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Abbreviations

CEO	Chief Executive Officer
CS	Civil Service
CSR	Civil Service Reform
ESW	Economic and Sector Work
GDP	Gross Domestic Product
HRM	Human Resource Management
M&E	Monitoring and Evaluation
NGOs	Non-government Organisations
OECD	Organisation for Economic Co-operation and Development
PIU	Project Implementation Unit
PSR	Public Sector Reform
REGO	American Reinventing Government
SOEs	State-owned Enterprises
WIT	Work Improvement Team

ABSTRACT

Public sector reform (PSR) efforts in developing countries have been less than successful in the past. Motivated by budgetary considerations, they have focused on downsizing and procedural changes without radically altering the outmoded incentive system, which, in many countries, is now characterised by declining real wages, wage compression, and 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 (HRM) will have to be reformed at an early stage to establish productivity incentives in the public sector. These will include introducing substantial autonomy to organisations 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 PSR—spread out over a considerable period and involving many different people and organisations—might need to build in decentralisation, local leadership and local incentives, and HRM.

PSR must be based on the recognition that people are at the heart of public service. As a result, managing human resources must be at the centre of any effort. The people who are at the center of this change can either be its architects and beneficiaries or its losers and therefore opponents of change. Design and implementation of reforms must, therefore, be sensitive to this important fact. It is essential that the reform is led by individuals at the organisation level who understand the vision as well as process of change. Governments must empower such leadership to guide, initiate, innovate, and manage change.

JEL classification: J21; J31

Keywords: Civil Services; Reforms

1. A HISTORY OF THE "DEVELOPMENT APPROACH" TO GOVERNANCE

Both development economics and developing countries were born post-World War II, when the "Great Reversal" was at its height and communism had captured the popular imagination [Rajan and Zingales (2001)]. Although it was also the era of struggle between capitalism and communism, both sides were intent on building strong, closed regulatory states with large governments and an emphasis on welfare. The new states that emerged from retreating colonialism took on the mantle of economic development, and the new development economics formulated a philosophy to deliver this development. Following the thinking of the time, the policy paradigm quickly established that it was for the government to lead development [Haque and Montiel (1994)].

The result was a long era of government-led development that centralised 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 his or her rent-seeking opportunities. Public sector employment expanded; governments learnt the political advantages of expanding public employment; and the public became accustomed to secure, non-demanding public sector jobs.[1]

Countries resorted to borrowing externally and domestically to finance this large, growing, and dominating public sector. However, as the inefficiencies of the sector, the distortions of a closed economy, and an extensive regulatory structure began to inhibit growth and development, it became apparent that the development model needed revision. Meanwhile, stagflation in industrialised countries 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. More recently, this frustration led to a rising interest in the catchall term "governance" in the 1990s. Now, considerable research carried out during that time has shown that "governance matters".[2]

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[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 programmes after paying the wage bill. Resources were spread so thinly that service delivery suffered." [Mukherjee and Manning (2002)].

[2]Kaufman and Kraay have done some very good work in this area [see Kaufman and Kraay (2003 and 2003a)].

Efforts to dismantle the excessive state were put into place through policies under the “Washington Consensus”. The new aims were to “remove distortions”, “get the prices right”, and “fiscal consolidation”, followed by “privatisation and internalisation”. Disjointed efforts to dismantle the earlier planning structures and state-owned enterprises (SOEs) led to a fragmented public sector. Fiscal consolidation was achieved through sporadic efforts to reduce expenditure and raise revenues. 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 1990s. More often than not, governments undertook CSR under budgetary pressure. Pressured by macroeconomic imbalances, many governments promised to cut the size of their bureaucracy on the advice of most international agencies. Experience has shown that even this limited objective was not achieved. In many cases, the result was demoralisation 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:[3]

(i) by slowing down reform in critical areas to maintain its grip on resources;
(ii) by seeking alternative means to make up for the real wage cut that public sector employees were experiencing: thus, “perks”—legalised and non-transparent means of non-wage resource extraction—became a major form of civil servants’ emoluments while tolerance towards corruption significantly increased; and
(iii) by the more skilled, less corrupt, and those seeking a more reform-oriented approach opting out of the public sector and, as opportunities shrank domestically, out of the country.

The result was an overgrown and fragmented public sector that had rapidly lost its skills and 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 significantly.

As in the rest of economic theory and, indeed, in life, there is a choice between “quality” and “quantity” in government employment and CSRs. The “governance good” is a product of the public sector and we must understand how it is produced, how it fits into the growth model, and how we can protect its production from political pressures. Only recently has political economy begun to ask such questions, and we are beginning to understand some of the key issues relating to building governance. It is not surprising that the early stages of CSR focused merely on downsizing the government and some procedural

[3]See United Nations Development Programme (1999) for a summary of experiences with downsizing.

improvements, rather than assessing the role of governance in the economy. While we still do not have a precise model of the role that governance and the public sector play in the growth process, several empirical indicators of governance have been developed and have proven that it is an important variable in explaining an economy's performance.[4]

The governance good is produced by the public sector and its employees. International financial and aid agencies have carried out CSRs in several countries but 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 in implementing CSR is that recent developments in the theory of incentives in organisations has received inadequate attention. We will summarise several key results from this important but technical literature to see what we can learn about conducting CSRs that improve domestic productivity.

The structure of the paper is as follows. Section 2 summarises the current state of CSR experience. We then review the empirical facts on the employment and incentive structure of the civil service in Section 3. Section 4 reviews the rich and rapidly growing incentives literature to summarise some key results that can be used in the CSR/public sector reform (PSR) process. Section 5 discusses key lessons from the incentives literature as a basis for designing a PSR plan. Section 6 brings in some results from the sociological and management literature, arguing that, since the PSR exercise involves the large government sector, we must adopt a multidisciplinary approach. The conclusion in Section 7 summarises some of the main results.

