

Creating Competitive Environments in the Public Sector: Experiences in OECD Countries and Korea

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I. Introduction

As part of the shift to a more results-oriented approach to management and accountability, some OECD countries like the United Kingdom, Australia, Canada, and New Zealand recognized, to varying degrees, that to more effectively and efficiently manage their programs and achieve significant improvements in performance, agencies and managers must be provided with greater flexibility over resources and incentives. In a sense, these countries implemented reforms which reflected a shift toward more business like methods. They eliminated detailed central control of departments' operating expenditures and staffing levels and provided departments with more authority to manage resources within overall their budget ceilings.

In the four countries mentioned above, to provide flexibility and incentives to line management, central management departments and central management within line departments sought to devolve greater decision-making authority over financial and human resources and provide incentives in the form of shared productivity gains and market-type mechanisms (MTMs), such as increased competition and user-charging. According to the OECD, MTMs encompass all arrangements where at least one significant characteristics of markets is present -- competition, pricing, dispersed decision-making, monetary incentives, and so on. This definition excludes the two polar cases of traditional public service delivery and complete privatization. MTMs are mixed strategies where a substantial amount of collective decision-making and management remains alongside markets elements.

The main concern of this paper is to briefly survey the experiences in some OECD countries with respect to market-type mechanisms and systems and to find out some useful implications to Korea. In Korea, concepts of market-type mechanisms or systems are not well-known and thus Korea's experiences in these areas are rather primitive. In this paper, in order to build a sensible bridge between OECD countries and Korea, we expand the concept of MTMs including privatization and focus on the implications rather than experiences in Korea.

II. Experiences in OECD Countries

1. Market-Type Mechanisms

The four countries sought to increase incentives for more effective and efficient management by introducing market-type mechanisms to the provision of some centralized government services, such as accommodation, procurement, information services, and training, to other departments. Market-type mechanisms included charging for services and allowing departments to retain the revenues, opening up government-provided services to competition, and allowing agencies to choose between government and private sector service providers.

Identifying clients, marketing services and optimizing revenues are among the more businesslike practices increasingly followed in these countries. In the selected jurisdictions, units within departments -- or the departments themselves, in New Zealand -- increasingly operate according to business plans, revenue targets, marketing strategies and feedback from client surveys. They may also be responsible for meeting annual financial performance targets, including revenue targets and a return on public investment. The widespread application of user fees has been a tool for improving financial performance.

The introduction of market-type mechanisms to government buildings -- or real property -- management in Australia, Canada, and the United Kingdom contributed to more effective and efficient provision of real property services to client agencies and improved customer satisfaction. In these countries, real property organizations (1) faced competition from the private sector, (2) began managing their real property assets more strategically to maximize return on investment and better meet customers' mission needs, and (3) separated their policy oversight and development roles from their roles as providers of building services to government agencies.

(1) User-Charging

The four countries implemented user-charging for internal government services to

improve the allocation of services. The four countries also expanded user-charging for services provided directly to the public or to businesses. The purpose of expanded user-charging was to better regulate demand for government services and to shift the cost of providing specific services to the beneficiaries and away from the general taxpayer. Services for which departments charged other departments fee were commercially oriented, such as real property management, audit services, legal services, training, publications, and technical advice.

(2) Retaining Revenues

Another form of flexibility adopted by the four countries for commercially oriented departments and agencies was the authority to fund their operations from revenues collected, such as user fees or asset sales or rentals. This replaced systems in which fee-collecting departments and agencies were funded entirely through annual appropriations and all revenues collected were turned over to the Treasury.

(3) Demonopolizing Government Services

Along with user-charging and revenue retention, the four countries demonopolized the provision of certain central government services, such as real estate, purchasing, accounting, and transportation, and subjected the government service providers to competition from the private sector or other government providers on the basis of cost and quality.

In New Zealand, centralized departments no longer provided services such as real estate, supplies, or pensions. Rather, departments were to obtain these services on their own within their operating cost budgets. Australia, Canada, and the United Kingdom were gradually allowing departments to purchase services from providers other than central government service providers.

Under its "market testing" reform, the United Kingdom implemented multi-year plans to subject a large number of government services to competition.

