January 12, 2007

Why Civil Service Reform does not work?

Nadeem Ul Haque
Abstract

Public sector reform (PSR) efforts in developing countries have been less than successful in the past. Motivated by budgetary considerations, they focused on downsizing and procedural changes without radically altering the outmoded incentive system which in many countries is now characterized by declining real wages, wage compression, a non-merit promotion and reward system. Using results from the incentives literature, this paper argues that for a reform effort to succeed, public sector human resource management will have to be reformed at an early stage to establish productivity incentives in the public sector. These will include introducing substantial autonomy to organizations in their work, incentive schemes and HRM along the lines of the now well accepted concept of central bank independence.

Past PSR efforts have also attempted to conduct a unified reform effort led centrally by the ministry of finance. A continuous process like the PSR spread out over a considerable period of time and involving many different people and organizations might need to build in decentralization, local leadership and local incentives and HRM.

PSR must be based on a recognition that people are at the heart of public service. As a result, managing human resources must be at the centre of any CSR effort. These people who are at the center of this change can either be its architects and beneficiaries or the losers and therefore the opponents of change! Design and implementation of reforms must therefore be sensitive to this important fact. It is therefore important that the reform is led by individuals at the organizational levels who understand the vision as well as the process of change. Governments must empower such a leadership to guide, initiate, innovate and manage change.
1. A History of the ‘Development Approach’ to Governance

Development economics and developing countries were both born in the post World War 2 era when the “Great Reversal” was at its height and communism had captured popular imagination (Rajan and Zingales (2001)). Although this was also an era of the struggle between capitalism and communism, both sides were building strong closed regulatory states with large governments and an emphasis on welfare. The new states that were born out of retreating colonialism took on the mantle of economic development and the new development economics developed thinking to deliver this development. Following the thinking of the time, the policy paradigm that was quickly established was that the government had to lead development (Haque and Montiel (1994).

The result is that this approach led to a long era of government-led development, which centralized policy- and decision-making, initiated planning, and created a wide range of public-sector institutions. The role of the government was thus extended into areas that were conceptually indefensible. In this manner, the power of the public servant grew as did her rent-seeking opportunities. Public sector employment expanded. Governments learnt of the political advantages of expanding public employment and the people got used to secure, non-demanding public-sector jobs.1

Borrowing externally and domestically was resorted to for the financing of this large, growing and domineering public sector. However, as the inefficiencies of the public sector and the distortions of a closed economy and the extensive regulatory structure began to inhibit growth and development, it became apparent that the model for development needed revision. Meanwhile, the stagflation in the industrial countries had also forced a rethinking of the welfare/regulatory state.

Development indicators measuring social and economic health have all remained fairly stubborn in the face of alternative policy paradigms. This frustration has lately led to rise in interest in the catchall term -- "governance" in the nineties. Now it has been shown in considerable research over the nineties that “governance matters!”2

Efforts at dismantling the excessive state were put into place through policies of the “Washington Consensus.” The new aims were to "remove distortions", "get the prices right", "fiscal consolidation", to be followed by "privatization and internalization.” Disjointed

1. “During the 1970s and 1980s, the wage bill of many developing country governments ballooned as new ministries, departments, and state-owned enterprises were created. These countries found there was little left over for public investment programs after paying the wage bill. Resources were spread so thinly that service delivery suffered.” Mukherjee and Manning (2002)
2 Kaufman and colleagues have done some very good work in this area (see Kaufman and Kraay (2003) and Kaufman et. Al. (2003)
efforts at dismantling the earlier planning structures and SOEs developed a fragmented public sector. Fiscal consolidation was achieved through sporadic efforts at expenditure reduction and revenue-raising. Since reducing public sector employment was politically risky, expenditure-reduction measures often relied on nominal wage freezes, which eventually translated into real wage cuts.

“Civil service reform” (CSR) acquired a certain prominence in development policy in the nineties. More often than not, governments undertook CSR under budgetary pressure. Pressured by Macroeconomic imbalances, many governments promised to cut the size of bureaucracy on the advice of most international agencies. Experience has shown that even the limited objective of cutting the size of government was not achieved. In many cases the result was demoralization and a further deterioration in the quality of government services as the public sector reacted to these strategic attacks on its recently expanded mandate in three ways:

- First, by slowing down reform in critical areas so that it's grip on resources could be maintained;
- Second, by seeking alternative means to make up for the real wage cut that the public sector employees was experiencing. Thus, "perks" -- legalized and non-transparent means of non-wage resource extraction -- became a major form of civil-servant emoluments while the tolerance towards corruption significantly increased.
- Third, the more skilled, the less corrupt, as well as those seeking a more reform-oriented approach opted out of first the public sector and later, as opportunities shrank domestically, out of the country.

The result was an overgrown and fragmented public sector, which had rapidly lost skills and also developed a tolerance for corruption and inefficiency. It is not surprising that in this milieu growth and investment slowed down sharply and perceptions of country risk increased sharply.

Like in the rest of economic theory, and indeed in life, there is a choice between “quality” and “quantity” in government employment and CSR of government.” The “governance good” is the product of the public sector and we must understand how it is produced, how it fits into the growth model and how to protect its production from political pressures. Only recently has political economy begun to ask such questions and we are beginning to understand some key issues relating to building governance. It is not surprising that the early stages of CSR were merely focusing on downsizing and some procedural improvements, not having a view on the role of the governance in the economy. While we still do not have a precise models of the role governance and the public sector in the growth process, empirically several indicators of governance have been developed and have proven that it is an important variable that explains an economy’s performance.

3 See UN (1999) for summary of experience with downsizing.
4 Rivera-Batiz (1999) shows that an increase in the quality of governance by one standard deviation, increases GDP growth by 1.2 percentage points. “democracy is a key ingredient of growth but only if it is associated with improved governance.”
The governance good is produced by the public sector and its employees. CSR’s have been conducted in several countries by international financial and aid agencies with very limited success. Public sector productivity remains low in many of these countries, wage bills high and employment excessive despite these efforts. This paper argues that one reason for the lack of success of CSR is that inadequate attention paid to recent developments in the theory of incentives in organizations. We will summarize several key results from this important but technical literature to see what we can learn of how to conduct a CSR that will improve domestic productivity.

The plan of the paper is as follows. We begin in section 2 by summarizing the current state of the CSR work. We then review the empirical facts, such as they are, on the employment and incentive structure of the civil service. Section 4 reviews the very rich and rapidly growing incentives literature to summarize some key results that can be used in the CSR/PSR process. Section 5 discussed some key lessons from the incentives literature for designing a PSR. Section 6 brings in some results from the sociological and management literature arguing that the given the PSR exercise involves the large government sector, we must adopt a multidisciplinary approach. The conclusion summarizes some of the main results.

2. The CSR Experience

CSR’s have been less than successful and governments now often balk at the term since it seems to connote the undertaking of a long term effort that only arouses negative feeling in the civil service. The World Bank in an extensive evaluation of the CSR experience over the nineties notes that “Bank-supported CSRs were largely ineffective in achieving sustainable results in downsizing, capacity building, and institutional reform….in part, due to significant political difficulties in implementing CSRs. Yet the relevance and ownership of reforms were also weakened by a technocratic approach that failed to mainstream institutional analysis and develop a coherent framework for intervening in administrative systems.”

Box 1 summarizes this experience and the key lessons learnt from it as laid out in the evaluation report of the Bank Operations Evaluation Unit. CSR remained motivated by budgetary considerations and remained focused on downsizing. Although recognition of capacity building and institutional reform came later, not much was achieved. What is of interest is that the assessment suggests that

- Ownership was not developed
- Incentives were not changed adequately
- CSR performance was not measured nor used for reform purposes.
- Morale remained low as “expatriate consultants and Project Implementation Units” led the reform

Reform must be people centered and change their incentives to vest them in the ongoing change. The CSR reform remained budget focused and as the World Bank report says

5 The study sample comprises 124 loans approved in 32 client countries, as well as economic and sector work (ESW) from a sub-sample of 11 countries, over the 1980–97 period.
technical i.e., concentrated on design and processes driven externally. In that sense it lost track of the motivations and a sense of involvement of the people whom the reform was going to affect. This paper argues that the incentives of the public servant must be must be central to the reform process. Without changing the incentives of the people who are going to implement the reform the reform will be unsuccessful.