2. THE CSR EXPERIENCE

In general, CSRs have been less than successful, and governments now often balk at the term since it seems to connote undertaking a long-term effort that only arouses negative feelings in the civil service itself. In an extensive evaluation[5] of the CSR experience of the 1990s, the World Bank (1999) 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".

[4]Rivera-Batiz (1999) shows that an increase in the quality of governance by one standard deviation increases gross domestic product (GDP) growth by 1.2 percentage points: "Democracy is a key ingredient of growth but only if it is associated with improved governance".

[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 during 1980–97.

Box 1 summarises this experience and the key lessons learnt as laid out in the Bank Operations Evaluation Unit's evaluation report. CSR remained

Box 1: World Bank Evaluation of CSR Work

In the 20 years since CSR was realised as important, it has been a learning experience for the World Bank. The learning has been described as taking place in three phases:

1. The first phase in the 1980s dealt with "endemic overstaffing accompanied by unsustainable wage bills".
2. In the second phase, somewhere in the late 1980s, "a combination of misaligned organisational structures, poor human resources, and inadequate incentives weakened administrative capacity to carry out core government functions" became an important issue.
3. 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 non-performance".

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 [civil service] 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:

1. "**Poor Information on CSR Performance**. With the exception of fiscal data, standardised indicators of CSR performance were neither fully developed nor operationalised for monitoring and evaluation (M&E).
2. "**Limited Role for Strategic Management and Cultural Change**. Did not envision appropriate roles for strategic management (including the reorganisation 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.
3. "**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.
4. "**Failure to Appreciate Labour Market and Institutional Constraints**. While all three contextual constraints—macroeconomic performance, labour 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 labour market and institutional trends (for example, projected demand for CS jobs or the level of political appointments in the CS) when elabourating reform scenarios".

Source: World Bank (1999).

motivated by budgetary considerations and focused on downsizing. Although recognition of capacity building and institutional reforms came later, not much was achieved. What is interesting 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, and
- morale remained low as “expatriate consultants and Project Implementation Units” led the reform.

Reform must be people-centred and able to change people’s incentives to vest them in the ongoing change. CSR should remain budget-focused and, as the World Bank (1999) says, technical, i.e., concentrated on design and processes that are externally driven. In that sense, the CSRs of the 1990s lost track of the motivation and sense of involvement of those whom the reform was actually going to affect. This paper argues that the incentives of the public servant must be central to the reform process. Without changing the incentives of the people who are going to implement these reforms, the reform process will be unsuccessful.

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

In this paper, we emphasise only the incentives and human resource management (HRM) approach primarily because it is a neglected element of CSR, especially in developing countries. The CSR literature has tended to follow PSR movements as they happened in the West and attempted to apply the underlying thinking to developing economies. As we show with data, the evolution of the public sector in these countries has 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 this, we also suggest that, for a successful reform, we need to move beyond economics to disciplines like sociology and management.

As mentioned earlier, the civil servant’s incentives must be central to the reform process. Most sequencing strategies suggest that wage structures shift 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, a manager will seek to run more departments. Similarly, if there are rewards for committee work, the more committees the better. If customs and police positions yield rent-seeking positions, they will attract more people. Unless a reform process addresses this issue, incumbents will "game" the reform.[6] Consequently, it is important to begin with a clear vision of incentives and their impact on the reform process.

3. THE PUBLIC SECTOR 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 utilisation 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.[7] Studies that provide information on certain limited aspects of public sector management are only meant to offer a snapshot of the public sector at a certain point.[8] It is not possible, therefore, to derive from them panel data of sufficient length to allow a formal empirical investigation.[9] This section begins with a summary of the available evidence on wage, employment, and human capital policies in the public sector.

3.1. Wages

Public wages decline in real terms over time. Evidence from a number of countries suggests that real wage levels for public sector employees have declined over long periods in many developing countries.[10] 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

[6]The gaming of reform is a very rich area of research that is not explored directly here. See Mil (2003) for an interesting analysis of this area 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 has been no systematic effort to collect more information on this issue, which is considered to be at the heart of economic development.

[8]See Lindauer and Nunberg (1994), Chaudhry, Reid, and Malik (1994), and Van Ginneken (1991).

[9]The available information is itself affected by public sector inefficiencies. For example, increasing public sector inefficiency leads to the problem of ghost workers, which makes it difficult to accurately 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, mid- and low-level salaries were so low at times that employees could not even afford a balanced diet.

Table 1

Trends in Real Wages in General Government (Annual Percentage Change)

Country	Period	Real Wage Trend in General Government
Argentina	1976–89	–3.1
Armenia	1992–95	–45.0
Belarus	1992–95	–14.0
Bolivia	1985–91	2.3
Bulgaria	1989–92	–17.7
Congo	1980–83	–3.8
Costa Rica	1974–93	1.7
Czechoslovakia	1989–92	–11.7
Estonia	1992–95	6.0
Fiji	1985–93	–1.7
Gabon	1985–91	3.4
Ghana	1986–90	4.4
Hungary	1989–92	–0.8
India	1979–84	3.8
Kenya	1982–92	–2.2
Kyrgyz Republic	1992–95	–20.0
Latvia	1992–95	7.0
Lithuania	1992–95	–10.0
Mauritius	1974–92	1.3
Morocco	1980–89	–1.6
Myanmar	1987–92	–0.5
Panama	1973–91	0.6
Poland	1989–92	–10.3
Romania	1989–92	–8.9
Russia	1992–95	–11.0
Rwanda	1985–89	–2.0
Solomon Islands	1988–91	1.6
Suriname	1984–86	–8.3
Ukraine	1992–95	–20.0
Average*		–9.0

Source: National authorities.

Note: The coefficient is significant at the 5 percent level.

*Estimated from a fixed-effects pooled regression of the countries listed.

wage levels in the general government declined in 19 of the 29 countries listed in the table. In the remaining five countries that registered positive growth rates, the highest was Ghana at 4 percent per annum. In transition economies, large-scale liberalisation of prices accompanied by wage controls has 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.