(4) New Information Systems

Government evaluations of reforms in Australia and the United Kingdom pointed out that commercial reforms, such as user-charging and competition, required the development of new information systems capable of determining the full costs of operations, including all depreciation and overhead. For example, United Kingdom agencies that sought to fund their operations through the collection of user fees instead of appropriations found the process difficult and time-consuming, partly because they lacked the needed financial and management information systems to manage their revenues and expenses.

(5) MTMs in the US

All executive departments are authorized to charge user fees to provide a wide variety of common administrative services and retain those fees in revolving funds to pay for operating expenses. These funds are allowed to charge for the direct costs of service provision and to also collect certain indirect costs, such as equipment depreciation. All fund receipts are typically available until spent and do not expire at the end of a fiscal year. Also, OMB seeks to promote efficiency by encouraging competition between the federal workforce and the private sector for providing commercial services needed by government agencies.

2. Market-Type Systems

(1) Accrual Accounting

To implement commercial reforms, such as user-charging, revenue retention, and competition, and to provide managers and oversight groups with better cost information for decision-making, Australia, New Zealand, and the United Kingdom introduced accrual accounting systems to supplement existing cash accounting systems. The concept of accrual accounting, which is standard practice in the private sector, requires that revenues and expenses be reported in the period in which they occur rather than when the related cash is received or paid. Implicit in this notion is the valuation and depreciation of capital assets and the recognition of liabilities. Accrual accounting provides information on the current cash budget needs for funding future payments, such as asset maintenance and replacement, pensions, debt service, and lease commitments.

Accrual accounting brings with it the ability to account for the real costs of government resource use. Supported by a good cost accounting system, it can provide more complete information about the costs of government activities in departments and agencies -- information necessary for better decision making and reporting on the achievement of results. Full accrual accounting could also give public service management a more comprehensive picture of financial operations than the present system; it could help safeguard capital assets by placing them under accounting control and could provide better information to managers facing difficult capital assets maintenance/replacement decisions.

Accrual accounting is emerging as a solid trend in financial management in many countries around the world, although it is more commonly applied on a piecemeal basis rather than comprehensively. In Australia and the United Kingdom, accrual accounting was being implemented incrementally, starting with commercially oriented agencies that charged for their services, such as government printing offices, real

property agencies, and consulting services. The State of New South Wales in Australia has had an accrual-based system for some years and other States are following suit. The Australian Federal Government is moving towards the adoption of accrual accounting. A green paper recently issued in the United Kingdom solely foreshadows financial management reforms including accrual accounting.

In contrast, New Zealand introduced accrual accounting government-wide and produced commercial-style accounts based on generally accepted accounting principles for each department and for the government as a whole. In Australia, New Zealand, and United Kingdom, the introduction of accrual accounting supported more accurate pricing of government services for commercially oriented agencies and provided a tool for improved measurement of financial performance.

Canadian departments and agencies do not operate on a full accrual accounting basis. Expenditures are recorded on an accrual basis, but the full cost of capital assets is charged to expenditure at the time of acquisition or construction. Further, although non-tax revenues are accounted for on an accrual basis, tax revenues are generally recorded in the year in which they are received.

Accrual accounting is accepted by many in the United States Administration as a desirable accounting standard, but the complex relationships between the Administration and the Congress have led the Office of Management and Budget to resist the move on what is sometimes reported as being grounds for concern that control would be lost in the complex networks of accountability relationships inherent in the US Constitution. This is a valid point in the sense that the adoption of the generally accepted accounting principles in government presume a facility to impose strict compliance with good accounting practice which is much easier in the simple constitutional environment of New Zealand.

(2) Financial Statements

Canada has been one of the leaders in reporting annual summary-level financial statements in a global and comprehensive manner. However, individual departments and agencies of the Government of Canada do not prepare periodic reports or annual financial statements on a full accrual accounting basis.

Consequently, the real cost of carrying out the activities of these departments and agencies is not shown. An exception to this is departmental revolving funds that are accounted for on a full accrual basis.

In New Zealand, the new set of financial statements for the national government has produced a great deal of additional information which should help meet objectives of public accountability and usefulness for decision making. Not only have an accrual based operating statement and balance sheet been produced along with a statement of

cash flows, but so have a series of other statements exceeding those produced by companies in the private sector.

