

**A TAXONOMY FOR  
BUDGETARY CONTROL OF STATE-OWNED ENTERPRISES**

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February 2002

# **A TAXONOMY FOR BUDGETARY CONTROL OF STATE-OWNED ENTERPRISES**

## **Purpose**

The establishment of controls and incentives for state enterprises requires a classification system. Several categories should be defined to reflect the range of the different nature and mandates of the many state enterprises. Each state enterprise should be assigned to one category in the classification. Each category has a specific set of controls, incentives, processes and systems. This paper provides a review of the various ways to classify state enterprises in terms of the degree of its commercial activities. The paper reviews the Canadian approach to classification, as well as those of other jurisdictions. It also provides examples of selecting controls and incentives for different categories in the classifications.

## **The Russian Context**

In Russia there are more than 20,000 state enterprises that have not yet been privatized. There are more than 15,000 100% state-owned enterprises. There are some 5,000 joint stock enterprises that are majority owned by the State. By and large they do not receive government subsidies. These enterprises are former parts of large ministries, and are now run by their managers in a very autonomous way, without much transparency.

In most cases, there are “soft” (unclear, impractical, and unenforceable) or non-existent budget constraints, and “soft” or non-existent administrative controls. Weak financial positions of enterprises are supported by easy loans, State subsidies and non-payment of taxes. There is no system of impersonal legal tax obligations, which are verifiable and enforceable. There is a need for “hard” (clear, feasible, and enforceable) budget constraints and “hard” administrative controls. Hard budget constraints and controls can be devised in many ways – the most effective controls will be those that involve countervailing political and legal safeguards. The Parliament and the government must provide the basis for the authority and m

## **Introduction**

Canada has a philosophy and logic underlining its budgetary control system

there should be an informal understanding that flexibility is available to change categories based on presentation of a comprehensive and persuasive business case. Obviously, it is also important to ensure that all State-owned enterprises are included in one category or another, no matter in what field of activity it is operating.

## **Spectrum of Enterprises, from Public to Commercial**

There is a wide variation in the nature of state-owned enterprises, including the degree of their commercial nature. Some enterprises will be indistinguishable from commercial, profit-oriented, private-sector enterprises. The apparently near-commercial enterprises may have some of the following characteristics:

- ⊕ They operate in a competitive environment with private sector competitors;
- ⊕ Their market revenues give them some independence from budgetary appropriations for operating purposes;
- ⊕ They are expected to produce a return on equity;
- ⊕ There is a reasonable expectation that they will pay dividends;
- ⊕ They can expeditiously raise capital from private sources without a government guarantee.

At the other end of the continuous public – private spectrum, there are enterprises that are largely dependent on the State, are expected to remain so, and provide essential public goods and services. The more “public” State enterprises operate in a non-competitive environment, in a monopoly or quasi-monopoly environment. Their operations are heavily dependent on budgetary appropriations. They are not expected to generate profits or earn dividends for the State. They cannot raise capital from private sources without a government guarantee.

The art in designing the budgetary controls/administrative constraints/incentive system is to select a mix of measures that is suitable for the different nature of the State-owned enterprises, based on their location on a spectrum going from the classic public sector model to one that operates like a private sector organization.

The Canadian approach has defined four categories of state-enterprises and to provide more “direction” and less “control” for the enterprises at the private end of the spectrum.

***PUBLIC SECTOR  
MODEL***

***PRIVATE SECTOR  
MODEL***

Government

Department



## The Province of Ontario Spectrum

Ontario uses a classification with seven classes of “Agencies” – Advisory, Regulatory, Adjudicative, Operational Service, Operational Enterprise, Crown Foundation, and Trust.

**Advisory Agency** provides ongoing information and / or advice to assist in the development of policy and / or in the delivery of programs.

**Regulatory Agency** makes independent decisions (including inspections, investigations, prosecutions, certifications, licensing, rate-setting, etc.) which limit or promote the conduct, practice, obligations, rights, responsibilities, etc of an individual, business or corporate body.

