

# CHALLENGES OF PUBLIC SECTOR REFORM IN CENTRAL AND EASTERN EUROPE

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Much of the world has been stirred by the courageous actions of Central and Eastern Europe moving forward with historic political and economic reforms. Because of the remarkable number of countries involved in this movement, the success or failure of the sweeping changes now underway will have a major impact on the rest of the world.

Worldwide experience has demonstrated many failures and near failures of economic and political reform because of (a) lack of political will to sustain the difficult, but often necessary, structural adjustments required for success, (b) the failure of economic theories to address the consequence of implementing those reforms, particularly their impact on the poor and those unemployed because of the reform, and (c) major deficiencies in the capacity of the governments receiving assistance to implement economic, social, or political reform. This paper will address the importance this last impediment to reform.

## INSTITUTIONAL CAPACITY FOR REFORM

Television, radio, and the press have overflowed with exciting stories about elections and movements toward market economies. However, a missing element in most of these press accounts, and until now, an element also missing from the action agenda of most of the donors is the role of reforming the machinery of government.

This linkage between governmental reform and economic reform needs to be articulated more forcefully and given greater prominence in national priorities. Leaders of some of the largest donors still labor under the illusion that the best way to move forward in the newly free countries is to "get the government out of the way". This false assumption could be jeopardizing the whole reform movement in many countries. Millions of families may suffer needlessly as a result. Let us look at why this premise is wrong.

1. Development of Private Sector. Hopefully, the new political environment in Eastern Europe will

provide badly needed opportunities for private enterprise to contribute heavily to the future of the people of these countries through jobs and strong economic growth. Only the private sector can provide this growth.

It is the public sector, however, which will either develop market-oriented policies and provide a positive environment for private enterprises, or conversely, produce policies that inhibit growth of the private sector and present certain obstacles, such as onerous processing of permits and licenses and inordinate customs delays because of red tape and inefficiency. Divestiture of expensive public enterprises obviously requires a public sector partner in the process.

The emergence of a vigorous private sector will require sustained economic reform and political stability, circumstances which are almost impossible without the establishment of a stable and competent government. The same is true of foreign investment. Macroeconomic policies, such as the avoidance of overvalued currencies and high inflation, are essential for a thriving sector. The new governments have limited experience in these critical areas, and technical assistance in developing an institutional capacity in the government for sustained implementation of privatization and economic reform would seem to be essential.

2. Democratic Institutions. Neither the yearning of people for democracy nor high-level policy decisions to achieve democratic institutions and practices in themselves produce reforms. This is clearly an area of drastic public sector changes that can be institutionalized only through careful planning. Experience in other countries demonstrates some of the difficulties involved.

The electoral process is a vital component of democratic initiatives, and with committed leadership, can be established rather quickly. Administration of justice that commands the confidence of the citizenry, however, involves many other governmental activities, national and local, and requires considerable time and effort to institutionalize. Police methods of arrests and investigation, handling of court trials, effective separation of the police and the military are among the issues which must be addressed.

3. Corruption. Recent world history is replete with instances in which, corrupt repressive governments have been swept away, only to be replaced with well intentioned leadership that lacked the competence to avoid emergence of a new brand of patronage and corruption.

Only the government can avoid corruption. Once permitted to take root, only government can end it. If patterns of patronage and corruption are permitted to redevelop in the early stages of the new government, however, they will be very difficult to eradicate later on.

4. Infrastructure. A vigorous private sector places large demands upon a government to take a variety of actions necessary to improve the infrastructure such as transportation and communication. These are expensive, requiring resources and a need for attention to serving various elements of society to a degree far beyond that which can be provided by private enterprise alone.

How well these and other elements of infrastructure are built and operated is of tremendous importance in economic recovery. In countries emerging from command economies, entirely new approaches to modernizing their infrastructure are required as governments move through the transition from command to market economies. Different approaches to whatever functions and activities the government retains for itself, as well as new approaches to its relationship to nongovernmental entities, are necessary.

5. Governance. Although these countries have some very able people in the new leadership, their ranks are thin. This means that a handful of people are faced with a very formidable task of quickly (a) developing a public sector, capable of planning and implementing a sustained economic program, (b) establishing a new political system requiring democratic institutions and practices, (c) establishing meaningful local government and effective relationships between Warsaw and those governments, (d) promoting market oriented incentives and a strong private sector, and (e) establishing procurement, financial and personnel management that will both guard against corruption and yet not inhibit the capacity of a fledgling government to act.

