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THE BIAS AGAINST PROFITS

It is hard to explain, but some government contracting agents show a very strong bias against for-profit concerns and a concomitant favoritism for so-called nonprofit institutions.

There are several implicit and generally fallacious assumptions working against the for-profit concerns. One of the most common is that an organization that works for a profit must necessarily be devoid of all ethical standards and commitments towards the quality of the product. Another frequent, and highly debatable, assumption is that nonprofits are less expensive than for-profit firms.

There is no evidence whatsoever to confirm the first prejudice. When it comes to competitive bids, in close-to-perfect or highly imperfect markets, nonprofits do not show a higher commitment to ethical values than a for-profit firm. In fact, experience shows many cases in which a nonprofit

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THE MINISTRY OF FINANCE IN A POST-COMMUNIST COUNTRY

The market economy is confusing and seemingly uncontrollable. The great economic philosopher Adam Smith talked about the invisible hand of self-interest as the guiding force for creating the wealth of nations. The beauty of the market system, when certain conditions are met — conditions that are almost never entirely complete — is that, left to their own devices, human beings will undertake economic activities in their own interests that will consequently also benefit the rest of society. When governments seek to impose restraint upon the anarchy of the market, the situation for most people involved usually worsens, although a few may benefit.

There is considerable difference between the allocation of resources and the production of goods and services through market mechanisms and doing the same through non-market mechanisms. When we discuss non-market mechanisms we are generally referring to the public sector, either through political or through bureaucratic processes.

To maximize a country's welfare we need to know what services people most want and how much of their incomes they are willing to give up in order to receive them. In the market this is a matter of offering goods and services for sale and seeing who will buy them. In the non-market atmosphere of the public sector the matter is woefully complex.

In the private sector, entrepreneurs who make bad decisions will lose their own or investors' or lenders' money and eventually either improve their operations or go out of business. In the public sector, we can misallocate resources for years without running the least risk of bankruptcy. However, politicians within the democratic system, who are unable to convince the electorate that they are serving in their best interests, will not retain their offices for long. There is even market-type competition in the political arena, but we vote for politicians on the basis of many or sometimes only a sole factor. Politicians represent package deals.

*IN A NUMBER OF COUNTRIES, THE
MINISTERS OF FINANCE WERE
BEACONS OF ECONOMIC REASONING
AND POLICY GUIDANCE.*

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MINISTRY OF FINANCE

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Politicians are eventually held accountable for their actions, and so too are bureaucrats. Politicians who feel their constituencies are not being well served in the budget process or in the provision of public services will attempt to exact a price from the bureaucracy. They have some say over who the ministers and deputy ministers are and which programs will be funded.

In a democratic society, ministers are accountable to the ruling party. However, they cannot blithely ignore the interests of other parties, for this would risk great confrontation that could upset their chances to carry out their own party's platform. Hence, there is a juggling act that keeps astute government officials and ministers always on alert.

Generally, the political system allocates duties and responsibilities to government institutions. These in-

clude ministries, special agencies, and different levels of government (central and local). The duty of the ministry of education is to ensure that a minimally acceptable level of education prevails throughout the land. The ministry of health is responsible for public health care. Other ministries and agencies have their own responsibilities. These ministries are allocated resources, generally in terms of financing, which they should use in the best way possible to achieve their objectives or missions.

In a democratic society, it is the political system that rewards or punishes ministers, deputy ministers, bureaucrats, and whole institutions based on their performance within some reasonable set of standards and given the system's constraints.

MINISTERS OF FINANCE IN OTHER COUNTRIES

The minister of finance in most western countries fulfills two major functions: he or she collects taxes and other revenues, and allocates financial re-

sources to the rest of government. The minister of finance is also responsible for ensuring that the fiscal program is understood by the legislative branch of the political structure and that, to the greatest extent possible, macroeconomic stability is achieved.

Usually, macroeconomic policy responsibilities are divided between the central bank and the ministry of finance, although others may certainly have important roles to play. The central bank generally is responsible for maintaining monetary policies that will keep inflation low without also squashing hopes for economic growth. It is generally constrained by fiscal policy. A central bank that is bound and determined to keep inflation down will drive interest rates up in the face of what it considers to be inadequate fiscal policy. At the same time, the ministry of finance is often constrained by the monetary policies of the central bank, which in great part determine the government's cost of debt service, the rate of growth in the economy (within great constraints), and credit constraints imposed by agreements made with international financial institutions.

The structure of the ministry of finance varies from country to country. As noted, in many western countries, the ministry of finance both collects taxes and duties and allocates the revenues to line ministries and other budget entities. These line agencies are then responsible for spending the funds. In other countries, these functions are often split, yet generally they are subordinate to the minister of finance.