**Adjudicative Agency** makes independent quasi-judicial decisions, resolves disputes, etc on the obligations, rights, responsibilities, etc. of an individual, business or corporate body against existing policies, regulations, and statutes, and / or hears appeals against previous decisions.

**Operational Service** delivers goods or services to the public usually with no, or only minimal, fees.

**Operational Enterprise** sells goods or services to the public in a

## Controls and Constraints

There are many levers or means of control. The art (not science) of control is to select feasible and effective means from the menu of possible approaches. The controls should be embodied in a formal, open, transparent system, accessible by Parliament and the Public. The menu of controls, constraints, rules and practices cover several categories:

- ⊞ Corporate Structure and Governance
- ⊞ Corporate Plans
- ⊞ Budgeting and Capital Management
- ⊞ Human Resources
- ⊞ Operational Control
- ⊞ Reporting and Auditing

Chart I displays the different categories for which control and incentive policies, rules, guidelines, and systems can be devised. There are many options for the nature and degree of control in each of these categories.

### **Chart I: Categories of Control**

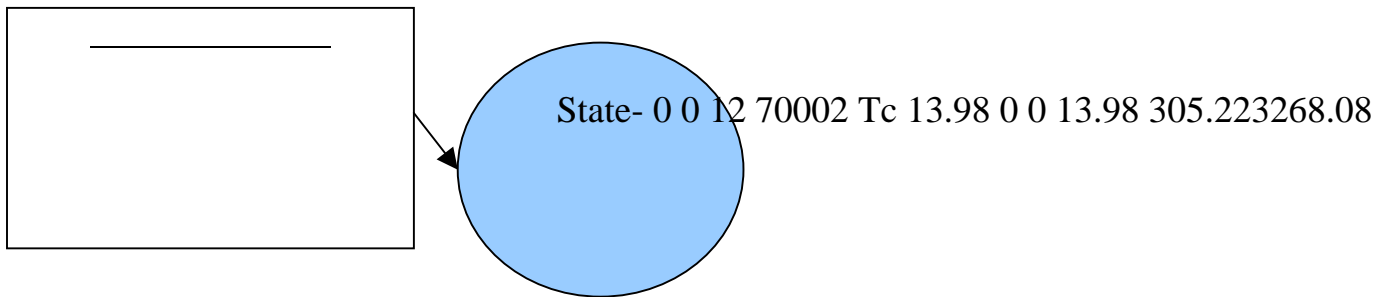




Chart I provides an indication of the extensive list of possible controls, constraints, incentives and rules. The critical question is to select the rules for each enterprise classification. Some of the rules or constraints should not be applied to state-owned enterprises at the commercial/private sector end of the spectrum. Other rules are not appropriate for enterprises close to the public/Ministry end of the spectrum. Each of the controls/constraints/rules has a variety of approaches and degrees of stringency. For example, job descriptions/classification levels and staff hiring practices are controlled for government departments and should not be for proprietary commercial corporations. Issues surrounding the Board of Directors – appointment, remuneration, and functions regarding corporate plans, risk management and audit are highest priority for control of proprietary commercial corporations.

**Chart II: Indicative Schematic for Functional Controls**

<b>Role of Government Directives</b>	Not applicable	Not applicable	Mandates and detailed orders	Mandates and guidelines	Guidelines and advisories
<b>Corporate Planning</b>	Government planning	Government planning	Enterprise undertakes planning, government approves	Enterprise undertakes planning, government approves	Enterprise undertakes planning, government approves
<b>Auditing: Risk Management and Organizational Effectiveness</b>	State auditor; focus on organizational effectiveness	State auditor; focus on organizational effectiveness	State auditor; focus on organizational effectiveness		