Several approaches to reform have been developed over the last 2 decades although it is fair to say that success in this area has really been achieved in the advanced countries like UK, New Zealand and the US (see Box 3). These experiences have been widely discussed and have generated several useful strategies for reform. Several important lessons such as getting the role of the government ‘right’ through getting the government out production and only into the regulation and management of the market and managing the government through outcomes and performance auditing. The Thatcher approach of government by autonomous executive agencies with clear mandates and professional management is an example. The American Reinventing Government (REGO) movement is an important process for getting involvement in changing the bureaucracy toward the goals of the public sector reform.

In this paper, we will emphasize only the incentives and the HRM approach primarily because it is the neglected element of CSR especially in the developing countries. The CSR literature has tended to follow the public sector reform (PSR) movements as they happened in the west and attempted an application in the developing economies. As we will show with some data, the evolution of the public sector in these countries is been substantially distorted and has certainly distorted the incentives of the civil servant. We need to study these incentives carefully to see how we can vest these people in any proposed reform strategy. For that we also suggest that for a successful reform we will need to go beyond economics to disciplines like sociology and management.

The civil servant and her incentives must be central to the reform process. Most sequencing strategies suggest that wage structure changes somewhere in the process of change. It must be remembered that the incumbents have settled into the current incentive system. For example, if there are extra allowances to be gained form managing more departments, the manager will seek to run more departments. Similarly if rewards are for committee work, the more committees the better! If customs and police position yield rentseeking positions, people will go there. Unless a reform process addresses this issue, the incumbents will ‘game’ the reform. Consequently, it might be important to begin with a clear vision of incentives and their impact on the reform process.

3. Public Sectors in Developing Countries: Facts on Incentives

Because the public sector has traditionally been viewed merely as a transfer mechanism, there is little systematic evidence available on input utilization in the government or on the quality of its output. Reliable data on the structure of public sector wages and employment are not available for most developing countries. The studies that do provide information on

6 The gaming of reform is a very rich area of research that we will not be directly taking up here. See Mil for an interesting analysis of this in Pakistan.

7 Snapshots on the basis of sparse and disjointed data series are obtained from some individual efforts which demonstrate the nature of problem. It is surprising that there is no systematic effort to collect more information on this issue which is considered to be at the
some limited aspects of public sector management are only meant to provide a snapshot of the public sector at a point in time. It is not possible, therefore, to derive from them panel data of sufficient length to allow a formal empirical investigation. Let us begin with a summary of the available evidence on wage, employment and human capital policies in the public sector.

A. Wages

W1. Public wages decline in real terms over time: Evidence from a number of countries suggests that real wage levels for public sector employees have been declining over long periods in many developing countries. Table 1 presents the trend growth in real wage levels in the general government. Our estimates include all the countries for which data were available and for as many years as the data permitted. The trend regressions indicate that, since the mid-1970s, real wage levels in the general government declined in 19 of the 29 countries. In the remaining five countries which registered positive growth rates, the highest was Ghana at four percent per annum. In transition economies, large-scale liberalization of prices accompanied by wage controls led to a decline in real wages in the public sector, particularly during the initial stages. For the sample as a whole, real wages declined by about 9 percent per annum.

W1.1. Declines larger in poor countries: The decline in government wage relative to per capita incomes is not uniform across countries. The poorer countries experienced a larger decline during the 1970s. During the 1980s the decline was reversed, but not enough to correct the declining trend over the entire period.

---

heart of economic development.

9 The information that is available is itself affected by public sector inefficiencies. For example, increasing public sector inefficiency leads to the problems of ghost workers that makes it difficult accurately to record public sector employment (see Lindauer and Nunberg (1994)).
10 For example, as far back as 1983, Gould and Amaro-Reyes noted that in Africa and Latin America, salary levels at middle and low level were at times so low that officials could not even have a balanced diet.
In the 20 years since the realization of the importance of CSR, CSR has been a learning experience for the World Bank. The learning has been described to take place in 3 stages:

- The first phase in the 1980s was dealing with “endemic overstaffing accompanied by unsustainable wage bills.”
- In the second Phase somewhere in the late 1980s “a combination of misaligned organizational structures, poor human resources, and inadequate incentives weakened administrative capacity to carry out core government functions” became an important issue.
- Finally, by the early 1990s, the Bank found that “the credibility and accountability of state institutions strained under the weight of cumbersome CS rules, political interference, and cultures of nonperformance.”

The Results: “On average, only 33 percent of closed CSR interventions and 38 percent of ongoing efforts achieved satisfactory outcomes. Even when desirable, outcomes were often not sustainable. Downsizing and capacity building initiatives failed to produce permanent reductions in CS size and to overcome capacity constraints in economic management and service delivery. There was no evidence that civil servants began to "own" and follow formal rules such as codes of ethics in any meaningful way. As a result, institutional reforms could not substantially limit arbitrary action by bureaucrats or politicians.”

Four factors undermined the efficacy of Bank-supported interventions:

- “Poor Information on CSR Performance. With the exception of fiscal data, standardized indicators of CSR performance were neither fully developed nor operationalized for monitoring and evaluation (M&E).”
- “Limited Role for Strategic Management and Cultural Change. Did not envision appropriate roles for strategic management (including the reorganization of work) and cultural change in strengthening incentives to perform. M&E often failed to acknowledge the detrimental impact of conventional Bank processes—such as the use of expatriate consultants and Project Implementation Units (PIUs)—on the credibility of standard operating procedures, as well as on the morale of civil servants. On a related point, the Bank’s skepticism about promoting greater autonomy for public sector managers meant that CSRs often compelled bureaucrats in client countries to be efficient without empowering them to be innovative.”
- “Absence of Coordination Arrangements, Checks, and Balances. Efficacy and sustainability suffered as borrowing governments carried out interventions without establishing the institutional arrangements necessary for coordination between government bodies or providing checks and balances to arbitrary action. For example, poorly defined authority between budgeting and personnel departments allowed overstaffing and the proliferation of ministries to continue, even after downsizing efforts. Similarly, in the absence of external checks on political interference, CS hiring remained a primary mode of dispensing patronage. Broad groups of stakeholders such as public employees, citizens, and private firms rarely participated in the process of defining and enforcing new rules and norms governing CS activities.”
- “Failure to Appreciate Labor Market and Institutional Constraints. While all three contextual constraints—macroeconomic performance, labor market trends, and institutional endowment—significantly influenced CSR outcomes, the Bank relied mainly on budget scenarios to guide the design of CSRs. Neither ESW nor M&E used models of CS systems that adequately accounted for labor market and institutional trends (for example, projected demand for CS jobs or the level of political appointments in the CS) when elaborating reform scenarios.”