Furthermore, there are detailed notes to the accounts and an overview in plain language accompanied by graphs and charts. In the next few years trend data will start to emerge. The reporting entity will be extended to State-Owned Enterprises and Crown agencies and sector reports may be produced, along with reports on payments on behalf of the Crown and the granting of coercive powers. Thus an even wider range of information will become available.

Parliament in New Zealand now has a comprehensive set of financial statements, exceeding those provided by private sector companies and the shift to an accrual basis of accounting gives a much more complete picture of assets, liabilities, revenues and expenses. Another advantage of the reforms in this area is that the range of information for assessing the Government's fiscal position has been extended.

In particular, the additional information provides a better view of longer-term fiscal consequences of current decision making. A further benefit may be that compiling and maintaining a more complete listing of Crown assets could help to ensure that public sector managers remain conscious of the need to accurately report and competently manage assets under the control of the Crown.

III. Korean Experience

In this section, we will briefly review the use of competition policy and market-type mechanisms in Korea's government sector. Although many forms of MTMs used in OECD countries have not yet been introduced in the Korean government, some of the broader competition policies, including privatization, contracting and user charging, have been used substantially or partially in order to enhance the efficiency of public service provision.

1. Privatization

The public sector in Korea has grown considerably in the course of Korea's economic development, both in its absolute size and in its share in the Korean economy. The growth of the public sector in Korea was accelerated due to the government policy of promoting public enterprises in many sectors of the economy. Establishing public enterprises was regarded as a tool for Korea's government-led development strategy, especially in the 1960s and 1970s.

Public enterprises are classified into departmental agencies (government enterprises), public corporations (equity investment by government above 50%), quasi-public

corporations (equity investment by government below 50%, with the government as the largest shareholder), subsidiaries of public corporations, and local public corporations (see Table 1). Most public and quasi-public corporations were established in the 1960s, while many subsidiaries of public corporations and local public enterprises came into existence in the 1980s and 1990s.

The history of privatization in Korea dates back to the late 1960s, when the government privatized some of its public enterprises, including the airline, trucking, maritime shipping, shipbuilding, and steel sectors (see Table 2). This first privatization program was close to the classical model of privatization in that the government not only sold out all of its equity shares but also left the management of these companies fully in the hands of private businesses.

<Table 1> Public Enterprises in Korea : 1972-1993

Type						(number of)	
	1972	1981	1984	1991	1993	Budget (1994) bil.won	Employees (1993)
Government enterprises	5	5	5	4	3	4,156	73,370
Public corporations	25	24	25	23	23	47,790	175,776
Quasi-public corporations	9	15	6	7	8	11,431	41,188
Subsidiaries of public corp.	44	28	54	91	102	15,177	69,449
Local public corporations	-	-	104	180	197	-	-

Source: Economic Planning Board.

Compared to the first privatization program, however, the second and third waves of privatization were regarded as partial privatization in the sense that the government maintained control over the management of the privatized corporations even after the liquidation of government ownership shares. The second round of privatization in the early 1980s was a good example. Most of the commercial banks were privatized, but their top managers continued to be appointed by the government. The so-called people's share program in the electricity and steel industries, which characterized the third round of privatization, was another example of partial privatization.

〈Table 2〉 Public Enterprises Privatized Prior to the 1993 Privatization Program

YEAR	COMPANY	YEAR	COMPANY
1968	Korea Machine Industry Co. Korea Transport Co. Korea Shipping Corp. Korea Airline Corp. Korea Shipbuilding Corp. Incheon Heavy Industry Co. Korea Ironmine Development Co.	1981	Korea Dredging Corp. Korea Petroleum Corp. Hanil Bank
1971	Korea Salt Co. Korea Mining & Refining Corp.	1982	Korea First Bank Seoul Trust Bank
1972	Korea Commercial Bank	1983	Choheung Bank
1973	Korea Fisheries Development Corp.	1986	Hyosung Trading Co.
1978	Korea Reinsurance Corp.	1987	Daeho Co. Donghae Pulp Co. Jinhae Chemical Fertilizer Co.
			Korea Tourist Bureau
		1988	Seorak Development Co. Korea Stock Exchange Pohang Iron & Steel Corp. ¹⁾
		1989	Korea Electric Power Corp. ¹⁾

Notes : 1) Minority shares were sold.

Source: Ministry of Finance and Economy (1995).