## Chart II: Indicative Schematic for Functional Controls

<b>Premises: Property/Leasing Control</b>	Government Agency controls	Government Agency controls	Government Agency approves	Corporate control – Government Agency is informed	Corporate control – Government Agency is informed
<b>Procurement</b>	Central purchasing agency	Central purchasing agency	Central purchasing agency	Enterprise control	Enterprise control
<b>Price-Setting for Services</b>	Not Applicable	Government set	Government approved range of prices	Enterprise sets	Enterprise sets
<b>Personnel: Full-Time Equivalents</b>	Central government agency sets FTEs	Central government agency sets FTEs	Central government agency sets FTEs	Enterprise sets	Enterprise sets

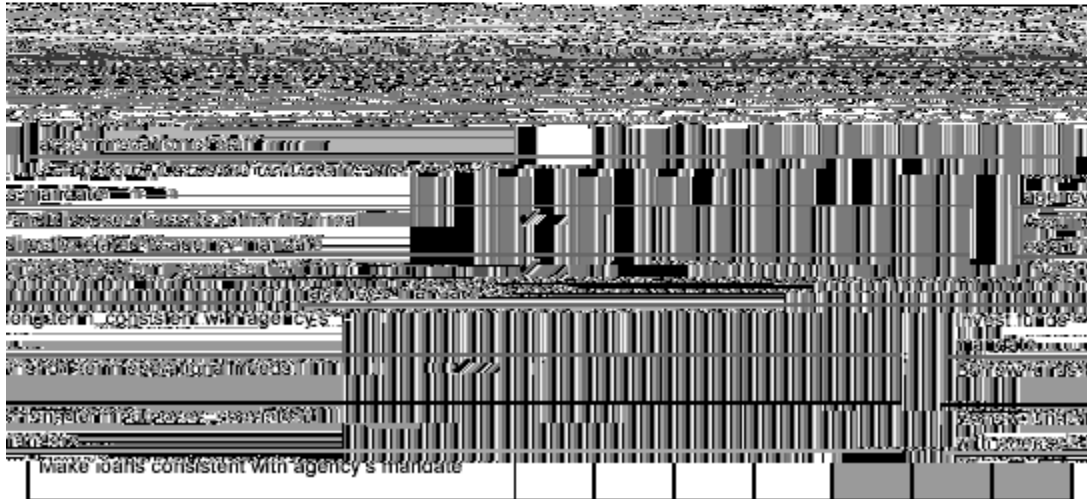
**Personnel: Classification Matrix**

Central government agency sets FTEs 170.88.2 10.38 ref/P 127.8 477.3 5.16 31.1.0.2 10.38882us

### Chart III: Ontario Classification

The following chart illustrates the maximum range of powers that are available to each Ontario agency class. This means that an agency will not be granted every power for its corresponding class when such power is not warranted to fulfill the agency's mandate and is not justified in the business case.

- Shading means that assigning the power would be consistent with the agency's function
- ✓ Check mark means that the additional power is consistent for a Regulatory Agency only when a governing board exists





## CHART IV US Government Corporations

Corporation Name	Year	Business Type	Ownership	Primary Business Means	Statute Requirements
1 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
2 Federal Crop Insurance Corporation	1938	Financial agent	I, L, W	S, S, I, N	
3 Federal Housing Administration	1934	Financial agent	I, L, W	S, S, I, N	
4 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
5 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
6 Federal Crop Insurance Corporation	1938	Financial agent	I, L, W	S, S, I, N	
7 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
8 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
9 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
10 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
11 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
12 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
13 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
14 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
15 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
16 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
17 Federal Reserve Bank	1914	Financial agent	F, I, W	S, S, I, N	
18 Rural Telephone Bank	1971	Financial agent	I, L, W	S, S, I, N	
19 Tennessee Valley Authority	1933	Energy	I, L, W	S, S, I, N	
20 Tennessee Valley Authority	1933	Energy	I, L, W	S, S, I, N	
21 United States Environment Corporation	1992	Energy	I, L, W	S, S, I, N	
22 United States Environment Corporation	1992	Energy	I, L, W	S, S, I, N	
Subtotal					
Total					22