Source World Bank (1999)
Table 1. Selected Developing Countries: Trends in Real Wages in General Government (Annual percent change)

<table>
<thead>
<tr>
<th>Time period</th>
<th>Real wage trend in general government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>1976-89</td>
</tr>
<tr>
<td>Armenia</td>
<td>1992-95</td>
</tr>
<tr>
<td>Belarus</td>
<td>1992-95</td>
</tr>
<tr>
<td>Bolivia</td>
<td>1985-91</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>1989-92</td>
</tr>
<tr>
<td>Congo</td>
<td>1980-83</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>1974-93</td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>1989-92</td>
</tr>
<tr>
<td>Estonia</td>
<td>1992-95</td>
</tr>
<tr>
<td>Fiji</td>
<td>1985-93</td>
</tr>
<tr>
<td>Gabon</td>
<td>1985-91</td>
</tr>
<tr>
<td>Ghana</td>
<td>1986-90</td>
</tr>
<tr>
<td>Hungary</td>
<td>1989-92</td>
</tr>
<tr>
<td>India</td>
<td>1979-84</td>
</tr>
<tr>
<td>Kenya</td>
<td>1982-92</td>
</tr>
<tr>
<td>Kyrgyz Republic</td>
<td>1992-95</td>
</tr>
<tr>
<td>Latvia</td>
<td>1992-95</td>
</tr>
<tr>
<td>Lithuania</td>
<td>1992-95</td>
</tr>
<tr>
<td>Mauritius</td>
<td>1974-92</td>
</tr>
<tr>
<td>Morocco</td>
<td>1980-89</td>
</tr>
<tr>
<td>Myanmar</td>
<td>1987-92</td>
</tr>
<tr>
<td>Panama</td>
<td>1973-91</td>
</tr>
<tr>
<td>Poland</td>
<td>1989-92</td>
</tr>
<tr>
<td>Romania</td>
<td>1989-92</td>
</tr>
<tr>
<td>Russia</td>
<td>1992-95</td>
</tr>
<tr>
<td>Rwanda</td>
<td>1985-89</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>1988-91</td>
</tr>
<tr>
<td>Suriname</td>
<td>1984-86</td>
</tr>
<tr>
<td>Ukraine</td>
<td>1992-95</td>
</tr>
<tr>
<td>Average *</td>
<td></td>
</tr>
</tbody>
</table>

Source: National authorities
* Estimated from a fixed-effects pooled regression of the countries listed. The coefficient is significant at the 5 percent level.

W2. **Declining public-private wage differential**: Some evidence of trends in the ratio of public to private wage for countries for which data was available is presented in Table 2. Once again we see that this ratio declined for most countries.\(^{11}\) On average, it shows a

\(^{11}\)Through a fairly comprehensive cross-country study of government wages relative to the private
decline of about 6 percent per annum. Flanagan (1995) finds that full-time employees in the private sector earn considerably more than their counterparts in the state sector in the Czech Republic.\textsuperscript{12}

Table 2: Selected Developing Countries: Trends in the Ratio of Government to Private Sector Average Wages (Annual percent change)

<table>
<thead>
<tr>
<th>Country</th>
<th>Time period</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bolivia</td>
<td>1985-91</td>
<td>4.0</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>1974-93</td>
<td>-0.8</td>
</tr>
<tr>
<td>Fiji</td>
<td>1985-93</td>
<td>-27.0</td>
</tr>
<tr>
<td>Ghana</td>
<td>1986-90</td>
<td>-8.0</td>
</tr>
<tr>
<td>Kenya</td>
<td>1982-92</td>
<td>-3.0</td>
</tr>
<tr>
<td>Mauritius</td>
<td>1974-92</td>
<td>-0.4</td>
</tr>
<tr>
<td>Panama</td>
<td>1973-91</td>
<td>2.0</td>
</tr>
<tr>
<td>Peru</td>
<td>1985-92</td>
<td>-25.0</td>
</tr>
<tr>
<td>Poland</td>
<td>1989-92</td>
<td>-0.4</td>
</tr>
<tr>
<td>Suriname</td>
<td>1985-92</td>
<td>-1.0</td>
</tr>
<tr>
<td>Average*</td>
<td></td>
<td>-6.0</td>
</tr>
</tbody>
</table>

Source: National authorities

sector, Heller and Tait (1984) showed that during the late 1970s and the early 1980s the ratio of public wages to private wages was lower in developing countries than in industrial countries. This evidence is somewhat surprising since one would expect that in developing countries, on average, the quality of human capital would be higher in the government relative to the underdeveloped private sector (Heller and Tait, 1984).

\textsuperscript{12}After controlling for schooling and potential experience, survey results show that workers in new private firms earn 18 percent more than those in current or former state enterprises.
W3. Wage compression: Wages at upper levels of public administration have often been reduced by more than those at the at lower levels. Figure 2 illustrates this phenomenon for several countries. With a base year of 1975=100, the figure shows the 1985 wage level at the lowest (solid) and highest (hatched) wage levels in the public sector. Note that with one exception, real wage declines were experienced at both the highest and lowest wage levels in the public sector in this sample. The numbers at the end of each country's

Figure 1: Wage compression in the Public Sector

See Haque and Aziz 1999

bar group present the ratio of the wage indices given in the figure for each country, expressing the relative 1985 real wage index for those at the lowest end of the wage scale as a multiple of the relative 1985 wage index for those at the highest end, converted to an index number. Since 1975 is the base year, a ratio in excess of 100 indicates an increase in wage compression. The countries are ranked in decreasing order of wage compression during the 1975-85 period. Note that wage compression is observed for all the countries in the sample except Morocco and Benin.


14 The data show that public sector wages are, in most cases, lower than private sector wages at both grade levels, particularly at the highest grade levels (see Haque and Sahay (1996)).
B. Employment

E1. The political imperative of protecting employment: During this period of compression and decline in real public sector wage levels, the share of the labor force employed in the sector showed a shallow increasing trend. The situation is illustrated in the left-hand portion of Figure 3, which shows the percentage of the population employed in the public sector in a group of developing countries drawn from the previous sample\textsuperscript{15} from 1975 through 1985, a period corresponding to that for which we have relative wage data. This steady share of employment has occurred despite the fall in wages in the public sector relative to other sectors. In more recent years, the right-hand portion of Figure 3 suggests that the public sector started to grow in the nineties after some years of fiscal restraint.

E1.1. Stabilization at the expense of public-sector efficiency: Some recent studies on stabilization programs suggest that fiscal adjustments often involve a decline in real wages in the public sector. The data show that short-term stabilization programs have a significant negative impact on real wages (Kraay and van Rijckeghem (1995)) while they protect overall wage expenditures of the government (Hewitt and Van Rijckeghem (1995)).\textsuperscript{16} It would seem that such programs protect employment at the cost of real wages.

\textsuperscript{15}The number of countries varies across years according to the availability of data.
\textsuperscript{16}Hewitt and van Rijckeghem (1995), examine the determinants of central government wage expenditures for 99 countries during 1980-1990. They found that heavily indebted countries tend
C. HRM in the public sector

H1. Hierarchical, unified, and non-meritocratic structures: Perhaps because of the paternalistic nature of the state, the civil services in most poor countries tend to be fairly rigid, often prevent entry and reward seniority rather than performance. Barriers to entry into the civil service are high while the pension rules are such that long service, well beyond productive years is rewarded. Public expenditure management is our only measure of bureaucratic performance and it measures only budgetary allocations, without really concerning itself with the service that each budgetary unit is supposed to provide (Premchand (1993)).

<table>
<thead>
<tr>
<th>Salary scale</th>
<th>professional &amp; scientific</th>
<th>administ.</th>
<th>Sub-professional</th>
<th>clerical &amp; financial</th>
<th>trades &amp; crafts</th>
<th>custodian &amp; manual</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>II</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>grade 1</td>
<td></td>
</tr>
<tr>
<td>III</td>
<td></td>
<td></td>
<td></td>
<td>grade 1</td>
<td>grade 2</td>
<td></td>
</tr>
<tr>
<td>IV</td>
<td></td>
<td></td>
<td>Grade 1</td>
<td>grade 1</td>
<td>grade 2</td>
<td>grade 3</td>
</tr>
<tr>
<td>V</td>
<td></td>
<td></td>
<td>Grade 2</td>
<td>grade 2</td>
<td>grade 3</td>
<td>grade 4</td>
</tr>
<tr>
<td>VI</td>
<td></td>
<td></td>
<td>Grade 3</td>
<td>grade 3</td>
<td>grade 4</td>
<td>grade 5</td>
</tr>
<tr>
<td>VII</td>
<td></td>
<td></td>
<td>Grade 4</td>
<td>grade 4</td>
<td>grade 5</td>
<td>grade 6</td>
</tr>
<tr>
<td>VIII</td>
<td></td>
<td></td>
<td>Grade 5</td>
<td>grade 5</td>
<td>grade 6</td>
<td></td>
</tr>
<tr>
<td>IX</td>
<td></td>
<td></td>
<td>Grade 6</td>
<td>grade 6</td>
<td>grade 7</td>
<td></td>
</tr>
<tr>
<td>X</td>
<td>grade 1</td>
<td></td>
<td>Grade 7</td>
<td>grade 7</td>
<td>grade 8</td>
<td></td>
</tr>
<tr>
<td>XI</td>
<td>grade 2</td>
<td></td>
<td>Grade 8</td>
<td>grade 8</td>
<td>grade 9</td>
<td></td>
</tr>
<tr>
<td>XII</td>
<td>grade 3</td>
<td></td>
<td>Grade 9</td>
<td>grade 9</td>
<td>grade 10</td>
<td></td>
</tr>
<tr>
<td>XIII</td>
<td>grade 4</td>
<td></td>
<td>grade 10</td>
<td>grade 10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>XIV</td>
<td>grade 1</td>
<td></td>
<td>grade 5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>XV</td>
<td>grade 2</td>
<td></td>
<td>grade 6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>XVI</td>
<td>grade 3</td>
<td></td>
<td>grade 7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>XVII</td>
<td>grade 4</td>
<td></td>
<td>grade 8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>XVIII</td>
<td>grade 5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>XIX</td>
<td>grade 6</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Robinson quoted in Mukherjee (1993)