The fourth large-scale privatization program, which was announced in December 1993 by the present administration, is now being implemented (see Table 3). The program includes the privatization of 58 public enterprises during the period 1994-1998 and the restructuring of 10 more public enterprises out of a total of 133 public enterprises considered. The 58 public enterprises have been selected on the grounds that they no longer need to be publicly-owned and managed and also that their privatization would obviously enhance their efficiency. The new privatization program is based upon a few essential principles which exhibit a striking difference from the previous privatization programs.

〈Table 3〉 1993 Privatization Program : Plan and Performance

		1994	1995	1996~97	1998
Plan (58)	privatization of management and ownership (35)	Citizens National Bank, Korea Fertilizer, etc. (25)	Korea Gas Corp., Korea Heavy Industries, etc. (5)	Korea PC Telecom, Industrial Bank of Korea, etc. (3)	Korea Tobacco and Ginseng Corp., etc. (2)
	sale of minority shares (23)	Lucky Metal Corp., etc. (21)	Daewoo Shipbuilding (1)	-	Maeil Dairy Industry (1)
	revenue estimate from divestiture ¹⁾ (billion won)	2,609	1,475	1,412	2,371
Result (as of June, 1995)	privatization of management and ownership (6)	Korea Fertilizer, etc. (5)	Facility Management Corp. (1)	-	-
	sale of minority shares (6)	Hansung Life Insurance, etc. (5)	Naejangsan Tourist Hotel (1)	-	-
	divestiture in process (5)	Korea Mobile Telecom, etc. (4)	Citizens National Bank (1)	-	-
	divestiture in process (billion won)	4292)	248	-	-

Note : 1) Rough estimates considering assets, liabilities, paid-in capital.

2) This amount does not include the revenue from the sale of Korea Mobile Telecom.

Source : Ministry of Finance and Economy; Yoo(1995b).

First, the objective of privatization has been clearly identified as the enhancement of efficiency in the public enterprises included in the program. Second, all government

ownership shares are to be sold out to the private sector, and the government is to cease exercise of control over the management. Thus, the privatization of both ownership and management is to be pursued. Third, the amount of ownership shares that enables a stable management is to be sold to the largest shareholder, who will be selected via an open competitive bidding process, while the remaining portion of ownership shares is to be distributed in many other ways.

Although it is too early to make an assessment of the present privatization program's success, it is expected to significantly enhance the efficiency of those enterprises to be privatized. There still remains, however, a few issues of policy concern. First, there exists social concern over the effects of deepening economic power concentration by the *chae-bol*, resulting from their acquisition of large-scale public enterprises. Second, another source of concern with respect to any allocative inefficiencies can be found in private monopolies. Although this sort of inefficiency can be minimized by introducing competition into the industries to be privatized, such deregulation itself is confronted by real world difficulties. Third, the poor development of the stock market in Korea is yet an important bottleneck to privatization.

2. Contracting-out

Contracting-out in Korea's government sector has had a long history. Since 1970, the Korean government has used contracting-out in order to enhance the efficiency of production by increasing competitive pressures on suppliers, and to reduce the size of the government sector. As is shown in Table 4, 576 of government activities have been contracted out since 1970. These activities include, *inter alia*, licencing, monitoring, registration, testing and property management. However, considering the fact that the total number of government activities exceeded 15,000 in 1994, the use of contracting out has been very limited.

The process for selecting activities for contracting out is as follows: First, the Ministry of Public Administration (MPA) sends the guidelines for contracting out to each ministry every year. Second, each ministry selects the activities to be contracted out and reports them to MPA. MPA reviews the reports and makes the final decision for contracting out. Therefore, it is the responsibility of each ministry to decide which and how many activities are to be contracted out.

〈Table 4〉 Trends of Delegation and Contracting

	(number of)										
	'70-'85	'86	'87	'88	'89	'90	'91	'92	'93	'94	Total
Intra-gov't delegation or contracting	2,135	116	274	136	140	259	566	200	130	55	4,011
Contracting-out	301	17	61	19	57	29	44	20	28	-	576

Source: Annual Report of Ministry of Gov't Administration, 1995.

However, there have not been sufficient incentives for the ministries to actively develop a contracting-out program or a competitive tendering process.