**Corporation type**

1 = Federal government corporation  
 2 = State government corporation

**Primary business means**

I = Insurance  
 L = Loans  
 W = Mixed ownership  
 S = Wholly owned

**Statute Requirements**

NA = Not subject to but administratively adopts the statute's requirements  
 PSA = Partially subject to the statute's requirements and also administratively adopts the statute's requirements  
 PSM = Partially subject to the statute's requirements and also implements an alternative mechanism to attain the objective(s) of the statute  
 S = Subject to the statute's requirements

*Note: With the exception of the Federal Reserve Bank, all other corporations listed in GCCA.*

Note: Chart continued on following page.

**CHART IV**  
**US Government Corporations**

Notwithstanding the above, any corporation which is established to carry out the functions of the Government and which is subject to the requirements of the statute shall be deemed to be a corporation established to carry out the functions of the Government and shall be subject to the requirements of the statute.

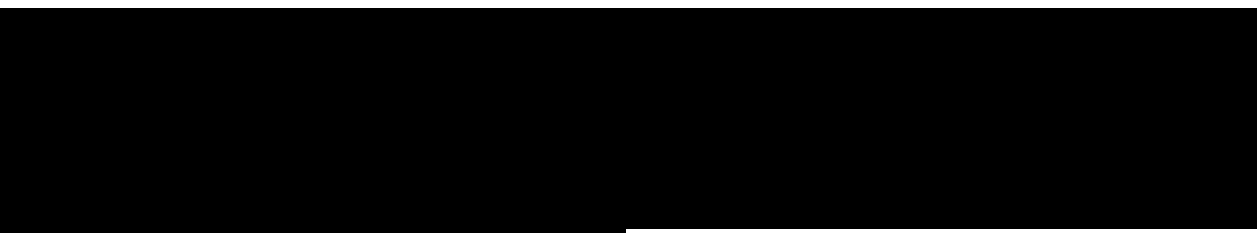
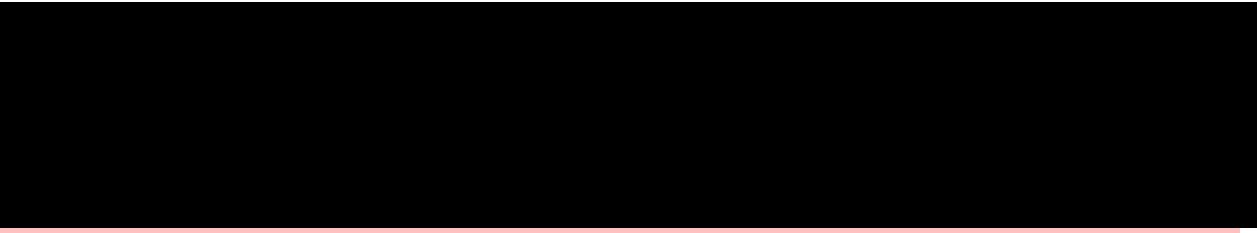
S = Subject to the statute's requirements

**Chart V: Inter-Jurisdictional Comparison**

United States			
	Government Department/Agencies	Government Corporations	Government-Sponsored
<b>Funding</b>	Funded by US Government	Fully or partially funded by US government	Implied financial backing by US government
<b>Adherence to Federal Statutes</b>	Strict adherence	Some flexibility	Little adherence, but some regulation to protect government's interest
<b>Independence from Government</b>	N/A	Varying levels of independence in decision-making bodies	Private ownership and control

**Germany**

~~GOVERNANCE~~





## Conclusion

The first step in establishing the system of budgetary control is the decision of how many classes of enterprises should be in the taxonomy. Canada has four. The more classes or categories, the greater is the possibility of sensitive and appropriate controls and incentives. The fewer the number of classes, the greater will be the demand for exceptions. However the greater the number of classes or categories, the more complex is the process of management and accountability. The second step is the decision of which aspects of management to control – Chart II listed 20 illustrative areas, topics or variables. Third is the laborious task of