to have lower central government wage expenditures relative to GDP.
17 Given the amount of funding that this area has received, it is difficult to understand why no effort has been made to develop data on several areas of HRM in some developing countries. Light (1999) has used survey methods not only to determine the size of government but also the labor market characteristics of the public service market.
Pay scales typically are organized in a pyramid of hierarchical grades that differentiate people and positions according to the skill level and knowledge required for particular jobs. Figure 3 provides one such example. Additionally, the whole civil service can be disaggregated vertically into narrower pyramids representing specific occupational cadres. For example, the medical cadre could comprise doctors and paramedics employed by government. Often different cadres have their own range of grades organized according to skill requirements that are difficult to compare across cadres. The combinations of grades and cadres provide a series of horizontal and vertical organizational structures. Table 3 shows how the Ethiopian civil service was organized into cadres and grades in the 1990s. Each grade is assigned a salary scale, with incremental steps leading from a minimum salary to the maximum of that grade. (Salary scales for different grades often overlap.) Each roman numeral in the example above represents a whole scale. Salary scales reward length of service and the accumulation of experience. Incremental (within scale) salary increases are often standard, while promotion to the next grade is contingent upon satisfying certain requirements and receiving a positive job evaluation.

**H2. Wage Setting:** Civil service salaries are revised annually or biennially in most industrial market economies. In contrast, they are adjusted infrequently in many developing countries. The process of adjustment is emotional and politically charged often involving a commission that will recommend an adjustment for the service as a whole.

Figure 4

![Cash Allowances as % of Total Current Monetary Rewards](source: World Bank Public sector website)
Box 2: Reward Structure in the Public Sector

Government pay determination is widely supposed to be transparent (as public money is being used) and fair (by paying equally for jobs of equal value -- such paying men and women equally for the same work). However, there are several components to civil servants' compensation and rewards. As the chart below shows, the total compensation package is a combination of current rewards and future expectations, contractual and intangible rewards:

<table>
<thead>
<tr>
<th>contractually-provided</th>
<th>non-contractual/intangible</th>
</tr>
</thead>
<tbody>
<tr>
<td>monetary</td>
<td>in-kind</td>
</tr>
<tr>
<td>base rewards</td>
<td></td>
</tr>
<tr>
<td>1. base wage/salary</td>
<td></td>
</tr>
<tr>
<td>2. health insurance</td>
<td></td>
</tr>
<tr>
<td>3. job security, prestige, social privileges</td>
<td></td>
</tr>
<tr>
<td>allowances</td>
<td></td>
</tr>
<tr>
<td>4. transportation, housing, meals, telephone, travel, cost-of-living</td>
<td></td>
</tr>
<tr>
<td>5. transportation, housing, meals, travel</td>
<td></td>
</tr>
<tr>
<td>6. trips abroad, training</td>
<td></td>
</tr>
<tr>
<td>future expectations</td>
<td></td>
</tr>
<tr>
<td>7. pension</td>
<td></td>
</tr>
<tr>
<td>8. housing, land, etc.</td>
<td></td>
</tr>
<tr>
<td>9. reputation, re-employment after retirement</td>
<td></td>
</tr>
</tbody>
</table>

W1. personal emoluments = cells 1 and 4 (current monetary rewards and allowances)
W2. personal disposable income = personal emoluments minus employer deductions for income tax withholding, provident fund/pension contributions, etc.
W3. total compensation = cells 1, 2, 4 and 5 (contractually provided current rewards and allowances)
W4. total rewards = cells 1 to 9 inclusive (contractual and non-contractual, current and expected rewards and allowances)

Mukherjee and Manning (2002)

H3. Perks and other emoluments: Unified pay structures are prevalent in public sectors and are expected to create a fair and transparent method of payment. In actual fact, their importance is declining in relation to the total rewards of the public sector as more of these rewards are now intangible, unrecorded and non-monetary in nature (areas 6, 7, 8 and 9 in Box 2). Figure 3 shows some scant data on how important cash perks can be and how they have evolved in some countries. In the more advanced OECD countries, they are held to a minimum, about 10 percent. Cash perks, however, may not be as large as some other unrecorded perks. For example, in Pakistan, the major reward from public service comes from the provision of prime
government land at subsidized prices. Additionally, corruption gains have increasingly become attractive in public service adding an important area to the reward structure taxonomy of Mukherjee and Manning presented in Box 2.19

H4. **Training:** The World Bank Administrative and Civil Service Reform website does provide some limited evidence of training in developing countries to show that it is not a priority item. In surveys, most employees reported limited or no formal training for their job and claimed to have learnt on their own on the job. Assessing training is exceedingly important in the rapidly advancing technology of today, for without continuous training, public sector work skills would erode faster than their private sector counterparts who are presumably being forced by the market to remain current.

H5. **Aged immobile public sectors:** Historically, civil service pension schemes were established as a form of reward for long service. Hence most benefit designs for these schemes are "backloaded" -- with little in terms of transfer of pension rights in case of early departure -- to encourage lifetime employment. However, as countries develop socially and economically, what used to be reward for long service becomes a barrier to labor mobility, prohibiting the flexibility to attract new blood through natural attrition, which is vital to allow the civil service to be modernized for the 21st century. Beginning with the 1980s, many industrialized countries realized the need for the civil service to be modernized, and started a trend to integrate civil service pension systems with national social security systems. Integration of civil service plan benefits into national social insurance plan benefits occurs to varying degrees in different countries. In the most complete sense of the term, total integration takes place when civil servants are treated no differently from private sector employees, as in Argentina and Peru, and throughout eastern Europe where preferential schemes no longer exist. A less complete form of integration occurs where a civil service pension system is operated by the State much like any other occupational pension plan in the private sector. Examples of this type can be found in the United Kingdom, Japan and other industrialized countries. Countries that have not switched to pension reform and to introducing mobility into and out of the civil service have a problem of an aging civil service. In many of these countries, the average age in the civil service has

---

18 The preservation of perks is an important deterrent to reform (see Mil (2003)).
19 Perks have an additional political economy dimension. When such large gains are coming in this nontransparent manner to the public servant, he is truly invested in preserving the status quo. Mere salary increases of a moderate kind may not move him from that equilibrium. (see Mil (2003))
20 Overall, an increasing number of civil service plans are being integrated in one way or another into national pension systems. In countries where integration has occurred, 60% of these integrated pension system frameworks were implemented after 1980. Some countries like Chile, Uruguay, Peru and Jordan have taken steps to terminate the civil service preferential scheme for new employees as part of the process of implementing pension reform for their national systems. Others such as United States and Hong Kong have established fully funded defined contribution schemes for new employees to allow for full portability of pension rights.
been increasing over the years while the motivation to work and the skill level, with limited training opportunities, has been declining. 21

4. LEARNING FROM INCENTIVE AND ORGANIZATION THEORY

Theory of incentives in organizations has been a fertile area of research in recent years and should be applied to CSR in developing countries. Basically these theoretical developments are based on two important assumptions:

- The fundamental point of departure for understanding any human behavior is the recognition of selfishness that is inherent in all human actions. This viewpoint is fundamentally opposed to the commonly held view that derived from the 19th century liberal view, which saw the government as a benevolent protector of the poor. The public servant, as the name implies, was considered to be selfless, kind and caring, devoid of the need for worldly goods and desires. She would, therefore, work for the common weal with no caring for family and the future! Clearly this view is incompatible with the paradigm of selfishness.