Several problems can be pointed out regarding the contracting-out practices of the Korean government. First, although the standards for selecting the government activities for contracting out are specified in the MPA's "Rules for Delegation and Contracting of Government Activities", these standards are quite general and abstract. More specific guidelines based on a competitive tendering process are needed to increase the market forces in public sector operations. Second, there has not been a proper evaluation process for the performance of private suppliers. Although the Audit Office is responsible for evaluation and monitoring, the process has not been satisfactory so far. Third, private contractors are not usually given full autonomy in production. Excessive intervention by the government agencies after contracting out has often been an obstacle to achieving improved efficiency.

To correct these problems, future contracting should make use of a competitive tendering process in which an organizer of a service selects an operator to provide all or part of a service, under contract. The market-testing program in UK will be a good example. Also, in-depth study on the use of various forms of MTMs, such as franchising, grants, vouchers, voluntary service, as well as contracting, is required.

3. User-charging

User-charge financing of public expenditures can not only create financial room for reducing budget deficits and tax burdens, but it can also contribute to increasing the efficiency and effectiveness of the public sector, by creating a more direct link between the consumer and the producer of a public service. In this regard, user-charging, as a means of generating proceeds from receipts, has been utilized to some extent in the

central and local government sectors in Korea.

As shown in Table 5, the proportion of user-charge out of the total Korean central government revenue has been fairly stable between 13~14% since the 1980s. More than half of user-charge financing comes from property income. The remaining amount comes from fees, charges, and non-industrial sales. The proportion of user-charge in the local governments is even higher, amounting to 22% in 1992. Considering the fact that the OECD average of non-tax revenue occupies 10.1% of the total central government expenditure, it can be said that the scope of user-charging in Korea is relatively large.

The concept of "user-charges" in Korea incorporates payments for all kinds of goods and services provided by the public sector to the private sector. The concept, however, does not yet encompass inter-departmental or inter-agency transactions within the government sector. In many OECD countries, including the UK, Australia, and New Zealand, inter-departmental

〈Table 5〉 User-charge financing of central government expenditure

	1985	1990	1993	1995
	(billion won)			
- Total Revenue	13,922 (100.0)	32,089 (100.0)	50,751 (100.0)	68,941 (100.0)
- User-Charge	1,817 (13.1)	1,727 (11.6)	7,203 (14.2)	9,583 (13.9)
• property income	1,273 (9.1)	2,465 (7.7)	3,852 (7.6)	5,038 (7.3)
• adm.fees, charges, non-industrial sales	311 (2.2)	534 (1.7)	781 (1.5)	927 (1.3)
• others	233 (1.7)	728 (2.3)	2,570 (5.1)	3,618 (5.2)

Source: MOFE, "Government Finance Statistics in Korea, 1995.

user-charging has been increasingly applied for services such as training, publications, and technical advice. The move to increase inter-departmental charging has the potential to improve efficiency by making users of public services more aware of the cost of public activities. They also recommend that service agencies should compete in the provision of services with outside sources, thereby increasing competitive pressures in the government sector. This type of internal user-charging should also be applied to the Korean government sector in the near future.

IV. Concluding Remarks

Compared to OECD countries, it would be fair to say that the effort to increase the competitive pressure in the Korean government sector has been insufficient thus far. Market-type mechanisms such as revenue retention and internal user-charging and market-type systems which include, *inter alia*, accrual-accounting and financial statements reporting, have not yet been introduced. Contracting and other competition policies are only partially applied.

Enhancing the efficiency and effectiveness of the public sector is increasingly more important in a globalizing economy. An important element of the structural reform process in the public sector generally is a drive to make the public sector more dynamic and market-oriented. The introduction of market incentives in the public sector has the potential to increase efficiency and to achieve a better value for money. Since the last decade, many OECD countries have implemented structural reforms as a means of enhancing efficiency and effectiveness in the public sector, and have developed various market incentives to increase competitive pressures. Although the Korean government lags behind, it should learn from these countries and initiate structural and commercial reform within the public sector in the near future. Most of the market-type mechanisms and systems developed in OECD countries are also applicable to the Korean government sector. An important concern will be how to make the government reform itself more efficient.

Notes

- 1) OECD(1995).
- 2) The main part of Chapter II below is drawn from Lee and Moon(1995).
- 3) 'Financing Public Expenditures through User Charges', PUMA, OECD, 1990.

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