

ECONOMIC THINKING AS A SIGNIFICANT PREREQUISITE FOR THE EFFICIENT MANAGEMENT AND FUNCTIONING OF THE DEFENCE SECTOR

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The objective of the article is to draw attention of readers to the importance of economic thinking in order to solve various current economic problems in the defence sector as well as to indicate how economic thinking and behaviour of the sector members, especially managers, can increase the overall efficiency of the Armed Forces activities or the efficiency of the defence sector activities. The author in the article defines the general economic principles (3E principles) of resource management, highlights the problem of application of the efficiency principle in the public sector and also in terms of the Department of Defence of the Slovak Republic and suggests some possible ways to solve some of current economic issues. In this context the author of the article also points to the need to educate managers in the economic field. The article is the output of a research and development project undertaken at the Armed Forces Academy of General M. R. Štefánik in Liptovský Mikuláš, the Slovak Republic

Key words: *economic thinking, efficiency, economic management, economization, education.*

1. INTRODUCTION

The current practical knowledge indicates that the efficient management of all entities of the national economy, whether profit-making or non-profit making, private, public, state, or self-administered bodies, is conditional not only on the application of management principles adapted to market conditions, but also on a responsible approach to management by every single manager. It thus appears that only a manager with economic thinking who respects basic economic principles and uses modern economic tools and methods in his work can lead the entity he manages to the road of success and long-lasting prosperity. The experience indicates that the requirement for the economical and efficient performance of the tasks has been proclaimed also in the public sector. The sphere of defence is not an exemption. On the contrary, the requirements for efficient allocation and economic and responsible use of

all resources have been enforced in recent years. In this context it appears that economic education of managers at various management levels of the defence sector should be a part of their preparation as a main prerequisite for the development of their economic thinking and stimulation of their economically rational behaviour in everyday practice.

The objective of the article is not only to draw readers' attention to the importance of economic thinking in order to solve various current economic problems in the defence sector, but also to indicate how economic thinking and behaviour of the sector members, especially managers, can increase the overall efficiency of the Armed Forces activities or the efficiency of the defence sector activities. In this context the author of the article also points to the need to educate managers in the economic field.

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2. THE NEED TO DEVELOP ECONOMIC THINKING AND TO STIMULATE THE ECONOMIC BEHAVIOUR OF THE MANAGERS OF THE DEFENCE SECTOR IN ORDER TO COMPLY WITH CURRENT PRACTICAL REQUIREMENTS

The existence of a large number of economic problems can be considered to be the main reason leading to the objective need to develop economic thinking and stimulate economically rational behaviour of managers at all levels of defence sector management. Based on the practical experience the guides from economic theory appear to be the most appropriate to solve these problems. Economic theory teaches how to recognize costs and benefits of crucial significance. The principles it uses are simple and generally valid, so the acceptance of these principles is a main prerequisite for the rational economic behaviour of private companies as well as public organizations and institutions. As Šefčík and Vítková claim [13], economic thinking seems to be the necessary solution to the economic problems of the defence sector: the problem of efficiency (especially the need for efficient allocation of resources/allocation efficiency and the need for efficient management of the defence sector resources), the problem of stability, preferring public interests to individual ones, the problem of a mutual relationship between the defence field and economic growth. All of the above are to be approached in detail in the next part of the article.

The theoretical and methodological bases of economic security of state defence requirements are studied as part of the state defence economy, which is an economic discipline by contents and a military discipline in its form. An efficient allocation of resources is the essential constituent of the defence

economic security in the Slovak Republic as well as within the alliance grouping. By comparison with the private sector, deciding on the allocation of resources within the defence and public sectors is governed by completely different rules. Despite this fact, the efficiency in the interests of national security is currently perhaps one of the most emphasized requirements.

With regard to enforcing the requirement for efficient allocation and rational use of resources in the defence as well as public sector there are many problems. In 1966 the American economist H. Leibenstein highlighted the condition typical for public sector organizations and marked it as the so-called X-inefficiency. According to Leibenstein, the production costs depend not only on the technology used, but also on the company effort to decrease the costs, or to produce the maximal output for the given combination of production factors. In this regard he stated that companies controlled by the state often sustain a loss of efficiency due to inadequate motivation of management to manage the costs effectively. If a private company reduces its costs by the unit, its profit increases by this unit. However, the same reduction by the unit within the organization of public sector leads to reduction of the total budget of the company by the unit. As a consequence, it can be considered as eliminating the importance of the company in question by bureaucrats [10].