Governance will need effective functioning of the top echelons of government if these basic objectives are to be realized. It will require, for example, the planning, implementation, and coordination of a variety of relatively inexperienced ministries and agencies on a sustained basis while dealing with a convergence of major issues, while operating in the unaccustomed environment of public visibility and open criticism.

Not many well established governments are capable of doing all these things under conditions far less demanding than those facing Central and Eastern Europe. In addition, the time pressures are enormous, particularly when one remembers how quickly large scale protests can develop from an impatient citizenry with unrealistic expectations of the improvements freedom will bring them in their quality of life and how soon those improvements will take place.

Many aspects of public sector reform will require a substantial effort over an extended period of time. This includes the establishment of effective accounting systems, personnel classification systems, executive and employee development programs, etc. The great urgency at the moment is not these detailed administrative systems, however, but establishment of a basic organization and management framework that will enable rapid implementation of policy decisions, as well as the prompt installation of basic finance, personnel, and procurement controls that will avoid corruption from the outset.

The great opportunity the courageous people of these countries have gained for themselves is far too important to lose because the donor world fails to provide proper cooperation and support.

The first major challenge, therefore, is that of persuading international donors of the significance of governmental reform. Further, where donors are now beginning to include this important area in their future plans, persuading them to move quickly from the planning board to action is an added challenge. Two valuable years have already been lost, and time is running short.

#### **RESHAPING TECHNICAL ASSISTANCE**

Another major challenge is to shape traditional technical assistance to fit the particular needs of Central

and Eastern Europe. Too much of the economic models prescribed for these countries has been based on experience in Third World and post World War II countries. Neither situation fits very well for the task of designing either economic or governmental reforms. In a related problem, there has been a wave of "experts" attempting to import programs developed in the West with only limited attention to the fact that the circumstances in the countries now in transition are very different in many ways.

Because of the rich culture of these transition countries and the high level of achievement in many areas of education, it is often difficult to realize the damage that two or more generations of a centrally controlled command system has caused to institutions, both public and private, and to the capacity to manage them. As a result, the task of managing reform in Central and Eastern Europe is more difficult than one might suspect, and issues typically encountered in reform management have to be addressed with even greater early attention than usual.

The balance of this paper will be devoted to issues of managing the reform process. In this discussion it should be remembered that the specific solution to these issues has to be tailored to the different circumstances of each country. Models are to be avoided.

## **COMPLEXITY OF REFORM**

The complexity of major institutional change is nearly always underestimated by those who advocate fundamental economic or political reform, thereby jeopardizing their goals no matter how desirable they may be. This is especially true of countries emerging from command systems in which the most fundamental elements of management have to be totally reversed. Institutions are composed of people and human behavior does not provide the predictability found in models used in other activities. Failure to recognize this complexity leads to greatly underestimating the timetable on which change can be institutionalized, the monetary and human resources required, the issues confronting the political leaders, and the extent of continued monitoring and adjustment required after the reform is launched.

The fact that needed transformation is difficult should not be used as an excuse for delay or lack of action. To the contrary, the author believes that we tend to think and plan too modestly. People deserve a government that has the vision and courage to design and execute basic reforms. Timid approaches that only

nibble at fundamental problems will not produce anything the citizens of a country can see as addressing their problems in a meaningful way.

Whatever the particular circumstances, it is important for the leaders to be candid about the sacrifices that have to be made over a period of time before benefits of restructuring will begin to be seen. The public also needs to understand that greater economic and political freedom carries with it greater citizen responsibilities. This recognition will not develop, however, if the citizenry believes their government does not trust them and is not honest about its intentions.

### **PHASING BOLD STRATEGIES**

It is argued here that success is most likely when the architects of reform have developed far reaching goals and strategies that are sufficiently bold that they will come to be seen by the public as making a difference in their lives. At the same time, these designers must also carefully assess the national capacity for rapid change, and then call for a number of the more ambitious objectives to be achieved through a series of steps or phases, each of which are manageable with the resources that can be brought to bear, all the while preserving the bold goals.

As with other elements in reform design, the phasing has to be tailored to the circumstances of a particular country. Timetables will differ. In virtually every case, soaring inflation has to be attacked quickly and decisively. On the other hand, circumstances have forced some countries to defer full devaluation of currency longer than one might wish, or to do it on a step by step approach over time. Major reductions in expenditures of ministries and enterprises require careful planning and can rarely be accomplished quickly in a responsible way, although it is generally advisable to give visibility to small actions that can be taken rapidly, even though their initial value may be largely symbolic. Generation of new jobs to replace those lost through the austerity reform measures is always slower than planned, a common source of public backlash against economic reform.