Larger wage declines in poor countries. The decline in government wages relative to per capita incomes is not uniform across countries. 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.

Declining public-private wage differential. Some evidence of trends in the ratio of public to private wages for countries for which data were available is presented in Table 2. Once again, we see that this ratio declined for most countries,[11] on average, at about 6 percent per annum. Flanagan (1995) finds that fulltime employees in the private sector earn considerably more than their counterparts in the state sector in the Czech Republic.[12]

Table 2

Trends in Ratio of Government to Private Sector Average Wages
(Annual Percentage Change)

Country	Period	Trend
Bolivia	1985–91	4.0
Costa Rica	1974–93	–0.8
Fiji	1985–93	–27.0
Ghana	1986–90	–8.0
Kenya	1982–92	–3.0
Mauritius	1974–92	–0.4
Panama	1973–91	2.0
Peru	1985–92	–25.0
Poland	1989–92	–0.4
Suriname	1985–92	–1.0
Average*		–6.0

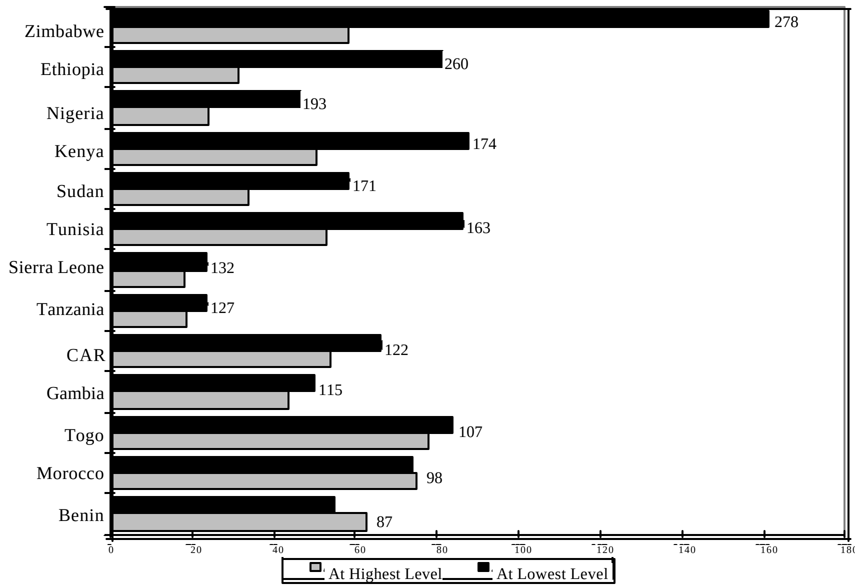
Source: National authorities.
*Estimated from a fixed-effects pooled regression of the countries listed.

[11]Through a fairly comprehensive cross-country study of government wages relative to the private sector, Heller and Tait (1984) showed that, during the late 1970s and 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, the quality of human capital would, on average, be higher in the government relative to the underdeveloped private sector.

[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 SOEs.

Wage compression. Wages at upper levels of public administration have often reduced by more than those at lower levels. Figure 1 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.

Fig. 1. Wage Compression in the Public Sector



Source: Haque and Aziz (1999).

Note that, with one exception, real wage declines occurred at both the highest and lowest wage levels in the public sector in this sample.[13] The numbers at the end of each country's 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]

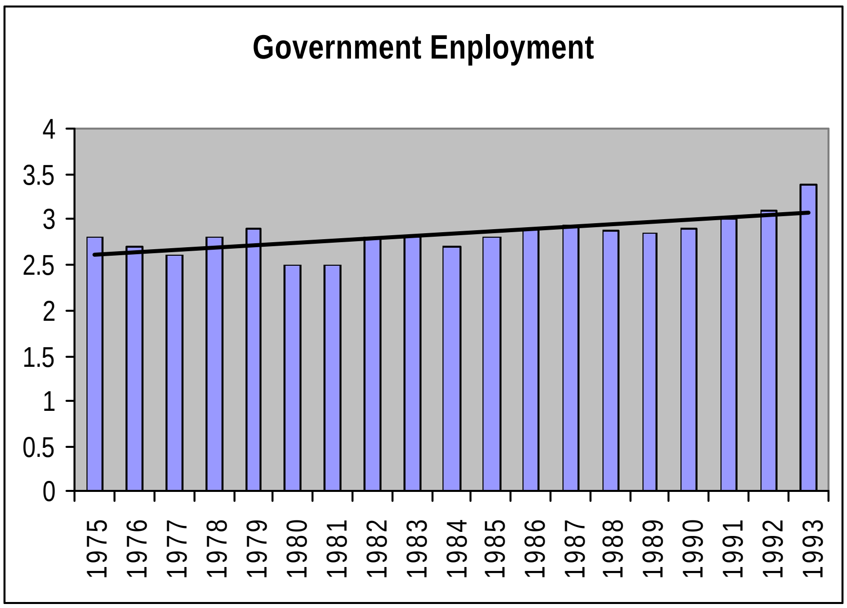
[13]See Van Ginnekin (1991), Lindauer and Nunberg (1994), Chaudhry, *et al.* (1994), and Haque and Sahay (1996).

[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)].

3.2. Employment

The political imperative of protecting employment. During this period of wage compression and decline in real public sector wage levels, the share of the labour force employed in the sector showed a shallow increasing trend. The situation is illustrated in the left-hand portion of Figure 2, which shows the percentage of the population employed in the public sector in a group of developing countries drawn from the previous sample[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 2 suggests that the public sector started to grow in the 1990s after some years of fiscal restraint.

Fig. 2. Government Employment



Source: Haque and Aziz (1999).

Stabilisation at the expense of public-sector efficiency. Some recent studies on stabilisation programmes suggest that fiscal adjustments often involve a decline in real wages in the public sector. The data show that short-term stabilisation programmes have a significant negative impact on real wages [Kraay and Van Rijckeghem (1995)] while protecting the government's overall

[15]The number of countries varies across years according to the availability of data.

wage expenditures [Hewitt and Van Rijckeghem (1995)].[16] It would seem that such programmes protect employment at the cost of real wages.