- Information is costly to collect and that people may have different amounts of information available to them, which they will use to their advantage. This means that all exchange must now take into account the information asymmetries and the cost of obtaining information. Public sector regulatory intervention is often required where informational asymmetries prevent the market from working. However, this also gives selfish public servants an opportunity!

This world of selfish individuals possessing asymmetric information leads to certain understandable forms of behavior:

- Moral hazard (hidden action) when one party has the incentive to shift the risk onto another uninformed party.

- Adverse Selection (Hidden Information) When one party has more information about a market transaction.

To deal with these issues, an analysis of contractual relationships, known as Agency Theory has been developed. An agency relationship is defined through an explicit or implicit contract in which one or more persons (the principal(s)) engage another person (the agent) to take actions on behalf of the principal(s). The contract involves delegation of some decision-making authority to the agent. Agency problems emanate from conflicts of interests, which arise out of selfish behavior in the presence of incomplete information, are common or endemic to most economic relationships.

Agency analysis has been used extensively to analyze how workers, managers, directors or investors respond to various incentives.22 One of the more fundamental results from that literature can be summarized as follows:

Proposition 1: (Incentive Compatibility) Even when effort is not directly

---

21 This could be an advantage in a holistic CSR as portability of pensions and some inducement could make retirement fairly desirable for an older, unmotivated, skill obsolescent public servant.

observable, rewards based on observables (output, monitoring) can motivate self-interested individuals to work hard (Holmstrom 1979).

This is a key insight—*incentives matter*-- which many traditional markets have been using for centuries. Since the employer does not know the amount of effort that the person is putting into a job, she promises to pay according to some observable that is closely linked to effort. Hence, we observe contracts that offer formal incentives such as piece rate wages, bonuses, stock options that are based on verifiable measures of performance such as items produced and profits. Even within firms and government agencies, foremen, fellow employees, bosses or boards of directors *monitor* work outputs of individuals to determine their wages increments and bonuses on the basis of relative performance evaluation.

These contracts rely on observability of performance and work well when the link between such performance and reward is strong (e.g. piece rate). Such incentives are *high powered* and *intrinsic* to the contract. As always, contracting does presuppose that the terms of the contract will be enforceable and that the risks associated with the contract will be shared. Government mandated guarantees of employment outside the contract would vitiate incentives to the detriment of the arrangement.

Contracts based purely on high-powered incentives (piece rates, profit sharing) transfer all the risk of the contract on to the employee. Since job security as well as income security are important to most people who are averse to risk, incentive contracts normally combine some form of secure payment (such as wages) with some periodic bonus as a reward for effort.

Piece rates work best when the job is simple and one-dimensional such as single activity job, assembly-line tasks or craft-related items or harvesting agricultural produce. Most jobs however, may require more than one task such as say teaching, which involves delivery of material, grading, discipline, research, participation in training and collegiality. Rewarding teachers on the basis of grading alone will bias their efforts in that direction to the detriment of other tasks. Holmstrom and Milgrom (1990) have shown that in the case of multitasking, it is difficult to write adequate pay for performance contracts and alternatives must be found.

**Proposition 2. (Multitasking)** When a job requires an agent to do more than one task, and not all tasks are observably distinguishable, direct high powered incentives may not be as effective as peer reviews and monitoring (internal and external) and subjective evaluations. (Holmstorm and Milgrom (1990) Dewatripont and Tirole (1998a and b)).

It is not surprising then to see firms using other methods to buttress pay for performance so that performance over several tasks can be balanced out. However monitoring and subjective evaluations too can lead to several biases, such as nepotism and extra power to supervisors, and need to be carefully implemented.

Not only do most real life situations involve multitasking but they also require considerable teamwork, which does introduce the possibility that some people in a team may carry an extra load.
Proposition 3: (Teamwork) when teamwork is required, “free-riding” can be reduced through peer monitoring and pressure. Team-based profit sharing could be an incentive. Holmstrom (1982)

Another important vehicle for inducing good effort that we observe very frequently is career ladders. People work hard and reveal their talents in the early stages of their career to rise up the ladder. Career concerns are powerful extrinsic motivation for workers—extrinsic because the contract pays only for past performance, the promotion is in the future based on the evaluation of the employer.

Proposition 4: (Extrinsic incentives) Promotions and career concerns motivate workers and reveal their talents for future rewards. (Fama (1980), Holmstrom (1982))

Promotions and career ladders are like tournaments, where the prize must increase with each higher level attained. This will mean that the prize increases as a person moves up the career ladder leading us to a general proposition on wage structures.

Proposition 5: (Convex wage structures) Returns in a career ladders must increase to a) offer a higher prize at the top and b) because the impact of more senior levels on productivity is magnified down the ladder. (Rosen (1986))

This essentially means that the wage line in any firm must be convex when seen from below i.e., progress in the organization is met with increasing rewards (see figure 5). This runs contrary to the liberal egalitarian thesis and it suggests that to induce higher productivity, we must live with higher inequality.

For the career concerns system to work, the tournament/promotion process must be credible i.e., on balance, it must be seen to work fairly and on the basis of merit. Of course this means that seniority alone cannot be rewarded and young talent must be allowed to move up as and when it is revealed. A byproduct of the promotion system is that workers work harder to reveal themselves when young and moving up the career ladder. Older workers, especially when they have peaked in an organization have limited incentive to work hard and may just coast along for a while.

Not only do all these problems affect the public sector but its size and multi-faceted objectives probably magnify them. In addition, the public sector has to face another very important issue that of answering to many masters. For the private sector, not only is performance very easily measurable through profitability of shareholder value, but also the set of employers are all commonly interested only in that measure. The public sector has no such clear measure but also has many masters to answer to. The executive, the legislature, the broader public and within the public the particular interests or groups that they serve all have expectations and goals. How should this be handled?

Proposition 6: (Common agency) When an agent (say civil service) is answerable to many principals (e.g. parliament, executive, consumers, and interest groups), incentive contracts should be supported by hard transparent missions (constitutionally determined). In addition devolution to self-selected and motivated agents and decentralization in the form of direct payment and
management by beneficiaries of the product or service could improve efficiency. (Dixit (1997)).

Devolution, delegation and decentralization are therefore necessary not only for the sake of distributing political power as commonly assumed, but also to provide appropriate incentives for economic efficiency. Given the nature of the government, devolution needs to be hard and credible. Hence it should be constitutionally or legally determined.

5. INCENTIVES IN THE DESIGN OF PUBLIC SECTOR REFORM

What do we learn from this review of incentives theory? Contrasting the state of the public sector HRM policies and its incentives in section 3 above with the brief summary of the incentives in organization literature in section 4, several lessons can be drawn for staffing a new reform in the public sectors.23

In view of proposition 1, the situation of declining real wages (W1 above) in the public sector, widening public/private wage differentials (W2), rigid pay scales with a non-meritocratic HRM (H1) is definitely not the incentive structure appropriate to good behavior. In response, we see the growing importance of perks and emoluments that are external to the job (H3). The difficulty in providing adequate incentives to civil servants may lie with the attempt to maintain rigid and uniform pay scales across the civil service. This also makes wage setting very difficult and political (H2)

The public sector product is extremely heterogeneous ranging over services such as health, police education, sanitation justice. Most CSR efforts seek to maintain a notion of a unified civil service that seeks to maintain uniform pay scales and performance measures over this extremely heterogeneous group of people. Proposition 1 says that the wages must be closely tied to the product and hence runs counter to this approach. We can therefore note our first lesson on incentives in public sector reform.

Lesson 1: (Heterogeneity of the public sector) While equity and standardization is desirable, large, uniform and monolithic (uniform pay scales, standardized increments and promotion policies) public sectors (of the post colonial and progressive eras) may not be amenable to incentive compatible contracting given the heterogeneity of public sector tasks.