Self discipline is required to assure that the phasing of actions is carried forward within the overall plan in such a way that the basic objectives and general timetable are kept well in mind. Otherwise, too many compromises will be made. Further, the inevitable problems of implementation will too easily shove the basic

goals into the background, and the reform will never be completed.

## PRIVATIZATION

In recent years, privatization has been used increasingly as an important component of economic restructuring, including its use as a means to downsize government organizations. It is an especially prominent in European countries moving away from a command economy. Most observers agree that many countries - often as a result of earlier encouragement from international donors -- have established far too many public enterprises that have become costly havens for expensive patronage and payroll padding, propped up by subsidies, and with few incentives for productivity. When they have been viewed as a solution for unemployment, taxpayers throughout the country have borne the financial burden of the costly inefficiencies of those enterprises.

But privatization contains no magic qualities. Neither is success automatic. In fact, it can be a mirage if handled poorly. Divestiture of a public enterprise in the absence of good management or clear cut objectives, for example, rarely succeeds.

To begin with, it is strongly suggested that people view privatization as a means to an end, not the end objective itself. In other words, privatization should not be viewed as important for the sake of private enterprise. This view can lead to economic exploitation and a lack of sensitivity to the social needs of a country. Rather, privatization should be viewed as important because of what it can do for the country.

We should support moves toward privatization because the private sector can best provide the vigorous economic growth that will enable a country to realize the revenues required to provide education, health care, and other services required by its citizens. It is needed to stimulate sustained outside private investment. We should also recognize that the government is a necessary partner in all forms of privatization, a partnership for which command systems of government in Central and eastern Europe have provided no prior knowledge or experience.

Major programs of divestiture tend to move forward before necessary regulations have been developed and installed. The "getting government out of the way" concept mentioned earlier discourages thoughtful analysis of what will be required to protect the public interest once major areas have been privatized,

particularly instances in which competition is limited or in which the public health or safety is affected. Without conflict of interest regulations in place, for example, divestiture and contacting-out are very vulnerable to favoritism and corruption.

On the other hand, the entrepreneurship, the creativity, the initiative, the risk taking, the tough decision making required for a successful business, are all blunted by overregulation. The balance between overregulation and inadequate protection of the public good is very difficult to strike, and no country does it perfectly. Further, this balance is an ever moving target, requiring constant vigilance and adjustment.

To play a fully productive role in society (and to reduce political pressure for undue restrictions on the private sector), private enterprises need to develop a social conscience. To the extent they are regarded as corporate "good citizens" in their community, a more cooperative and productive partnership is likely to develop between the public and private sectors. Elements of a social conscience needed by the private sector range from measures to reduce pollution in the air, ground and water to the welfare of its employees. Because these measures are often perceived to be dramatically opposed to the profitability of business, this is not an easy concept to embrace. Again, we see the task of balancing the necessity for private business to make a profit in order to survive with the necessity to operate in a way that is consistent with the public good.

## **DOWNSIZING**

Large layoffs often leave in their wake significant management and political problems, some of which are unavoidable. Extraordinary efforts have to be devoted to the morale of those who remain, as well as those who are losing their jobs. For those who become unemployed, the experience can signal the end of productive careers, resulting in greater cost burdens to society through the need for unemployment benefits and provision of other "safety net" social services. The whole family is impacted in many ways by the economic and emotional stresses induced. Healthy diets, health care, and educational opportunities for children are often reduced drastically for long periods, if not permanently. One survey in the U.S. also showed suicide rates of those losing jobs at 30 times that of the national average, as well as dramatic increases in family violence and alcohol abuse.

At times large scale layoffs have created difficult political pressures that have forced some countries



to back off needed reforms. In most of these cases, more careful planning and management of the cutbacks resulting from privatization and other modernization measures would have at least reduced the pain and the resulting outcry.

Doing more with less is feasible and a very desirable objective in many cases, but it necessitates careful design, often including the detailed flowcharting of the new processes. Downsizing programs that have resulted in greatly increased efficiency over the longer term have at the same time generally created major short term operational problems that require mitigation quickly.

## LEADERSHIP

Few things are more obvious than the need for the right leadership to carry major reform forward. There are many events and personal characteristics that result in a particular person having been selected to hold the reins of government during economic reform, but these factors do not often have much to do with preparing that leader for the intricacies of a constructive governmental role economic restructuring and the development of a market economy. He or she will have an urgent need to rely heavily on a mixture of technical advisors and experienced managers. But where are they to be found in countries in transition?

