INCENTIVES AND HUMAN RESOURCE MANAGEMENT: THE CRITICAL MISSING LINK IN PUBLIC SECTOR REFORM IN DEVELOPING COUNTRIES

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Abstract

There is a broad recognition that civil service reforms in developing countries have been less than successful in the past, as they tended to focus on downsizing and procedural changes without radically changing the outmoded incentives system. Drawing on the incentives literature, this paper argues that the success of reforms in the future is conditional upon the adoption of a combination of productivity-based incentives at an early stage of the process, granting organizations more autonomy in their daily operations, and introducing an efficient system of human resource management. The paper concludes that managing human resources must be at the center of any public sector reform effort, and highlights the important role of leadership, vision and a clear mandate for reform.

ملخص

هناك اتفاق عام على أن الجهود التي أولتها معظم الدول النامية لإصلاح الجهاز الإداري الحكومي قد أسفرت عن نجاح محدود في الماضي. ويرجع ذلك إلى أن هذه الجهود كانت تركز بشكل رئيسي على تخفيض العمالة والجوانب الإجرائية دون تعديل نظام الحوافز العتيق المعمول به في هذه الدول. واستنادا إلى الأدب الاقتصادي الذي يتناول موضوع الحوافز، ترى هذه الدراسة أن نجاح جهود الإصلاح في المستقبل يتوقف على عدة عوامل، من أهمها: تبني مجموعة من الحوافز المرتبطة بالإنتاج في مرحلة مبكرة من عملية الإصلاح؛ منح المؤسسات درجة أكبر من الاستقلالية في إجراء عملياتها اليومية؛ وأخيرا الأخذ بنظام كفء لإدارة الموارد البشرية. وتخلص الورقة إلى ضرورة أن تحتل الموارد البشرية مكانة محورية في جهود إصلاح القطاع العام، وإلى أهمية وجود كوادر قيادية ذات كفاءة عالية، بالإضافة إلى رؤية مستقبلية وتفويض واضح للمضي قدما في عملية الإصلاح.

I. A History of the Development Approach to Governance

Development economics and developing countries both emerged in the post-World War II era when the "Great Reversal" was at its height and communism had captured popular imagination (Rajan and Zingales, 2001). This era also witnessed the struggle between capitalism and communism, though both sides were building strong and closed regulatory states with large governments and an emphasis on welfare. The new states born out of retreating colonialism took on the responsibility of economic development, while the new development economics fostered the ideas to develop it. The thinking of the time led to the establishment of the policy paradigm that the government had to lead development (Haque and Montiel, 1994).

This approach led to a long period 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 public servants grew as did their rent-seeking opportunities. Public sector employment expanded. Governments understood the political advantages of expanding public employment and the people got accustomed to secure, non-demanding public-sector jobs.[1]

In order to finance the large, growing and domineering public sector, governments resorted to borrowing externally and domestically. As the inefficiencies of the public sector, 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. In the 1990s, this frustration led to increased interest in the catchall term – governance. Considerable research over the 1990s has shown that "governance matters!"[2]

[1] "During the 1970s and 1980s, the government wage bill of many developing countries 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] Kaufmann and Kraay (2003a and b) have done some very good work in this area.

Policies attempting to dismantle the excessive state were put into place by the Washington Consensus. The new aims were to remove distortions, get the prices right, undertake fiscal consolidation, followed by privatization and internalization. Disjointed attempts at dismantling the earlier planning structures and state-owned enterprises (SOEs) resulted in 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 1990s. More often than not, governments undertook CSR under budgetary pressure. Pressured by macroeconomic imbalances, and on the advice of most international agencies, many governments promised to cut the size of bureaucracy. However, 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. The public sector reacted to these strategic attacks on its recently expanded mandate in three ways:[3]

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

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

[3] See UN (1999) for a summary of experiences with downsizing.

As in economic theory, and indeed in life, there is a choice between “quality” and “quantity” in government employment and CSR. Good governance 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 focused merely on downsizing and some procedural improvements, without a view of the role governance plays in the economy. While we still do not have precise models of the roles of governance and the public sector in the growth process, several empirical indicators of governance have been developed and have proven that it is an important variable that explains an economy’s performance.[4]

Good governance is produced by the public sector and its employees. CSR programs 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 remain high and employment excessive despite these efforts. This paper argues that one reason for the lack of success of CSR is that inadequate attention is paid to recent developments in the theory of incentives in organizations. We will summarize several key results from this important but technical literature to determine what can be learned about how to conduct a CSR program that will improve domestic productivity.