But how should this be done? To begin with this lesson argues against one broad unified reform effort and suggests a more heterogeneous process of reform anchored by a vision of public sector efficiency. Perhaps each agency should have latitude to set their own performance measurement, appraisal and reward systems.

23 Since our focus is on incentives, we will not be reviewing issues such as “getting the government out of production and markets and back into governance and regulation,” “separating policy from service delivery” and on “private provision of public goods” (see Box 3 for the these principles and how they were applied in UK). Note how these principles are derived from incentive theory. The conjecture offered by this paper is that the reason that these principles did not take root in the developing countries is that the incentives of the incumbents were not aligned with the intended reform and its objectives.
and some monitoring agency (such as a civil service department) can keep these under review to see how these systems are evolving in relationship to each other.

No doubt equity and some measure of budget control is required to ensure that stresses and strains do not develop across the public sector. And some review process can and should be put in place. For equity purposes, market valuation of various jobs skills and professions can be a good signal. After all, the public sector has to compete for skills in the market.

Given the heterogeneity of the public sector and its objectives, it is important that managers of various agencies be given control of their instruments, personnel decisions, working practices etc and held accountable for their objectives. Promotions, job assignments, and other personnel decisions must be firmly in their hands though of course subject to some external oversight (and not as in current practice (see H 1).24

**Lesson 2: (Perks) Perks should be eliminated as they are not related to job performance. High powered incentives require that all payment be in cash and fully related to some performance measure.**

Perks (such as the provision of cars and housing, payment of utility bills) which have crept up in civil services as salaries have been declining in real terms have the potential of setting up alternative incentive mechanisms which may run counter to productivity. In any case perks are also difficult to maintain adding to expenditures and do create grounds for further rent seeking. In addition they do run the risk for being valued less than it costs the government to provide them. For all these reasons, eliminating perks through and monetizing their value in salaries may be efficient.

Should the public service always pay competitively with the private sector? Many studies have shown that the desire to do public service is strong in some people. Light (1999) has shown using a US based survey that even today the young would like to do public service and are joining NGOs only because they find government not attractive enough and too bureaucratic to fulfill this ambition. Heckman et. Al (1996) showed how motivated public servants performed on the job purely for the sake of service.

**Lesson 3: (Public service) Public service can be an important incentive for joining the public sector if the public sector is public service oriented (Light (1999), Heckman et al(1996) ).**

The government can indeed attract the motivated with an opportunity to do public service. This was indeed the ethos under which British colonial civil services were built and indeed acquitted themselves very well over a long period of time. For this to work, public service must be held in some regard by society and clearly seen to provide benefits. An inefficient public service looked upon with suspicion and poorly rated by Transparency International will not be able to offer the right

---

24 The outmoded concept of transfer from one job to another that still prevails in some countries, is only means for promoting rentseeking (Wade (1982) or political control and should be discontinued.
incentives.

It has been shown that the dominant culture of the civil service is determined by the kind of incentive mechanism that prevails. If the appropriate incentives for public service and productivity in the public sector are not in place, then it is also quite likely as set out in the corollary to lesson 1, the corruption or rentseeking may be the primary incentives attracting those who have a proclivity for these activities.

**Corollary to lesson 3: (Allocation of talent)** Public sector orientation (rentseeking, powerhoarding) will attract the commensurate talent. (Murphy et al (1991) Acemoglu (1995)).

Unfortunately, this is a self-reinforcing equilibrium and can lead to a loss of confidence in governance and eventually affect growth and productivity. In the limit such equilibria have led to civil strife.

The public sector need not pay a fully competitive wage not only because of the self selection between the business-minded and those given to public service, but also because public sector employment could also be a form of signaling of achievement and talent. In advanced countries often, public sector experience improves earnings and opportunities in the private sector (Haque et al (2000)). Of course, the public sector has to be efficient and worthy of respect for its professionalism and good conduct.

**Lesson 4: (Signaling and credibility)** Good performance in the public sector can be an important market signal for future employment if the public sector is recognized to be credibly efficient and skill enhancing (Spence (1976)).

Experience of the public sector can be valuable in the marketplace especially if the public sector provides valuable market training. A good example of this is how armies are marketing themselves as employers in the advanced countries. They recruit on the basis of their training. Their claim is that their training has market potential. They teach skills like engineering, broadcasting etc. Moreover, army veteran status also shows that the person has the discipline and motivation to put himself through a rigorous training and endurance process.

For this model to work, the government should also be continuously training its personnel. Surveys of young job seekers also shows that in a dynamic job market these entrants know that they will probably not work for only one employer or one skill for their entire career (Light (1999)). Consequently, training and improvements are an important component of their demands these days. But as we have seen governments do not seriously invest in this area in developing countries (H4 in section 3).

Some of the most successful Asian economies emphasize the importance of recruiting talented people and improving their skills through constant training. Hong Kong and Singapore carry out aggressive recruitment at entry level, entice high-flyers for further training, and generally pay salaries comparable with the private sector. Singapore, a serious reformer has maintained a systematic focus on efficiency as the sole criterion for retaining or retiring senior civil servants, with seniority no longer the basis for promotion.
Monetizing perks and establishing a public sector that is an employer that creates skills for future employment will allow the public sector wage to be set at a reasonable discount to the public sector. The reform can be graphically envisaged in Figure 5. Given that wage compression and the old HRM will have to end (as noted in lesson 1), the public sector salary profile will move from the concave (from below) compressed line to the dotted line. The difference will have to be carefully monitored and maintained to ensure adequate staffing quality in the public sector.

Wilson (1989) noted that government agencies face the risk of being assigned multiple tasks. The risk of multitasking is large and must be dealt with by means of “mission setting.” He provides examples of agencies such as Tennessee Valley Authority, National Forest Agency and Texas Prisons that have through clear mission setting achieved good results. Our next major lesson for PSR:

Lesson 5: (Missions and autonomy) Clear (legislated or well publicized) missions for governments agencies help overcome the common agency problem but only if these missions can be pursued with adequate autonomy (Wilson (1990)).

Wilson also notes that in developing a sense of “mission,” the organization must eschew vague objectives and define a set of “critical tasks” or “operational goals.” The “culture” of an organization needs to be changed to see that these critical tasks are and how to deal with them. The “mission” is a single culture that is widely and enthusiastically shared by the members of the organization.

Wilson also emphasizes the incentive cost of the pursuance of multiple goals. He stresses the need to focusing on subset of tasks even at the price of sacrificing other tasks. This pursuit of focus may lead well run agencies to resist being granted new tasks “conglomerate agencies rarely can develop a sense of mission; the cost of trying to do so is that few things are working well.” We, therefore have a related lesson on focus.

Corollary to Lesson 5: (Focus) The mission of each agency must be carried out with focus on a few measurable tasks. Additional tasks, though politically desirable, must be resisted.

It needs to be stressed that an agency of government can truly remain focused on its mission if it has independence or at the very least autonomy. This is very well illustrated in Central Banking where there is now global convergence of thinking that Central Banks must be independent professional organizations focused only on price stability. As a result almost all countries have passed laws to this effect and implemented them. Inflation everywhere has come down and this improvement can, in part, be attributed to this development. As inflation is under control and this has seen to be a result of central bank independence, that independence has received more political support. Thus, it seems that a strong sense of mission with

27 Wilson page . 371.
its concomitant changes in culture and productivity improvements can be self reinforcing since they will be perceived to be more effective and will consequently be given more freedom.

Autonomy and independence are also strategies that would help deal with the “common agency problem” that is endemic in government. A central bank or a regulatory agency or even a public sector school has to answer to many masters—the parliament, executive, community, and there is always the possibility of being captured by special interests. We know from the incentives literature that:

**Lesson 6:** (Decentralization, delegation and devolution) The public sector provides a variety of services to many different subsets of society. As the common agency problem would suggest, it is best that these services be provided in the most decentralized fashion to allow maximum interface, both in terms of evaluation and payment, between the immediate beneficiaries of the service and the providers public service (Dixit (1997) Wilson (1990).