3.3. HRM in the Public Sector [17]

Hierarchical, unified, and non-meritocratic structures. Perhaps because of the paternalistic nature of the state, the civil service in most poor countries tends to be fairly rigid, often preventing entry and rewarding seniority rather than performance. Barriers to entry to the civil service are high while pension rules are such that length of service—well beyond a civil servant's 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 (1996, 1996a)].

Pay scales are typically organised in a pyramid of hierarchical grades that differentiate people and positions according to the skill level and knowledge required for particular jobs. Table 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 government-employed doctors and paramedics. Often, different cadres have their own range of grades organised according to skill requirements that are difficult to compare across cadres. The combinations of grades and cadres provide a series of horizontal and vertical organisational structures. Table 3 shows how the Ethiopian civil service was organised into cadres and grades in the 1990s. Each grade was assigned a salary scale, with incremental steps leading from a minimum salary to the maximum for that grade (salary scales for different grades often overlap.) Each roman numeral in this example represents a whole scale. Salary scales reward length of service and accumulated experience. Incremental (within-scale) salary increases are often standard, while promotion to the next grade is contingent on satisfying certain requirements and receiving a positive job evaluation.

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 not rational and can be politically charged, often involving a commission that recommends an adjustment for the service as a whole.

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[16] Hewitt and Van Rijckeghem (1995) examine the determinants of central government wage expenditures for 99 countries during 1980-90. They found that heavily indebted countries tend 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 there has been no effort 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 labour market characteristics of the public service market.

Table 3

Cadres in Ethiopian Civil Service (1990s)

Salary Scale	Professional and Scientific	Administrative	Sub-Professional	Clerical and Financial	Trades and Crafts	Custodian and Manual
I						
II						Grade 1
III					Grade 1	Grade 2
IV			Grade 1	Grade 1	Grade 2	Grade 3
V			Grade 2	Grade 2	Grade 3	Grade 4
VI			Grade 3	Grade 3	Grade 4	Grade 5
VII			Grade 4	Grade 4	Grade 5	Grade 6
VIII			Grade 5	Grade 5	Grade 6	
IX			Grade 6	Grade 6	Grade 7	
X		Grade 1	Grade 7	Grade 7	Grade 8	
XI		Grade 2	Grade 8	Grade 8	Grade 9	
XII		Grade 3	Grade 9	Grade 9	Grade 10	
XIII		Grade 4	Grade 10	Grade 10		
XIV	Grade 1	Grade 5				
XV	Grade 2	Grade 6				
XVI	Grade 3	Grade 7				
XVII	Grade 4	Grade 8				
XVIII	Grade 5					
XIX	Grade 6					

Source: Robinson, quoted in Mukherjee (1993).

Perks and other emoluments. Unified pay structures are prevalent in the public sector and are expected to create a fair and transparent method of payment. In fact, their importance is declining in relation to the total rewards of the public sector, which are now increasingly intangible, unrecorded, and non-monetary in nature (areas 6, 7, 8, and 9 in Box 2).

Figure 3 shows scant data on how important cash perks can be and how they have evolved in some countries. In the more advanced Organisation for Economic Co-operation and Development (OECD) countries, they are held to a minimum (about 10 percent). Cash perks, however, may not be as large as other unrecorded perks. For example, in Pakistan, the major reward of public service is the provision of prime government-owned land at subsidised prices.[18] Additionally, corruption gains have become increasingly attractive, adding an important area to the reward structure taxonomy of Mukherjee and Manning (2002) presented in Box 2.[19]

[18]The preservation of perks is an important deterrent to reform [Mil (2003)].

[19]Perks have an additional political economy dimension. When such large gains come to the public servant in this non-transparent manner, he or she is truly invested in preserving the status quo. Mere salary increases of a moderate kind may not move him or her from that equilibrium [Mil (2003)].

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 table below shows, the total compensation package is a combination of current rewards and future expectations, and contractual and intangible rewards.

		Contractually -provided		Non-contractual/
		Monetary	In-kind	Intangible
Current rewards	Base rewards	1. Base wage/salary	2. Health insurance	3. Job security, prestige, social privileges
	Allowances	4. Transportation, housing, meals, telephone, travel, cost of living	5. Transportation, housing, meals, travel	6. Trips abroad, training
Future expectations		7. Pension	8. Housing, land, etc.	9. Reputation, re-employment after retirement

Personal emoluments = cells 1 and 4 (current monetary rewards and allowances)

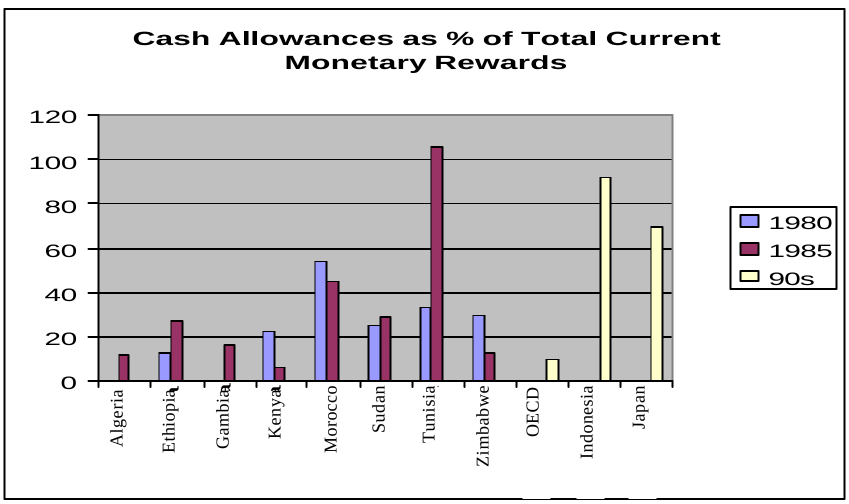
Personal disposable income = personal emoluments less employer deductions for income tax withholding, provident fund/pension contributions, etc.