The paper is organized as follows. Section II summarizes the current state of the CSR work. Section III reviews the empirical facts on the employment and incentive structure of the civil service. Section IV examines the very rich and rapidly growing incentives literature to summarize some key results that can be used in the CSR/PSR (civil service reform/public sector reform) process. Section V discusses some key lessons from the incentives literature for designing PSR. Using some results from the sociological and management literature, Section VI argues that since the PSR exercise involves the large government sector, we must adopt a multidisciplinary approach. The conclusion summarizes some of the main results.

[4] Rivera-Batiz (1999) shows that an increase in the quality of governance by one standard deviation, increases GDP growth by 1.2 percent. He notes that “democracy is a key ingredient of growth but only if it is associated with improved governance.”

II. The CSR Experience

CSR programs have been less than successful and governments now often balk at the term since it implies undertaking a long-term effort that only arouses negative feelings in the civil service. In an extensive evaluation[5] of the CSR experience over the 1990s, the World Bank (1999) notes that "Bank-supported CSR programs were largely ineffective in achieving sustainable results in downsizing, capacity building, and institutional reform…in part, due to significant political difficulties in implementing CSR. Yet the relevance and ownership of reform was also weakened by a technocratic approach that failed to mainstream institutional analysis and to develop a coherent framework for intervening in administrative systems."

Box 1 summarizes this experience and the key lessons learned from it as laid out in the evaluation report of the Bank Operations Evaluation Unit (World Bank, 1999). 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 focused on the people and change their incentives in order to give them a vested interest in the ongoing change. The CSR remained budget-focused and technical i.e., it concentrated on design and processes driven externally. In that sense it lost track of the motivations and the involvement of the people whom the reform was 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 will implement the reform, it will not succeed.

[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.

BOX 1

World Bank Evaluation of CSR Work

The 20 years since realizing the importance of CSR, the topic has been a learning experience for the World Bank. This period can be classified into three phases:

The first phase, in the 1980s, dealt 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 were strained under the weight of cumbersome civil service (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 did not overcome capacity constraints in economic management and service delivery. There was no evidence that civil servants began to aquire 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 nor 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 economic and sector work (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).

Several approaches to reform have been developed over the last two decades, although it is fair to say that success in this area has only really been achieved in advanced countries like the 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 can be learned such as getting the role of the government 'right' by moving the government out of production and into only the regulation and management of the market, as well as managing the government through outcomes and performance auditing. The Thatcher approach to government of establishing autonomous executive agencies with clear mandates and professional management is an example. The American Reinventing Government (REGO) movement is an important process for changing the bureaucracy toward the goals of public sector reform.

This paper will emphasize only the incentives and human resource management (HRM) approach primarily because it is the neglected element of CSR especially in developing countries. The CSR literature has tended to follow the PSR movements as they happened in the West and attempted to apply their lessons to the developing economies. As the paper will show, the evolution of the public sector in these countries has been substantially distorted, which has reflected on the incentives of the civil servant. These incentives need to be carefully studied to see how civil servants can acquire a vested interest in any proposed reform strategy. The paper also suggests that successful reform will require going beyond economics to disciplines such as sociology and management.

Civil servants and their incentives must be central to the reform process. Most sequencing strategies suggest that the wage structure changes somewhere in the reform process. It is important to remember that the incumbents have settled into the current incentive system. For example, if there are extra allowances to be gained from managing more departments, the manager will seek to run more departments. Similarly, if rewards are given for committee work, then more committees are better. If customs and police employment yield rent-seeking positions, people will go there. Unless a reform process addresses this issue, the incumbents will 'game' the reform.[6] Consequently, it might be important to begin with a clear vision of incentives and their impact on the reform process.

[6] The gaming of reform is a very rich area of research that we will not be directly taking up here. See Mil (2003) for an interesting analysis of this issue in Pakistan.

III. 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.[7] The studies that do provide information on some limited aspects of public sector management are only meant to provide a snapshot of the public sector at a certain point in time.[8] Therefore, it is not possible to derive sufficient panel data to conduct a formal empirical investigation.[9] Let us begin with a summary of the available evidence on wage, employment and human capital policies in the public sector.

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.[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 wage levels in the general government declined in 19 of the 29 countries with 5 countries registering positive growth rates, the highest of which was Ghana at 4 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 income 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.