Not surprisingly, those who have pressed hardest for reform often lack the experience to contribute greatly to developing the mechanics of how their aspirations can be implemented. Thrust quickly into leadership positions, their enthusiasm and dedication cannot fully overcome their inexperience in translating their goals into implemented programs. On the other hand, incumbents with the most experience may be uncomfortable, or hostile, to basic change, making early success equally unlikely. When existing leadership is dedicated to reform and takes a leading role in seeking fundamental changes, many management problems are reduced, yet they are formidable under the best of circumstances, and the critical necessity for qualified aides is ever present.

There also has to be the organizational capacity of the leaders to coordinate effectively the different government organizations involved in economic reform. The control of the money supply, convertability of currency and maintaining its proper valuation, decontrol of prices, the handling of debt, reserves, and interest rates, the reduction in overstaffed ministries and enterprises, establishment of the policies required for a market

economy, the elimination of stultifying procedures used in a command system and the development of a public environment conducive to the development of a market economy; these and many other components of economic restructuring demand a level of interagency coordination and managerial capabilities well beyond those which is usually faced by government.

One must recognize that, although the top leaders should ensure that the management components of the reform program are given heavy weight and support, they are too busy with many other pressing matters to spend time personally guiding the details of the reform. In most cases, day-to-day management and coordination needs to be provided by a small unit in the front office of the chief of state. This function should be lodged with a permanent unit having a continuing responsibility for management improvement, but in the case of fundamental reform this institutional machinery may need to be supplemented temporarily to a special temporary group set up for the purpose of helping the chief of state carry out a particular reform. The point is there has to be some mechanism with the primary mission of helping leaders manage the reform.

#### EXTERNAL TECHNICAL ASSISTANCE

It is useful to look at experiences in other countries before embarking on reform. When the reform calls for a transition to an entirely new political or economic system, the need for looking at the experience of other countries becomes imperative. How to utilize this information, however, is not always easy.

First of all, no one from another country should ever be called upon to design carte blanche any major reform. It is impossible for a foreign advisor to sufficiently grasp the political, economic, and cultural background that is required for to be given such a task. In addition, if the reform is perceived as being forced upon a reluctant government by an international donor, there is likely to be resentment of the imposition of outside concepts. Further, those in the host country who have the responsibility for carrying out the reform are not likely to have an adequate understanding of what went into the design. When problems become serious, people are tempted to blame them on the "foreign designers" and want to start over again even if the design simply needs better management built into it or more tailoring to meet indigenous circumstances.

At the same time, external advisors, both individual experts and institutions, can be of tremendous help when properly selected and utilized. The possessor of numerous press clippings and an impressive vita may

or may not lead to the right person or institution. Much more important may be the extent to which consultants have in the past functioned as an ad hoc member of the host country economic team rather than aspiring to become the prima donna at the opera.

Much of the usefulness of a consultant, in the view of the author, is through facilitating the client's access to experiences in other countries and helping the client think through its own solution, as opposed to having an outsider somewhat unilaterally prescribe what should be done, in which case the country is more or less presented with a "take it or leave it" situation. To be effective, external assistance must be teamed with host country counterparts. The role of the host country has to be sufficient to develop a sense of ownership in the recommended changes.

When to use individual consultants and when to use institutions for advice is a question that continues to trouble both donors and recipients of grants and loans. There are many ways in which individual consultants offer the necessary technical assistance for limited or short term problems more cheaply than can profit or nonprofit organizations. Nevertheless, only a consulting institution can provide the interdisciplinary breadth of expertise, reliability, continuity of support, and continuing relationship that is needed for most institutional reforms.

Balancing costs against other factors in the selection of consultants; either indigenous or outside, is not easy. Resources are rarely adequate. Yet overemphasis on the lowest bid tends to encourage the parachuting in of those who have preconceived models developed in a foreign country, with only cosmetic changes in substance and labels. It also handicaps the consultant in efforts to develop a meaningful level of involvement of people in the organization requesting the assistance. The critically needed follow-on relationship to help ensure implementation is often eliminated through the cost negotiation process. From a financial standpoint, the cost of installing and maintaining the type of administrative system recommended by a consulting firm is far more significant than the contract cost of engaging the consultant.