Total compensation = cells 1, 2, 4, and 5 (contractually provided current rewards and allowances)

Total rewards = cells 1-9 inclusive (contractual and non-contractual, current and expected rewards and allowances)

Source: Mukherjee and Manning (2002).

Fig. 3. Cash Allowances as a Percentage of Total Current Monetary Rewards



Source: World Bank public sector website.

Training. The World Bank Administrative and Civil Service Reform website provides 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 while 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 those of their private sector counterparts, who are presumably being forced to remain current by the market.

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 "back-loaded"—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 a reward for long service becomes a barrier to labour mobility, prohibiting the flexibility to attract new blood through natural attrition, which is vital to modernising the civil service for the 21st century. Beginning in the 1980s, many industrialised countries realised the need for the civil service to be modernised, and started integrating civil service pension systems with national social security systems. The integration of civil service plan benefits with national social insurance plan benefits occurs to varying degrees in different countries. 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 when a civil service pension system is operated by the state much like any other occupational pension plan in the private sector. Examples of this can be found in the UK, Japan, and other industrialised countries.[20] Countries that have not switched to pension reform and to introducing mobility into and out of the civil service find they face the problem of an aging civil service. In many of these countries, the average age in the civil service has increased over the years while the motivation to work and the skill level, with limited training opportunities, has declined.[21]

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[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 percent 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 the US and Hong Kong have established fully funded, defined contribution schemes for new employees to allow for full portability of pension rights.

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

4. LEARNING FROM INCENTIVES AND ORGANISATION THEORY

The theory of incentives in organisations has been a fertile area of research in recent years and should be applied to CSR in developing countries. Essentially, these theoretical developments are based on two important assumptions, which are described below.

- First, the fundamental point of departure for understanding any human behaviour is the recognition that selfishness is inherent in all human actions. This view is fundamentally opposed to the commonly held view that derives from 19th century liberal thought and sees the government as a benevolent protector of the poor. The public servant, as the name implies, is considered selfless, kind, and caring-devoid of the need for worldly goods and desires. He or she will, therefore, work for the common good, irrespective of family and future. Clearly, this view is incompatible with the paradigm of selfishness.
- Second, information is costly to collect; people are likely to have different amounts of information available to them, which they will use to their advantage. This means that all exchange must take into account information asymmetries and the cost of obtaining information. Public sector regulatory intervention is often required where information asymmetries prevent the market from working. However, this also gives selfish public servants the opportunity to use asymmetric information to their advantage.

This world of selfish individuals who possess asymmetric information leads to certain understandable forms of behaviour:

- moral hazard (hidden action), when one party has incentive to shift risk onto another uninformed party; and
- adverse selection (hidden information), when one party has more information about a market transaction than other.

An analysis of contractual relationships known as "agency theory" has been developed to deal with these issues. An agency relationship is defined as 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 delegating some decision-making authority to the agent. Agency problems emanate from conflicts of interest, which arise out of selfish behaviour in the presence of incomplete information and are common or endemic to most economic relationships.

Agency analysis has been used extensively to analyse how workers, managers, directors, or investors respond to various incentives.[22] One of the more fundamental results of this literature can be summarised as follows:

Proposition 1. Incentive compatibility. Even when effort is not directly observable, rewards based on observables (output, monitoring, etc.) can motivate self-interested individuals to work hard [Holmstron (1979)].

This is a key insight-incentives matter. Many traditional markets have been using this insight for centuries. Since an employer cannot know the amount of effort a person puts into a job, he or she will promise 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, or 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 individuals' work outputs to determine their wage increments and bonuses on the basis of relative performance evaluation.

These contracts rely on observable performance and work well when the link between such performance and reward is strong (e.g., piece-rates). Such incentives are high-powered and intrinsic to the contract. As always, contracting presupposes 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 (e.g., piece rates and profit sharing) transfer the entire risk of the contract to the employee. Since both job security and 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 a job is simple and one-dimensional, such as single-activity jobs, assembly-line tasks, the production of craft-related items, or the harvesting of agricultural produce. Most jobs however, require carrying out more than one task: teaching, for instance, involves delivery of material, grading, maintaining discipline, research, participating 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 (1991) 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-

[22]See Gibbons and Waldman (1999) and Prendergast (1999) for excellent comprehensive surveys of the literature.

powered incentives may not be as effective as peer reviews and monitoring (internal and external) and subjective evaluations. [Holmstorm and Milgrom (1991), and Dewatripont, Jewitt, and Tirole (1999, 1999a)].

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 biases such as nepotism and extra power to supervisors, and need to be carefully implemented. Not only do most real-life situations involve multitasking, they also require considerable teamwork, which introduces 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 can be an incentive in this case [Holmstrom (1982)].

Proposition 4. Extrinsic incentives. Another important vehicle for inducing good effort is career ladders. People work hard and reveal their talents in the early stages of their career in order to climb a career ladder. Career concerns provide powerful extrinsic motivation for workers—extrinsic, because the contract pays only for past performance, i.e., a future promotion is based on the evaluation of the employer [Fama (1980) and Holmstrom (1982)]. Promotions and career ladders are like tournaments, where the prize must increase with each higher level attained. This means that the prize increases as a person moves up the career ladder, leading us to the general proposition on wage structures below.

Proposition 5. Convex wage structures. Returns on ascending a career ladders must increase (i) to offer a higher prize at the top, and (ii) because the impact of more senior levels on productivity is magnified down the ladder [Rosen (1986)]. This means that the wage line in any firm must be convex when seen from below, i.e., progress in the organisation is met with increasing rewards (see Figure 4). This runs contrary to the liberal egalitarian thesis and 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 those who have peaked in an organisation, have limited incentive to work hard and may just "coast along" for a while.