If the idea that there is an analogy between the management within the private sector shown in the theory of business economics and the management of the public sector (with the defence sector as its integral part) is accepted, then there is a real need to also implement the principles of business economics in the management of the public sector entities. The practical experience indicates that the most applicable theory in the sphere of economic management of the public sector entities is the theory of costs - knowledge of business economics based on microeconomics theory. According to Jirásková [6] "every manager has to know the methods of managerial economics

and their application in decision making processes. Furthermore, he has to formulate his demands on subordinate staff sufficiently well so that they can perform their tasks. If a manager is not able to express his requests in a professional and specific way, he cannot request the subordinate staff to fulfil them. For this reason, the teaching of subjects – Business Administration and Financial Management should be an indispensable part of education for managers in the defence sector”.

Provided that the behaviour of public sector entities is rational and their management complies with the principles of rational economic behaviour, we search for relationships between inputs and outputs and between outputs and allocation targets. We observe whether the value of outputs provided (“Value for Money“) exceeds the costs for their production. However, this is just the first (absolutely insufficient) condition of economic behaviour. At the same time, we have to search for the economically most beneficial variant, taking into account the allocation criterion chosen (e.g. from among the criteria marked as 3E, namely Economy, Efficiency, or Expediency, and Economic Effectiveness) [10]. Interconnection between the above mentioned criteria and ongoing processes within a certain public sector entity is shown in Figure 1.

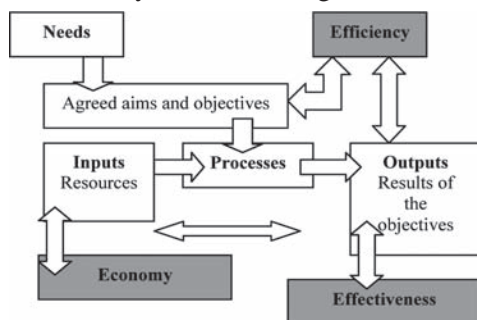


Figure 1. Effectiveness, efficiency, and economy of a public sector entity

The effort to use the resources available in a more efficient, economic and expedient way can be considered to be one of the priorities in this context. Attention is mainly centered on

financial resources. According to the Act No. 502/2001 Coll. on financial control and internal audit all public authorities are obliged to comply with the principles of effectiveness, efficiency and expediency with regard to management of public money and other activities.

The system of economic management has been implemented in the defence sector in order to secure efficient, effective and expedient use of appropriations. The main objective of the system is to determine the basic principles of management under the conditions of budget chapter of the Ministry of Defence of the Slovak Republic (hereinafter referred to as MoD SR). The need to implement this system resulted from the conclusions of the project „Audit of organizational structures of the MoD SR“ conducted in 2005. However, in the broader context of this problem there is a need to select unproductive plants or operations, find hidden reserves and to initiate the necessary changes. It appears that the application of the principle of effectiveness, efficiency and expediency can be considered to be the starting point for the creation of a strategy to secure rational budgetary expenditure savings within the defence sector.

Efficient use of resources available within the defence sector is one of the evaluated areas according to the approved politico-strategic document White Paper on Defence of the Slovak Republic (2013). The document states that [3]: “*Long-lasting disagreement between defined tasks and resources as an external (objective) factor has been deepened by an internal (subjective) factor – by lower efficiency of use of resources in the process of defence planning, including low functionality, effectiveness, and transparency of public procurement. These factors have increased the resource deficit in the defence sector. Moreover, the real resources allocated to the defence sector have not always been used for the planned priorities of the development of the armed forces required abilities due to these factors together with inappropriate requirements. Program plans and budget proposals have reflected strategic*

long-lasting objectives insufficiently. Furthermore, during the financial year concerned the amount of allocated funds was modified, or priorities were changed. As a consequence, there were changes in annual plans for procurement of contracts. The contracts were performed after the changes had been made. However, no realistic assessment of the negative impacts of departure from the original plans has been made. This system of resource management has proved to be ineffective and non-transparent.” To solve this problem it will perhaps be necessary to make deeper and more fundamental changes in the management and control process of how the funds are spent. Many experts (e.g. Krč, Kunc, Ochrana and others) consider these facts to be a challenge for the defence sector. According to them, the business thinking should be more prevalent throughout the defence sector and the sector should be presented to the public as an economic entity.

In terms of the management of the defence or public sector entities the problem of performance assessment and related efficiency, expediency and effectiveness seems to be a permanent problem. The performance should always be assessed in accordance with the specified criteria (i.e. 3E) and based on the objectively planned and subsequently identified facts. Criteria, or performance indicators, which serve for the measurement of objectives achievement should be transparent and structured with regard to the specific conditions. According to Vylet' al and Foltin [15] the marketing and process approach principles may be the foundation for performance assessment. This means that it is necessary to determine the processes according to which a regular performance assessment will be realized. The issue of performance assessment of processes and especially economic efficiency related to them is linked, to a great extent, with the issue of needs and their satisfaction as well as with the issue of expectations of entities and their parts (i.e. people as final beneficiaries and evaluators of benefits of the given assessment). As Ochrana (2003)

asserts, performance in the public sector is “a tool for the stimulation of management staff activity” [10]. Imagine that a commander has to organize combat shooting as planned indicators twice a year. If the results of the first shooting are excellent, there will be no need to organize the second shooting. The part of avoided costs originally planned for shooting may be used for material stimulation of subordinated staff provided that it complies with the established rules and legislation.