## **ROLE OF THE BUREAUCRACY**

An extremely important factor contributing to economic transformation success or failure involves the role of different levels of the governmental bureaucracy in the affected ministries and enterprises. Much is

to be gained by giving higher priority to this part of the action plan than it is usually accorded. This will be particularly important, as well as especially difficult for countries in transition. Techniques that some have found useful in reducing bureaucratic opposition or foot dragging include:

- **Honesty in stating what is intended.** It is tempting to minimize the extent of changes that are contemplated, on the theory that full knowledge among employees would lead to widespread concern and increase opposition. This sugar coating of true intentions is generally counterproductive. Deception is quickly discovered, adding to the natural tendency of the bureaucracy to be suspicious of change and intensify resistance. In an environment of secrecy, rumors of what may happen are nearly always worse than what is actually contemplated. And once employees find their leaders are not telling them the truth, it is virtually impossible to gain their confidence and their cooperation. In the end, forthright statements gain respect, even though they may not produce agreement.
- **Explain the reform clearly and fully to the employees at the outset, particularly what is expected of them.** The explanations need to be repeated, orally and in writing, with ample opportunity for questions and employee discussion in a non-threatening environment. The lowest level employees need to be brought into these discussions, although the focus has to vary with the different groups.

Even when employees are not persuaded of the wisdom of the reform, and often they are not, they should at least see that there is a credible rationale for new approaches and that their leaders value them as individuals and regard their concerns as warranting top-level attention. If a candid explanation of the reform objectives has been provided, the amount of disagreement will probably be narrowed and the intensity and emotion of their opposition will be lessened in most cases.

- **Men and women in the various levels of bureaucracy should be made to feel that they have**

an important role in attaining the goals of the reform. And they do. To the extent they feel they have a significant part in the undertaking, and that their efforts are appreciated and recognized, their support is much more likely to develop.

One excellent way in which to bring about this sense of being a part of the reform team is to enlist their participation in developing the plans for carrying out the objectives which have been established by national leaders.

Short-term internal task forces with diversified members may be useful. Workshops are often held. Such actions not only give employees a sense of "ownership" in the program, and therefore some commitment to its success, their input improves the quality of the implementation by giving the reform leaders the opportunity to draw upon their knowledge and practical experience. In these discussions a distinction should be made between the basic objectives which have been already established by the leadership, and for which the time for debate has passed, and the means of implementation which is the area in which their input is solicited.

These and other techniques can make a tremendous difference in how employees approach reform.

In short, genuine cooperation of the bureaucracy has to be earned; it cannot be ordered.

#### **TRAINING: FOUNDATION FOR REFORM.**

It should be obvious that there is an urgent and critical need for extensive training and retraining of those who are to operate a government that is entering into fundamental reform. This is particularly true when a nation changes from a command economy to one that is market oriented, requiring privatization and basic economic reforms, in combination with transformation from a centralized political system to a multi-party system. These are drastic changes intended to bring about nothing less than a transformation of the nation.

Political reforms that move toward transparency and public responsiveness are more complex and very different to operate than those of a centralized type. Employees have to learn how to talk with the public, be sensitive to their needs, and respond to them to the extent possible. This may be in sharp contrast to their prior training which has been often focused on responsiveness to party leaders in the nation's capital, with little

regard for the impact of delays in service or lack of responsiveness to the needs of citizens. Middle and high level managers have to learn how to make more decisions on their own, take initiative, be creative, delegate effectively, have their work opened up to external scrutiny, and be held accountable for their actions. Where governments are in transition, much has to be learned by their employees with respect to how to communicate in a free society, both within the bureaucracy and with the public.

The transition to a market economy requires a wide range of actions for which managers trained in a command economy have no experience. Policies that foster the development of a strong indigenous private sector are only the beginning. Most privatization steps require ministry leaders who understand those incentives that are necessary for a private sector which can truly provide the engine of economic growth. They also need to understand the disincentives that must be removed or avoided by the government if private business is to thrive. Contracting with the emerging private sector to provide goods and services for the government requires new managerial techniques in order to provide responsiveness to program needs while also providing efficiency and avoiding favoritism and corruption. The lowest levels of the bureaucracy are not likely to be concerned with understanding these policy matters, but they need to learn how their day to day handling of such seemingly routine matters as issuing of licenses and permits, and the expeditious processing of customs can make a big difference in the success of private enterprises, especially the smaller ones.

## CONCLUSION

Discussion of changes that are necessary to increase the capacity of government to achieve economic restructuring could be quite lengthy. As indicated at the outset, this paper is simply intended to discuss the critical role of governmental change in achieving change, and to list the issues the author has encountered most often with respect to managing reform in the United States and in other countries. The way in which these problems are addressed is necessarily different in every nation, but in virtually every case, there has been a failure by outside advisers to fully recognize public sector reform as an essential of instrument in addressing economic reform. As a result, the task of managing economic reform has been underestimated, and the reform

has become unnecessarily difficult and perhaps, when added to other difficulties, in some instances, even placed in jeopardy.

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