Not only do all these problems affect the public sector, they are probably magnified by its size and multifaceted objectives. 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 easily measurable through the profitability of shareholders' value, employers are all commonly interested in only that measure. The public sector has no such clear measure and is also accountable to more than one master. For the executive, legislature, 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 (e.g., the civil service) is answerable to many principals (e.g., the parliament, executive, consumers, and interest groups), incentive contracts should be supported by hard transparent missions that are constitutionally determined. In addition, devolution to self-selected and motivated agents and decentralisation in the form of direct payment and management by beneficiaries of the product or service could improve efficiency [Dixit (1997)].

Devolution, delegation, and decentralisation 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 and, hence, 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? If we contrast the state of public sector HRM policies and its incentives in Section 3 with the brief summary of incentives in the organisation literature given in Section 4, we can draw several lessons for staffing a new reform plan for 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), and rigid pay scales based on non-meritocratic HRM (H1) do not constitute an incentives structure appropriate to good behaviour. 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 in the attempt to maintain rigid and uniform pay scales across the civil service. This also makes wage setting a very difficult task from a political point of view (H2).

The public sector product is extremely heterogeneous, ranging over services such as health, police, education, sanitation, and justice. Most CSR efforts seek to maintain the notion of a unified civil service with uniform pay

[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 "private provision of public goods" (see Box 3 for the these principles and how they were applied in the UK). Note how these principles are derived from incentives theory. The conjecture offered by this paper is that the reason these principles did not take root in developing countries is that incumbents' incentives were not aligned with the intended reform and its objectives.

scales and performance measures over this extremely heterogeneous group of people. Proposition 1 says that 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 PSR.

Lesson 1. Heterogeneity of the public sector. While equity and standardisation is desirable, large, uniform, and monolithic (uniform pay scales, standardised 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.

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 the latitude to set its own performance measures and appraisal and reward systems, while a separate monitoring agency (such as a civil service department) keeps these under review to gauge how the systems evolve in relation to each other.

No doubt equity and some measure of budget control are required to ensure that stresses and strains do not develop across the public sector. Moreover, some review process can and should be put in place. For equity purposes, the 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 over their instruments, personnel-related decisions, and working practices, and be held accountable for their objectives. Promotions, job assignments, and other personnel-related decisions must remain firmly in their hands, although of course subject to some external oversight (and not as in current practice [see H 1]).[24]

Lesson 2. Perks. Perks should be eliminated because they are not related to job performance. High-powered incentives require that all payment be made in cash and be fully related to some performance measure.

Perks (such as the provision of cars and housing, and the payment of utility bills), which have crept up in the civil services as salaries, have declined in real terms and have the potential to set up alternative incentive mechanisms that could run counter to productivity. In any case, perks are also difficult to maintain, adding to expenditures and creating grounds for further rent-seeking. In addition they run the risk for being valued at less than what it costs the government to provide them. For all these reasons, eliminating perks through and monetising their value in salaries could prove an efficient measure.

[24]The outmoded concept of transfer from one job to another, which still prevails in some countries, is only means for promoting rent-seeking [Wade (1982)] or political control and should be discontinued.

Should the public service always pay competitively relative to the private sector? Many studies have shown that the desire to engage in public service is strong among some people. Light (1999) has used a US-based survey to show that, even today, young people are keen to engage in public service and join non-government organisations (NGOs) only because they find government service not attractive enough and too bureaucratic to fulfill this ambition. Heckman, Smith, and Taber (1996) have shown how motivated public servants perform 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 sector is public service-oriented [Light (1999) and Heckman, *et al*. (1996)]. Indeed, the government can attract the motivated with an opportunity to engage in public service. This was the ethos according to which the British colonial civil services were built and acquitted themselves very well over a long period. For this ethos to work, public service must be held in some regard by society and clearly seen to provide benefits. An inefficient public service that is perceived with suspicion and rated poorly by Transparency International will not be able to offer the right incentives.

It has been shown that the dominant culture of the civil service is determined by the prevailing incentive mechanism. If the appropriate incentives for public service and productivity in the public sector are not in place, corruption or rent-seeking can become the primary incentives attracting those with a proclivity for these activities.

Corollary to Lesson 3. Allocation of talent. Public sector orientation (rent-seeking and power-hoarding) will attract the commensurate talent [Murphy, Shleifer, and Vishny (1991) and Acemoglu (1995)]. Unfortunately, this is a self-reinforcing equilibrium and can lead to loss of confidence in governance, eventually affecting growth and productivity. Beyond a certain 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 that occurs between the business-minded and those given to public service, but also because public sector employment could be a form of signaling achievement and talent. In advanced countries, public sector experience often improves earnings and opportunities in the private sector [Haque, Montiel, and Sheppard (2000)]. Of course, the public sector has to be efficient and worthy of respect for it to maintain 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 recognised as credibly efficient and skill enhancing [Spence (1973)].

Public sector experience can be valuable in the marketplace, especially if the sector provides valuable market training. A good example of this is how armies currently market themselves as employers in advanced countries. They recruit on the basis of their training and claim that this training has market potential, teaching skills such as engineering and broadcasting. Moreover, army veteran status also indicates that a person has had the discipline and motivation to put him or herself through a rigorous training and endurance process.

For this model to work, the government should also train its personnel continuously. Surveys of young job seekers show that, in a dynamic job market, these entrants know they are unlikely to work for only one employer or use only one skill during their entire career [Light (1999)]. Consequently, training and skill improvement are important components of their demands. However, as we have seen, governments in developing countries do not seriously invest in this area (H4 in Section 3).

Some of the most successful Asian economies emphasise 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 with the promise of 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.

Monetising perks and establishing a public sector as an employer that creates skills for future employment allows the public sector wage to be set at a reasonable discount to the public sector. The reform is graphically envisaged in Figure 4. Given that wage compression and old approaches to 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) notes 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 the Tennessee Valley Authority, National Forest Agency, and Texas Prisons that have, through clear mission setting, achieved good results.