The achievement of maximum benefit at minimum cost is the main objective of Value Management, whose use in the defence sector raises a number of questions. Experts claim that it is irrelevant to discuss Value Management if there is no concern with costs (resource consumption). That means the objective “to minimize costs” is not defined even for managers. However, the economic and efficient allocation of resources has been defined as it has already been stated above. The conclusion is that only the implementation of cost management along with managerial accounting opens the possibilities for Value Management application within the MoD SR.

In addition to the foregoing, the other facts complicate the effort to optimize the allocation of resources and enforce the requirement for efficient resource management in the defence sector. The main objective of the sector is to secure the public good – defence (i.e. the defence capability), although it is very difficult to express the objective quantitative scale of this goal. National defence is provided to every citizen, there is no rivalry in relation with the consumption of this public good and no person can be efficiently or purposely excluded. Defence thus represents the collective/public good with automatic consumption (consumption is not divisible, public good is available for everyone). The defence sector is a budgetary organization. It manages the resources allocated to the sector, not the resources created by the sector itself. It can thus be concluded that the defence sector is not materially engaged in the management of these resources. The current system

of management of resources in the defence sector of the Slovak Republic is predominantly characterized by passive consumption. As a result, it does not create the conditions for high effectiveness, quality and flexibility of consumption. The inability to use savings at the level at which they were created or inability to transfer inputs saved to the following programming period, are good examples. The expenditure management system (i.e. the expenditure approach of economic management) has been applied in the defence sector. In contrast with the private entities there is a tendency to spend the funds allocated without a deeper analysis whether such spending is efficient. It can be concluded from the above that the market sector is characterized as a stimulator of economic efficiency. On the contrary, the defence sector tends to be inefficient and inefficiency seems to be an intrinsic feature of it. From the society-wide view it means that expansion of defence would deepen inefficiency. In this regard experts intensively emphasize the need to seek and find such procedures, methods and tools of economic management that would increase the efficiency of the defence sector economic entities and use them in practice. In other words: "by the introduction of new elements of economic management the defence sector may benefit more from the funds transferred from the national budget to the budget chapter of the MoD SR" [17].

Among the questions concerning stability in relation to the defence issue there are the ones particularly concerning price trends of defence outputs, stability of the balance of costs for defence of the alliance, or stability of states. The notion of stability can be understood as a balanced economic development or recovery following a previous state of crisis. The problem of stability is closely related to the study and analysis of the armament policy. In compliance with the principles of armament projects preparation the requirement for "sustainment of stability of programmes and plans for 2 or 3 years at least" [1] has been emphasized in the current system of defence planning. There is also a

requirement for stability in the area of personnel policy of the sector. The achievement of stability in the personnel area was one of the priorities of the last training years [14].

Economic problems of the defence sector include also preference of public interests in which the elected representatives and state administration are mostly interested in. When analysing the budgetary impacts of defence decisions, reallocation needs to also be taken into account. The fact that all economic decisions shall be accompanied by the adequate financial security indicates that all distribution aspects are always clearly associated with allocation aspects.

The last economic problem raised in this part of the article is the relation of the state and defence economic growth which includes a number of partial aspects such as an impact of the defence related costs on the economic growth and development, influence of research and development on civilian as well as military output, and the impact of defence burden-sharing on the growth comparison among allies. The economics of defence deals with the examination of the bilateral relation of economics and defence. Thus, economics determines the national possibilities of forming the numbers of the armed forces and the level of their structure, quantity and quality of the armed forces armament, material and technical security as well as the methods of conduct of armed conflict. The performance of the tasks of the Armed Forces of the Slovak Republic is significantly affected by the development of the percentage of defence expenditures in the gross domestic product. According to Ivančík [5] "the government and the Parliament shall make decisions on allocation of resources and according to the state budget determine what proportion of the funds will be allocated to the Ministry of Defence so that the Armed Forces may perform their duties. The Ministry of Defence shall subsequently define what proportion of these funds will be earmarked for the Armed Forces and what proportion for other sections of the

Ministry of Defence[18]. The Ministry of Defence shall also determine what proportion will be earmarked for material needs, modernization and investments as well as to define the volume of funds for service income of soldiers and salaries of civilian workers, compulsory contributions, energies, material, fuel, food, spare parts, etc., or what proportion will be earmarked for the purchase of new combat technique or weapon systems.” On the other hand, it is important to stress that the needs of defence influence the tempo of national economic development, the structure of economic sectors, its geographic distribution and a wide range of value proportions, its durability, mobility, etc. “The current tense relations between the state economy and defence significantly influence the numbers in our army, options of its modernization and total allocation of resources for defence“[9].