While public sector agencies must have the mission and autonomy necessary for good performance, performance itself must be monitored as directly as possible by those who demand it. Moreover, the financing of that service must in some sense be controlled by the very people who demand it. The best example of this is the school voucher system which allows parents to choose the school for their kids even though the government subsidizes the schooling. In every area, solutions such as this that truly provide a community level control of the valuation as well as the financing of public sector would elicit more responsible performance from the public sector.

### 6. BEYOND ECONOMICS

We have seen that public sector reform in developing countries has been driven mainly by macroeconomic budgetary considerations while for its success we may need to understand microeconomics and its incentive theory. But to remain confined to economics on the reform of the most important, and in many cases the largest, sector of the economy—the public sector—would also be folly. For its success many disciplines need to be combined. In connection with our subject— incentives and HRM—the management and sociological literatures have fairly interesting ideas and suggestions.28 In my view there are at least 2 ideas that have not made an impact in this area especially in poor countries. These are the role of professionalization and leadership in a successful public sector reform and management.

Professionalization of public services is important for several reasons

1. Needless to say, in these days of the knowledge worker, even the public sector positions must have the requisite skills. The days of the generalist in charge of government or even an agency are gone.

---

28 Of course, checks and balances, performance and other forms of auditing, transparency and openness, as well as the recourse to legal action will all be needed in constituting a good public sector.
2. Professions are communities that share knowledge standards, a culture of work and arrange peer reviewed contests for achievement and excellence. In doing so, professionals keep the work of their fellow professionals under review at all times. Professional networking and monitoring may, therefore, be an additional safeguard against the common agency and the multitasking problems. And because the professional is networked in the profession and expects rewards through the peer review process, she is properly incentivized.

3. Professionalizing an agency and networking it with the professional community creates a further protection of autonomy as direct interference in professional and professionally observed work is that much more difficult. Wilson also acknowledges this fact is his classic work "The maintenance of some agencies depends so critically on their appearing professional and nonpolitical that it would be foolhardy for an elected official to compromise that appearance."29

Consequently, we can state another lesson which has not been used in the CSR/PSR literature.

Lesson 7: (Professionalization) Professionalization of public services places the agency, its mission and its tasks under scrutiny of the profession. Moreover, professionals employed by the government are additionally disciplined by professional peer pressure and incentives of external professional mobility. 30

For professionals to be attracted to the public sector, their incentives both monetary and non-monetary have to be correctly set. As noted above, public sectors in many developing countries are monolithic with limited entry possibilities especially into senior positions. Moreover, as the World Bank OED report has alluded, the extensive use of consultants for policymaking purposes leaves limited room for the professional to take pride in her professional work. An important incentive for a professional is to see her work flourish and to be associated with her name. Peer acknowledgement which lies at the heart of professional honor, can only be obtained if the work of a fellow professional is visible and clearly seen to be hers.

If both senior positions in the public sector are in the hands of generalist incumbents and policymaking and research in the hands of donor consultants, then any professional in the government is committing professional suicide. It is not surprising that either professionals stay away from the government or those that join it, lose their skills as well as standing fairly quickly.

One important element of the new HRM in the public sector should then be to open out recruitment at all levels to professionals. Concomitantly, this new approach

29 Wilson p. 199
30 Tirole and Dewatripont (1999b) formally model professionalism as the specialization in a single task and hence requiring less monitoring. They note the advantages of hiring such professionals in an environment of multi-tasking. IN that sense they are only capturing the essence of the first advantage of professions that has been mentioned here, that of technical competence, but not the other two networking/peer review, and the professionalization as a protective device.
would encourage both inward and outward mobility from the public sector. The current practice of lifetime public sector careers would have to be given up in deference to the requirements of the new more flexible professional labor market.

**Corollary to Lesson 7: (Mobility)** To attract the best professionals and to keep them under peer review, the public service jobs at all levels must be open to external competition. Similarly, public sector employees should be encouraged to seek jobs in the market.

The encouraging of greater mobility into and out of the public sector will also prevent the age structure of the public service from being too skewed in the direction of older workers. As we have seen younger workers, more energetic and career conscious are keen to upgrade skills and stay modern. The more successful civil service reforms such as Singapore have resulted in younger groups taking leadership of the service.

Equally important, the local professional would be allowed to take leadership of thinking, research and policy in her environment. This would necessarily mean that in the new arrangements, the well funded donor consultant would have to follow the lead of the professional in government. Perhaps some of this funding could, as Haque and Khan (1999) argued, even be directed towards building reform leadership in the agencies that need to be modernized.

This naturally brings us to another concept from the management literature that somehow the PSR/CSR thinkers have totally missed out on---leadership. For the reform to become reality, it should have leaders--people who are committed to the change, whose personal reputations are linked to the change, who have a vision for it and who will gain in terms of their professionals standing from it. Without these leaders, the reform is a technical exercise and we should not be surprised that it is not successful.

**Lesson 8: (Leadership)** Reform of the public sector at every level and in every agency has to be built around leaders who have the drive, vision, knowledge, and risk taking abilities.

Note that a successful reform needs not one but many leaders. It seems to me that one major flaw in the CSR work has been its continuing reliance on a central leadership of the reform process—most often the finance minister. This was because the reform was being driven by budgetary considerations. For the successful reform that improves public sector productivity, it has to stretch over the myriads of public sector agencies with their heterogeneous objectives, cultures and environments. In each area, reform will deepen according to the depth of its leadership. Consequently, much effort should be put into finding and developing reform leadership in each area and agency.

Developing leadership in the public sector runs the risk of autocratic control. Here leadership has to be defined in modern management parlance. The emphasis there is on learning, creativity, vision and consensus building, passion, risk taking, leading and gaining trust (See Kotter (1996), Bennis (1989)). A leader must be able to build an organization beyond her self and her tenure. She should then not be
judged only by her title and her privilege but by the professional quality of her team and their commitment to change. Additionally, has she built a dynamic learning organization that will continually accept change? Finally, the organization should be resilient to changes in leadership in particular, should be able to survive the leader who created it.31

Leadership backed up by competent teams will also insulate the reform from political interference which is so important for its success. Such insulation will also enhance the credibility of the reform and hence strengthen the reform process while softening the resistance.

A large part of public sector work has to be done in teams and as we have discussed incentives within teams can be diffuse and autocratic structures can stifle team development (Proposition 3). The US government did adopt a mechanism for inducing better team behavior by means of instituting an award for good team performance in the of the REGO movement for improving government cost-efficient and productivity. “The Vice President's Hammer Award is reserved for teams of pioneers who create an innovative and unique process or program to make government work better and achieve results Americans care about.”32 A similar initiative was taken in 1982 in Singapore with the introduction of work improvement teams (WITS). Developed on the pattern of quality control circles employed by successful and innovative private sector companies, WITS allowed groups of staff from varying levels to openly discuss obstacles to quality and to devise practical solutions for service improvement. The Botswana Government introduced a productivity and quality improvement program in 1993 by creating WITS within various institutions and departments. The Malaysian program to enhance positive attitudes provides a good example of a practical approach to the establishment of appropriate values within an entrepreneurial public sector.

The Hammer awards and WITS initiatives point to the need to develop teams and leadership in every area of the public service. This approach is in line with current management thinking emphases horizontal team based organizations and contrary to the practice of development policy which seeks to concentrate power in the hands of some reform leadership such as the finance minister. We can therefore conclude that the design and implementation of public sector reform must go beyond economics into management, sociology and other social sciences without losing sight of incentive economics. Without the correct motivation, reform will stay unimplemented and on paper!

**Conclusion**

31 The role of the charismatic leader and the routinization of charisma into bureaucracy was discussed by Max Weber in the 19th century. Surprisingly, PSR literature has not discovered it. I may point out that the leaderships that modern management thinkers like Bennis, Kotter and Covey are thinking about is instrumental, goal oriented leadership and not quite the singular charisma that Weber was talking about. It is much more a received ability to lead teams—something that can be acquired, though with dedication and passion, rather than inborn.
Civil service reform has traditionally focused on downsizing and changes to the procedures and structure of the service without emphasizing the human element—incentives, professionalization, mobility, leadership and teamwork. It is not surprising then that the results have been less than desirable and that change has been severely resisted from within the civil service. It is the contention of this paper that we can learn from incentive theory as well as from other branches of social sciences and management in order to design a PSR reform that will be incentive compatible and that has a greater chance of success.

