percent of ownership, while private capital investors held 50 percent and were allowed to manage the SOE administration.

The intention was to avoid the accumulation of losses that the State had been financing or subsidizing every year. With these actions, the State expected to generate profit while developing competitive enterprises. However, it did not always turn out that way.

This process involved capitalizing two electrical generation companies, a thermal generation company, three electrical distribution companies, and some other industries and service enterprises. By this time, many of the companies that came from the Trujillo legacy had already been liquidated or retained only land or warehouses. They could not compete in the market, so they were sold. Ten sugar production plants and some State hotels were turned into long-term lease agreements. The State maintained its hydroelectric power generation, which is approximately 20 percent of the electrical generation and transmission of the country. Also, airports were privatized and a process allowed private contracts to manage ports and highways.

The privatization era ended in the late 1990s with relative success. Some enterprises were more successful under private management, and they were allowed to generate benefits and grow. For example, the ports and airports can be considered successful from the standpoint that they have expanded their capacity. Also the Dominican Republic is essentially a tourism-based country and needs, above all, airports.

However, with the highway system, the State ended up losing millions of dollars under a concession contract. For instance, a private enterprise signed a contract to invest in the improvement of a highway, but the highway already existed, so the company charged tolls for three years and made no new investments in the highway. The State paid $US135 million to the company in exchange for its agreement to break off the contract, with basically no investment on its part. Unfortunately, this type of situation happens in countries with weak institutions.

The Assets Fund of Reformed Enterprises was created in 2001 to help with the management of state capitalized companies. The reform sought to improve compliance contracts and manage the benefits contained in public works and social programs. Unfortunately, the management of the assets fund has not been transparent. In practice, funds were used for clientelist political ends, the same practices used by the old state enterprises.

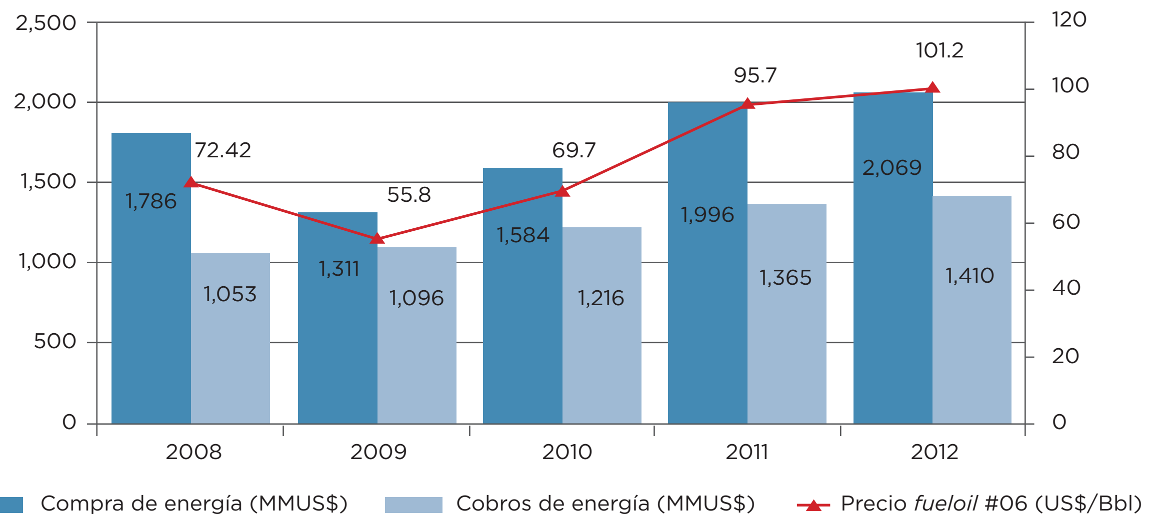
During the first 10 years, US$280 million was received from dividends that were invested with discretion in projects such as in schools, housing, aqueducts, sports facilities, and public works. The major loss for the State related to the electricity industry. Electrical power entities are very profitable for private industry, but not for the State. The company consists of 50 percent private capital and this participation has more power over the money's administration. The government, however, appoints some board members, but the only qualification has been to be a member of a political party committee. Because of institutional weaknesses, this industry is very profitable for private capital but not necessarily for the State.

A law that was approved to regulate the electrical market was never applied in practice; many enterprises realized that it is more convenient to manage the sectorial commerce through direct contracts with the State. These enterprises had already established records that allowed buying under quite comfortable conditions. During the first years, there were important investments, but they stopped coming. At present, the country has a very high cost of electricity generation and insufficient levels of capacity.

Even worse is the situation of electrical distribution companies. About half of the households in the Dominican Republic do not pay for electricity or they make a symbolic payment not related to consumption. Consumers have a fixed fee that is not representative of consumption. The companies realized that it was easier to request State subsidies than to bill and collect from their customers, so no real effort was made to improve this situation. The losses continued, until the State decided to renationalize the companies.

Now, the State is the sole owner of electrical distribution companies. Some of them produce profits, but the State is losing approximately US$1.2 billion each year in that sector. Figure 17, taken from a presentation of the executive vice-president of the State holdings, shows that, for distribution companies, the purchasing power today is affected by the cost of fuel oil, but its selling prices are tied to political decisions.

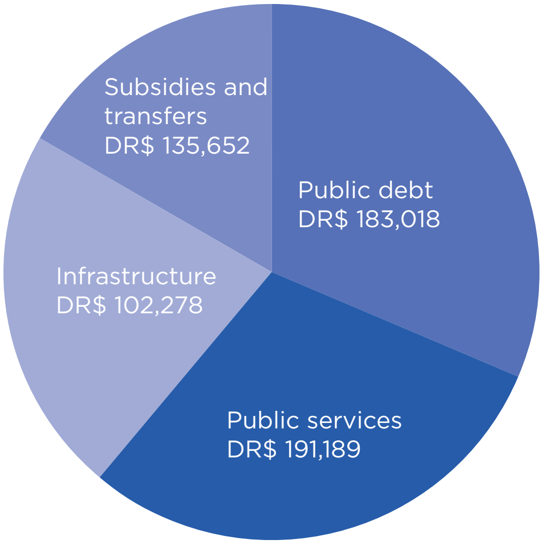
FIGURE 17. Net Total Loss of Electricity Companies in Dominican Republic (in USD)



Source: Authors' elaboration.

Losses in other enterprises also add up. For the electricity and transport sectors—the latter manages the Santo Domingo Metro and the highway concessions—the State loses about US$2,000 million a year. At present, State subsidies and transfers to companies contribute to fiscal inflexibility, which is the country's greatest problem. In the next graphic, it is possible to see that State subsidies and payment of the public debt are absorbing more than half of the country's fiscal resources, removing any governmental capacity to provide new and better services and infrastructure.

FIGURE 18. Government of Dominican Republic Distribution of the Budget in fiscal year 2014 (In milions of Dominican Pesos)



Total: DR$ 613,137

To avoid the bleeding of resources related to privatization, which has not worked, the State is in the process of investing again in electrical generation, aiming to cut costs and to compete with private companies in order to drive down prices.

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