Lesson 5. Missions and autonomy. Clear (legislated or well publicised) missions for government agencies help overcome the common agency problem, but only if these missions can be pursued with adequate autonomy (Wilson 1989). The study also notes that, in developing a sense of "mission," the organisation must eschew vague objectives and define a set of "critical tasks" or "operational goals."[25] The "culture" of an organisation needs to be changed to identify these critical tasks and assess how best to deal with them.[26] The "mission" is a single culture that is widely and enthusiastically shared by an organisation's members.

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[25] Wilson (1989), pp. 25, and 32–34.
[26] Wilson (1989), p. 93.

Wilson (1989) also emphasises the incentive cost of pursuing multiple goals. He stresses the need to focus on a subset of tasks even at the cost 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."[27] We thus have a related lesson on focus.

Corollary to Lesson 5. Focus. Each agency must carry out its mission focusing on a few measurable tasks. Taking on additional tasks, while politically desirable, should be avoided.

It needs to be stressed that a government agency can truly remain focused on its mission if it is independent or at the very least autonomous. This is well illustrated in central banking, where there is now a global convergence of thinking on the importance of central banks functioning as independent professional organisations that focus only on price stability. As a result, almost all countries have passed and implemented laws to this effect. Inflation every where has come down and this improvement can, in part, be attributed to this development. With inflation under control and this seen to be a result of central bank independence, independence too has received more political support. Thus, it seems that a strong sense of mission with its concomitant changes in culture and productivity improvements can be self-reinforcing because organisations will be perceived as more effective and consequently be given more freedom.

Autonomy and independence are also strategies that can help deal with the "common agency problem" that is endemic to government. A central bank or regulatory agency, even a public sector school, has to answer to many masters—the parliament, executive, and community—and there is always the possibility of it being captured by special interests.

Lesson 6. Decentralisation, delegation, and devolution. The public sector provides a variety of services to many different subsets of society. As the common agency problem suggests, it is best that these services be provided in the most decentralised fashion possible to allow maximum interface, both in terms of evaluation and payment, between the immediate beneficiaries of the service and its providers [Dixit (1997) and 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 their children's schools even though the government subsidises schooling. In every area, solutions such as this would provide community-level control over the valuation and financing of the public sector, and elicit more responsible performance from it.

[27]Wilson (1989), p. 371.

6. BEYOND ECONOMICS

We have seen that PSR in developing countries has been driven mainly by macroeconomic budgetary considerations. Its success requires that we understand microeconomics and incentives theory. However, to remain confined to economics on the reform of the most important and, in many cases, 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] There are at least two ideas that have not had an impact in this area, especially in poor countries: (i) professionalisation, and (ii) leadership in successful PSR and management.

The professionalisation of public services is important for several reasons:

- In these days of the knowledge worker, even public sector positions must have the requisite skills. The days of the generalist in charge of government or even an agency are over.
- Professions are communities that share knowledge standards and a culture of work, and arrange peer-reviewed contests for achievement and excellence. In doing so, professionals keep their colleagues' work under review at all times. Professional networking and monitoring can, therefore, be an additional safeguard against the common agency and multitasking problems. Since the professional is networked in his or her profession and expects rewards through the peer review process, he or she also has proper incentives.
- Professionalising an agency and networking it with the professional community further protects autonomy as direct interference in professional and professionally observed work is that much more difficult. Wilson (1989) also acknowledges this: "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 that has not surfaced in the CSR/PSR literature:

Lesson 7. Professionalisation. Professionalising a public service places the agency, its mission, and its tasks under scrutiny of the profession. Moreover,

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[28] Of course, checks and balances, performance, and other forms of auditing, transparency, and openness, as well as recourse to legal action are all needed in constituting a good public sector.

[29] Wilson (1989), p. 199.

professionals employed by the government are additionally disciplined by professional peer pressure and the 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, the public sectors in many developing countries are monolithic and provide only limited entry possibilities, especially into senior positions. Moreover, as the World Bank (1999) has alluded, the extensive use of consultants for policymaking purposes leaves limited room for professionals to take pride in their professional work. An important incentive for a professional is to see his or her work flourish and for it to be associated with his or 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 his or hers.

Given that senior positions in the public sector are in the hands of generalist incumbents and policy-making and research positions in the hands of donor consultants, for a professional to take up a position in the government is tantamount to professional suicide. It is not surprising therefore that professionals tend to stay away from the government, while those who join it lose their skills and their standing fairly quickly.

One important element of the new HRM approach in the public sector should then be to open recruitment to professionals at all levels. Concomitantly, this new approach would encourage both inward and outward mobility in the public sector. The current practice of lifetime public sector careers will have to be given up in deference to the requirements of the new, more flexible, professional labour market.

Corollary to Lesson 7. Mobility. To attract the best professionals and keep them under peer review, 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. Encouraging greater mobility into and out of the public sector will also prevent the age structure of the public service from becoming too skewed in the direction of older workers. As we have seen, younger workers are more energetic and career conscious, and keen to upgrade their skills constantly. The more successful CSRs, such as in Singapore, have resulted in younger groups taking leadership of the service.

Equally important, the local professional should be allowed to take leadership of thinking, research, and policy in his or her environment. This would necessarily mean that, under the new arrangements, the well-funded

[30]Dewatripont, *et al.* (1999a) formally model professionalism as the specialisation in a single task that hence requires less monitoring. They note the advantages of hiring such professionals in an environment of multitasking. In that sense, they only capture 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 professionalisation as a protective device.

donor consultant would have to follow the professional's lead in government. Perhaps some of this funding could, as Haque and Khan (1999) argue, even be directed towards building reform leadership in agencies that need to be modernised.

This naturally brings us to another concept from the management literature that PSR/CSR thinkers appear to have bypassed: leadership. For a reform to become a reality, it should have leaders—people who can envision and are committed to the changes proposed, whose personal reputations are linked to this change, and who will gain from it in terms of professional standing. Without these leaders, reform is a technical exercise and we should not be surprised if it is not successful.

Lesson 8. Leadership Reforming the public sector at every level and in every agency has to be built around leaders who have the necessary drive, vision, and knowledge, and are willing to take the necessary risks.