Such a reform will have to use incentives in a way that the public servant’s welfare is improved while also improving efficiency and productivity of government is increased. For this rewards must be aligned with productivity and the old monolithic, uniform, and non-meritocratic human resource management of the civil service abandoned and replaced with new method of management that is much closer to practices in the private sector.33 The Thatcher reforms of the eighties are a good example of the principles laid out here (see Box 3).

To the extent that the public service is valued for its intrinsic (doing good) and for its extrinsic reward (experience), recruits may be willing to take a discount but the discount cannot be as large as some countries are currently offering to their public servants. For the public sector to be perceived to offer such intrinsic and extrinsic rewards, it must credibly be seen to be efficient and skill enhancing.34 Successful Asian reformers emphasize the importance of recruiting talented people and improving their skills through constant training. Hong Kong and Singapore carry out aggressive recruitment at entry level, entice high-flyers for further training, and generally pay salaries comparable with the private sector. Singapore has maintained a systematic focus on efficiency as the sole criterion for retaining or retiring senior civil servants, with seniority no longer the basis for promotion.

There are 2 important differences in applying the standard theory to the public sector. First a typical public servant may have to work for more than one objective as well as on multiple tasks and second the public sector answers to more than one owner with no clear measure of performance such as profit or value maximization. Incentive theory suggests that to get over these problems the public sector should be organized around autonomous agencies that have a clear sense of mission as well as a focus on that mission in its work. Measurable outcomes based on that sense of mission can be used to incentivize workers in the agency. Increasing

33 Some governments are successfully experimenting with flexible working conditions (Australia, New Zealand); moving collective bargaining from the entire public service to the workplace (Australia, United Kingdom); and the application of private sector law to the public sector (New Zealand).
34 Imaginative training initiatives have also been initiated in a number of countries. In Mauritius and the United Kingdom training is being tailored to rank, and in Singapore, Ghana, Australia and Trinidad and Tobago, customer service training for staff has been introduced. In the Canadian public service, staff training and development is given high priority with close attention paid to its cost-effectiveness.
Departmental and agency autonomy allows for innovations in producing, measuring and rewarding individual performance. This greater autonomy, however, has to be undertaken while maintaining the traditional civil service standards of integrity, merit and professionalism. Greater autonomy with a strong sense of mission is now widely accepted in the running of central banks which by law are given independence to focus on price stability. This model is still to be extended beyond central banking.

Decentralization of public sector management is also recommended to prevent excessive politicization of any public sector organization or agency. As far as possible such an agency should be managed and paid for by the users of its output. In New Zealand for example, it was considered that the Department of Education which dominated both policy-making and the delivery of education services should be abolished and education decentralized to the community level.

Another illustration of this principle of decentralization is the distancing of implementation from policy development (see Box 3). Examples of this are the establishment of statutory boards in Singapore, executive agencies in the United Kingdom, and the experience of corporatization in Australia. These have allowed a clear delineation between the functions of policy formulation and policy implementation. In this way, areas of relative freedom from bureaucratic constraint have been created in which a more business-like climate can be generated. Establishing an operational unit around a clearly demarcated set of functions, allows the development of operational goals, uniting staff with a clearer sense of mission.

Looking beyond economics, PSR is a process that is continuous and is spread out over considerable time. It also has to permeate through a large number of public sector organizations, agencies and units. It is only natural then to look for local leaders of the reform everywhere and as much as possible use modern management principles to guide the reform. Too often reform has been centralized around a high office and around a few individuals to the detriment of the reform. Professional networks can act as an agency of restraint both on politicization and on the professionals operating in the public sector. But this will depend on the extent of professionalization allowed in the public sector.

While the broad objectives in each country are similar, no unique solution or approach has emerged as a 'model' to be universally adopted. Success will depend on an incremental approach; a step-by-step process within the framework of a clear long-term vision. Rather than pursue a uniform reform through the entire civil service, a more prudent approach might be to first achieve efficiency-enhancing reform in key organizations and let the downsizing and change radiate outwards from there.35

35 For example, reform could begin with key economic agencies, such as the central bank, finance ministry, customs and taxation, labor ministry (if there is one) because presumably modernization and change in these ministries will contribute the most quickly to efficiency increases and at the same time create an important constituency for change. Following on from these the key areas of public service provision—health
Reform must, however, be based on a recognition that people are at the heart of public service. As a result, managing human resources must be at the centre of any CSR effort -- not technology, not market forces. These people who are at the center of this change can either be its architects and beneficiaries or the losers and therefore the opponents of change! Design and implementation of reforms must therefore be sensitive to this important fact. It is therefore important that the reform is led by individuals who understand such a process of change. Governments must empower such a leadership to guide, initiate, innovate and manage change.

and education can be tackled. Thus the reform can be spaced out and develop a core that can radiate change.
Box 3: Thatcher Reforms

Margaret Thatcher’s Government adopted the following principles for running the British government in 1988:
1. Separation of service delivery and regulatory functions into discrete chunks, each one called an Executive Agency.
2. Agencies to have control over their budgets, personnel systems and management practices.
3. Agency chief executive to be paid adequately to attract talent needed. Performance bonuses of up to 20 percent of their salaries could be paid but they must be forced to reapply for their jobs every three years.
4. Agency CEOs to negotiate a three-year performance contract with their department, specifying the results they would achieve and the management freedoms they would be given.
5. Setting of annual performance targets for each agency.
6. All agencies on trial for their lives every five years.

Results:
1. 126 Executive Agencies, which employ almost 75 percent of all civil servants;
2. CEOs now have the freedom they need to manage effectively; but both their pay and job security depend on their agency's performance against quantifiable standards.
3. If his agency doesn't perform, it may be abolished, privatized or restructured at its five-year review.

Overall, the British have shrunk their civil service by 15 percent by 1994-95 and performance has steadily improved. Operating efficiency has increased by at least 2 percent a year. On average, agencies got by on 4.7 percent less operating money in 1994-95 than they had the year before.

Haque and Aziz (1999)
References


Dewatripont, Jewitt and Tirole (1999a) 'The economics of career concerns, part 1: Comparing information structures', Review of Economic Studies, 66,


Dixit, Avinash (May 1997) “Power of incentives in public versus Private organizations” AER 87 no 2 pp378-82


Flanagan, Robert J. “Wage Structures in the transition of Czech Economy” International Monetary Fund Staff Papers 42: 4 pp 826-54


Gould, David J. and Jose Amaro Reyes “The Effects of Corruption on Public Administration Performance: Illustrations from Developing Countries” World Bank Staff Working Papers 580, Management and Development Series No. 7

Haque, Nadeem Ul and Peter J. Montiel The Role of Government in Economic Development Hacienda Espanola 1994


Heller, Peter S. and Alan A. Tait “Government Employment and Pay: Some International Comparisons” IMF occasional Paper No. 24


Prendergast (1999) 'The provision of incentives in firms', Journal of Economic Literature, 37, pp.7-63


Rosen, Sherwin 1986 “Prizes and incentives in elimination tournaments” AER 76 pp 921 939

Rosen (1988) 'Promotions, elections and other contests', Journal of Institutional and Theoretical Economics, 144, pp.73-90


UN Public Sector Downsizing: “Early Retirement Schemes and Voluntary Severance Pay” SURF for Arab States May 1999


World Bank (1999) OED evaluation of Civil service Reform programs
http://www1.worldbank.org/publicsector/civilservice/evaluationofdonor.htm
Possible public sector payline after reform: The lowered levels still paid at private sector levels (or even a premium) while the upper levels who get real (public service) and invisible (fame and later opportunity) benefits will be willing to be paid below the private sector. However, the difference must be relatively small if corruption and the “perks game” are to be avoided.

Public sector wage compression: lower levels are paid better than the private sector, upper levels are taxed.

Private sector convex wage line where rewards increase with merit-based promotions and responsibility.

Figure 5