In the United States, the Office of Management and Budget is responsible

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for medium- and long-term budgeting on behalf of the executive branch of government, while the Department of Treasury is responsible for tax and customs administration and for making all of the government's disbursements and debt management.

In a number of countries that have experienced thorough economic reform over the past two decades, the ministers of finance were beacons of economic reasoning and policy guidance. Two important cases are Chile and Mexico. In Mexico, the Secretary of Finance and Budget, Fernando Aspe, and his Sub-Secretary, Francisco Gil Diaz, were the leaders of economic reform. Their policy extension went beyond the confines of ordinary fiscal policy; they also spearheaded efforts to privatize state-owned firms, reform the banking sector, and open the country to trade and competition.

Two especially well-regarded finance ministers were Hernan Büchi and Rolf Lüders of Chile, who presided over a reform process that eliminated deficits, reduced tax rates, raised tax revenues, radically altered how public spending was executed, targeted resources on battling poverty, opened the economy to international trade and investment, reformed regulation of telecoms, electricity, and other major sectors, and generally ushered in an era of rapid, sustained growth and reduction of poverty.

In most Latin American countries, tax and customs administration as well as budgeting and treasury operations are all carried out within the ministry of finance. The latest trend has been the creation of an independent, semi-autonomous agency to administer the tax system. Although

the jury is still out, there is indication that this has worked rather well in some countries that had been having severe difficulties in administering their tax systems. Apparently these agencies are given targets for performance and are evaluated, externally, on their ability to meet these targets. By setting tar-

**STRENGTHENING THE MINISTRY
OF FINANCE SHOULD ESTABLISH
MECHANISMS FOR ENSURING
GREATER ACCOUNTABILITY AMONG
BUDGETARY ENTITIES.**

gets in this way, the ministry of finance, although not directly responsible for tax administration, is capable of demanding revenue performance from these agencies.

**THE ROLE OF THE POST-
COMMUNIST MINISTRY OF FINANCE**

The role of the ministry of finance is to support the minister of finance so that he or she can fulfill the responsibilities discussed above. This it should do with the proper understanding of responsibility and accountability.

With the liberalization of the post-communist society, greater freedom of action has often been devolved to the budget entities and local governments. While this is reasonable in and of itself, it usually has not been accompanied by imposing greater accountability upon these entities. The ministry of finance's role is to allocate resources to the budgetary entities, but these entities must now be even more accountable to government, the legislature, and the people. Hence, strengthening the ministry of finance should help to establish more clearly the roles and responsibilities of budget entities and the ministry of finance itself, and it should also establish the mechanisms for en-

sureing greater accountability for the use of budgetary resources by these entities.

The roles of responsibility and accountability are important. When we discuss responsibility, we mean, "Whose job is it?" Generally, line ministries are responsible for using the resources allocated to them to provide specific services for public consumption. Local governments are responsible for carrying out public works and providing services to their local constituencies.

When we discuss accountability, we mean, "To whom is the responsible party to respond, to satisfy that the responsibility was appropriately executed?" Ministers are accountable to the Prime Minister or President. The Prime Minister is accountable to the people and to the legislature. And the legislature is accountable to the electorate.

The ministry of finance, merely because it is responsible for the allocation of resources among sectors, cannot be responsible for the implementation of the entire government's programs. This would be an impossible task, and, if attempted, it would merely lift the responsibility for budget implementation from the respective budget entities; that responsibility could not be replaced by ministry of finance controls.

The ministry of finance should be held accountable for meeting and setting fiscal policy and for doing its best toward meeting these objectives by the Prime Minister or President, who will in turn be held accountable by the legislature or the electorate. ♦

— Mark Gallagher
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firm could deceptively use its “vocation” to sell competencies and dedications that are not warranted by its behavior or the quality of its deliverables.

On the question of cost-effectiveness, many contracting agents erroneously believe, or appear to believe, that the profit fee added to contract costs increases the overall cost of the contract. They forget that the profit fee is generally around five or six percent (it rarely gets close to 10 percent) and it must cover interest expense and taxes, let alone nonallowable expenses. In the end, the net fee can get to three percent, but that can hardly increase the cost of a project. In a competitive environment, total cost is what matters,

and nonprofit institutions, besides charging fees for profit (the difference is that they are not distributed among the shareholders), can be much more expensive than a for-profit entity, depending on the salaries and benefits they pay to their managers and employees.

Our contention is that there is no basis for discrimination between for-profit firms and not-for-profit institutions. If the latter are charitable and can subsidize certain projects, it is obvious that a for-profit outfit might not be able to compete. Otherwise, there is no reason why an institution should be discriminated against simply because its cost structure is different or because the concept of profit is not ideologically acceptable to a contracting agent. ♦

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