Note that a successful reform needs not one but many leaders. In this sense, one major flaw in CSR work has been its continuing reliance on a central leadership, most often the finance minister. This is because the reform process has been driven by budgetary considerations. A successful reform that improves public sector productivity has to stretch over a myriad 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, where the emphasis is on learning, creativity, vision and consensus building, passion, risk taking, leading, and gaining trust [Kotter (1996) and Bennis (1989)]. A leader must be able to build an organisation beyond him or her self and his or her tenure. He or she should then not be judged on title and privilege but on the professional quality of his or her team and their commitment to change. Additionally, one needs to ask whether he or she has built a dynamic learning organisation that will continually accept change. Finally, the organisation should be resilient to changes in leadership, in particular, should be able to survive the leader who created it.[31]

Leadership backed by competent teams will also insulate the reform from political interference, which is essential to its success. Such insulation will also

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[31]The role of the charismatic leader and the routinisation of charisma into bureaucracy was discussed by Max Weber in the 19th century. Surprisingly, PSR literature has not discovered it. 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.

enhance the credibility of the reform and strengthen the reform process while softening any resistance to it.

A large part of public sector work has to be done in teams and, as we have discussed, incentives within teams can be diffused and autocratic structures can stifle team development (Proposition 3). The US government adopted a mechanism for inducing better team behaviour by instituting an award for good team performance in the wake of the REGO movement for improving government cost-efficiency and productivity: "The Vice President's Hammer Award is reserved for teams of pioneers who create an innovative and unique process or programme to make government work better and achieve results Americans care about."[32]

A similar initiative was carried out 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 at different levels to openly discuss obstacles to quality and devise practical solutions for service improvement. The Botswana government introduced a productivity and quality improvement programme in l993 by creating WITS within various institutions and departments. The Malaysian programme to enhance positive attitudes provides a good example of a practical approach to establishing 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 public service. This approach is in line with current management thinking, which emphasises horizontal team-based organisations and is contrary to the practice of development policy which seeks to concentrate power in the hands of some reform leadership. We can therefore conclude that the design and implementation of PSR must go beyond economics into management, sociology, and the other social sciences without losing sight of incentive economics. Without the correct motivation, reform will stay unimplemented and theoretical.

7. CONCLUSION

CSR has traditionally focused on downsizing and changing the procedures and structure of the service without emphasising the human element: incentives, professionalisation, 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. This paper contends that we can learn from incentives theory as well as from other branches of the social sciences and management in order to design a PSR that will be incentive-compatible and has a greater chance of success.

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[32] See http://govinfo.library.unt.edu/npr/library/awards/hammer/ for more information on the Hammer awards.

Such a reform will have to use incentives in a way that improves the public servant's welfare while also improving government efficiency and productivity. For this, rewards must be aligned with productivity and the old monolithic, uniform, and non-meritocratic HRM of the civil service abandoned and replaced with a new method of management that is much closer to practices in the private sector.[33] The Thatcher reforms of the 1980s are a good example of the principles laid out here (see Box 3).

Box 3: The Thatcher Reforms

In 1988, Margaret Thatcher's government adopted the following principles for running the British government:

1. Separation of service delivery and regulatory functions into discrete blocks, 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 the talent needed. Performance bonuses of up to 20% of their salaries could be paid but they must be forced to reapply for their jobs every three years.
4. Agency chief executive officers (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 an agency does not perform, it can be abolished, privatised or restructured after its five-year review.

Overall, the British had 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 expended 4.7 percent less operating money in 1994-95 than they had the year before.

Source: Haque and Aziz (1999).

[33]Some governments are successfully experimenting with flexible working conditions (Australia and New Zealand), moving collective bargaining from the entire public service to the workplace (Australia and the UK), and the application of private sector law to the public sector (New Zealand).

To the extent that the public service is valued for its intrinsic (doing good) and extrinsic rewards (experience), recruits may be willing to settle for discounted compensation, but the discount cannot be as large as what some countries currently offer 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 emphasise 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 two important differences in applying the standard theory to the public sector. First, a typical public servant may have to work towards more than one objective as well as on multiple tasks; second, the public sector answers to more than one owner, with no clear measure of performance such as profit or value maximisation. Incentive theory suggests that, to resolve these problems, the public sector should be organised 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 incentivise workers in the agency. Increasing 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 the independence to focus on price stability. This model has yet to be extended beyond central banking.

Decentralising public sector management is also recommended to prevent excessive politicisation of any public sector organisation 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, authorities considered abolishing the department of education, which dominated both policy-making and the delivery of education services, and decentralising education to the community level.

Another illustration of this principle of decentralisation 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 corporatisation in Australia. These have

[34]Imaginative training initiatives have also been initiated in a number of countries. In Mauritius and the UK, training is 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.

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 continuous process that is spread out over a considerable period. It also has to permeate through a large number of public sector organisations, agencies, and units. It is only natural then to look for local leaders of the reform everywhere and, as far as possible, use modern management principles to guide the reform. Too often, reform has been centralised around a high office and a few individuals to the detriment of the reform. Professional networks can act as an agency of restraint both on politicisation and on professionals operating in the public sector. However, this will depend on the extent of professionalisation allowed in the public sector.

While the broad objectives of PSR are similar in most countries, no unique solution or approach has emerged as a "model" that could 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 organisations and let the downsizing and change radiate outwards from there.[35]

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 or market forces. The people who are at the centre of this change can either be its architects and beneficiaries or its losers and therefore opponents of change. The design and implementation of reforms must, therefore, be sensitive to this important fact. It is essential that the reform is led by individuals who understand such a process of change. Governments must empower such leadership to guide, initiate, innovate, and manage change.

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[35] For example, reform could begin with key economic agencies such as the central bank, finance ministry, customs and taxation, and labour ministry (if there is one) because presumably modernisation 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 and education—can be tackled. Thus, the reform can be spaced out and develop a core that radiates change.

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