3. THE CURRENT STATE OF ECONOMIC THINKING AND BEHAVIOUR IN THE DEFENCE SECTOR - THE RESULTS OF EMPIRICAL INVESTIGATION

Based on the results of long-lasting empirical investigation of this issue the conclusion to be drawn is that there are many examples of the defence sector behaviour in practice, or its parts, that could be described as inefficient, wasteful or non-economic.

As an illustration, the results of the empirical survey conducted in 2011 with 61 respondents – managers from randomly selected military units and focused on the investigation of theoretical knowledge and practical skills of these managers concerning the use of economic tools for management. highlight some of the problems in this area. The method of individual questions was used in the questionnaire. The results of the survey show that neither of the respondents considered the current level of theoretical knowledge and practical skills concerning the use of economic tools for management to be “definitely sufficient”, and only 31 % of those asked considered this level to be “sufficient”.

On the contrary, 21% of respondents considered the level to be “insufficient”, 11 % of respondents considered the level to be “definitely insufficient” and 37 % of those administered the questionnaire stated that they are “unable to assess the problem” [see 7].

The knowledge about the way allocated funds in the MoD SR is managed was the result of the empirical survey [2] conducted as part of the diploma work undertaken within the Department of Management at Armed Forces Academy in Liptovský Mikuláš in 2011. The respondents answered the question whether they use economically all the resources allocated when performing their functions as follows: 19 % answered “yes, always”, 25 % of respondents stated “very often/almost always“, 47 % stated “often/usually“, 3 % stated “rarely/occasionally“ and 6 % stated “never”. The respondents considered the waste of financial resources to be the most serious problem. Other problems from the point of view of the respondents include a high level of corruption and subsequent inefficient management of processes and activities. The area of public procurement was marked as the area with the largest reserves with regard to efficient and expedient spending of budget appropriations. The personnel area was considered the least problematic. Further results show that only 3% of those asked use economic principles when performing their function, very often/almost always 3 % of respondents, often/usually 13 % of respondents, rarely/occasionally 43 % and never 38% of respondents [see 12]. It can be concluded that insufficient level of the use of economic principles related to the managerial work of commanders may result from various causes which need to be further examined. The fact that the priority of current military education is training future experts is indisputable. This approach is correct. However, the fact that the development of economic thinking of managing officers should be a part of the training is neglected.

The practical experience points to the number of problems which the sector

faces in the area of material resources management. The physical inventory of fixed assets is considered the highest check of state property management. Thus, checks of this type can highlight the most serious problems in this area. A good example are the results of the last physical inventory which point (among others) to the incorrect accounting for material removal from the stock of everyday consumption. The inventory proved the recurring inventory discrepancies and the shortages identified have been increasing for the past years [see 11].

Based on the empirical knowledge the conclusion is that application of economic rationalism with regard to resource management in the defence sector in the Slovak Republic is (similarly as our neighbours' situation) significantly influenced (in a negative sense) by the physical and moral wear of military technique and weapons, often by the unsuitable state of the used facilities and equipment, and by the lack of interest of employees (including managers) to use resources in an efficient and economical way. Another reason is lack of fundamental principles of rational management [see 4].

4. CONCLUSIONS

The findings presented can be regarded as a clear call for seeking the answers to the questions: how can we increase the Armed Forces' efficiency with limited budget resources, how can we achieve an optimal allocation of resources, how can we manage limited resources better, etc. We agree with the opinion of experts (Krč, Kunc, Ochrana and others) who state that the way to respond to those questions is the need to implement the process of economization of activities in the area of defence. This economization shall predominantly be reflected in stronger effort to make the value aspect of the tasks performance within the sector more objective and transparent, in the effort of managers to make economically acceptable decisions, in the responsible management of all phases of budgetary process, in the use of tools and methods of economic

management and in other areas [8, 10]. In this context it has to be underlined, that success of the economization of processes highly depends on "economic literacy" of the defence sector employees (especially managers responsible for the achievement of the set objectives). The practical requirements related to the need to develop economic thinking and behaviour of managers or the employees of the sector should be reflected in the system of their further education and training. The system should enable them to acquire economic knowledge necessary for the efficient management and performance of different tasks.

Theoretical and empirical knowledge shows, that according to economic theory, the existing general guidelines for management with limited budgetary resources and various specific methods and tools suitable for the process of economic management, can be applied also in the defence area. According to the experience of advanced armies, economic education of the defence sector managers is a significant prerequisite for the development of their economic thinking and behaviour. It is a fundamental starting point for the development of their ability to apply the economic principles in everyday practice.

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