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[7] Snapshots on the basis of sparse and disjointed data series can be obtained through individual efforts which demonstrate the nature of problem. It is surprising that there is no systematic effort to collect more information on this issue since it 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 information that is available 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, Gould and Amaro-Reyes (1983) noted that in Africa and Latin America, middle and low salaries were at times so low that officials could not even afford to eat a balanced diet.

Table 1: Selected Developing Countries: Trends in Real Wages in General Government (annual percent change)

	Time 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**

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

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

Source: National authorities.

W2. Declining public-private wage differential: Table 2 presents some evidence of trends in the ratio of public to private wages for countries for which data was available. Once again we see that the ratio declined for most countries.[11] On average, it shows a 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.[12]

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

	Time 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**

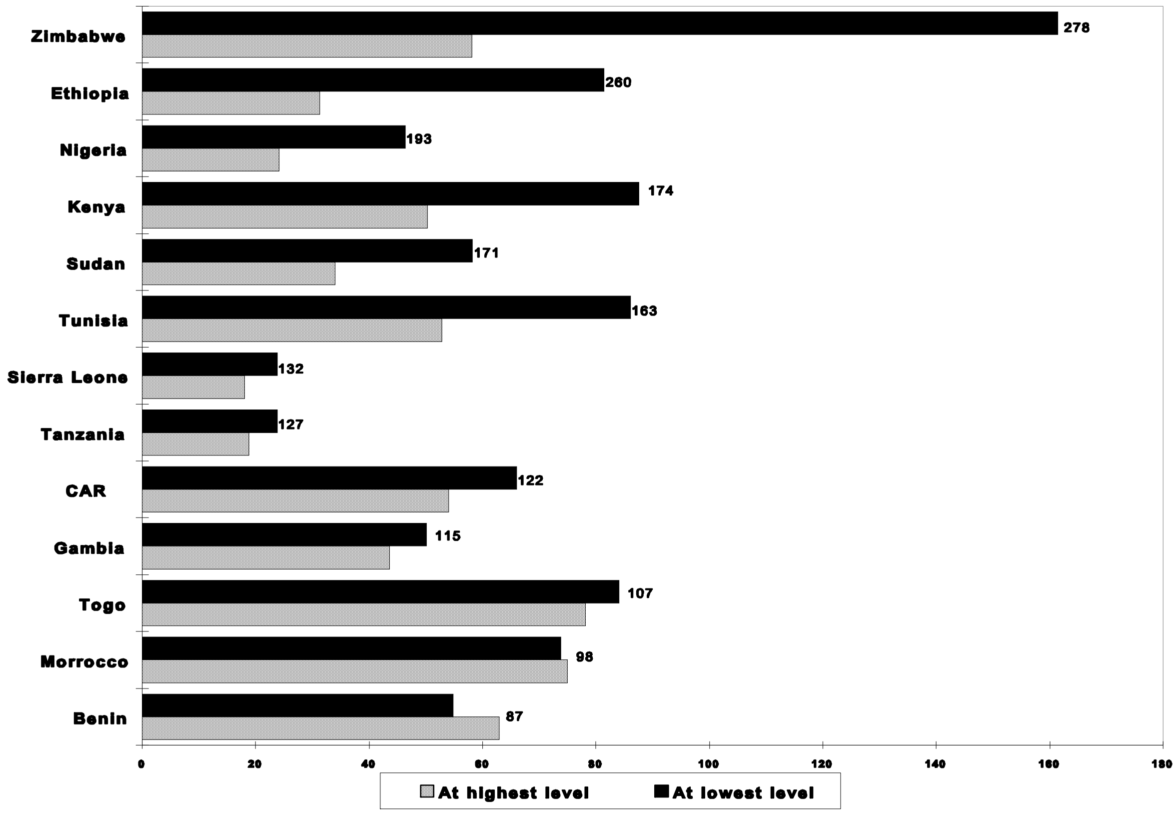
Source: National authorities.

[11] Through a fairly comprehensive cross-country study of government wages relative to private sector wages, 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, on average, the quality of human capital would 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 state enterprises.

W3. Wage compression: Wages for the upper levels of public administration have often been reduced by more than those at the 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. Note that with

Figure 1: Wage Compression in the Public Sector



Source: Haque and Aziz (1999).

one exception, real wage decreases were experienced 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 represent 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

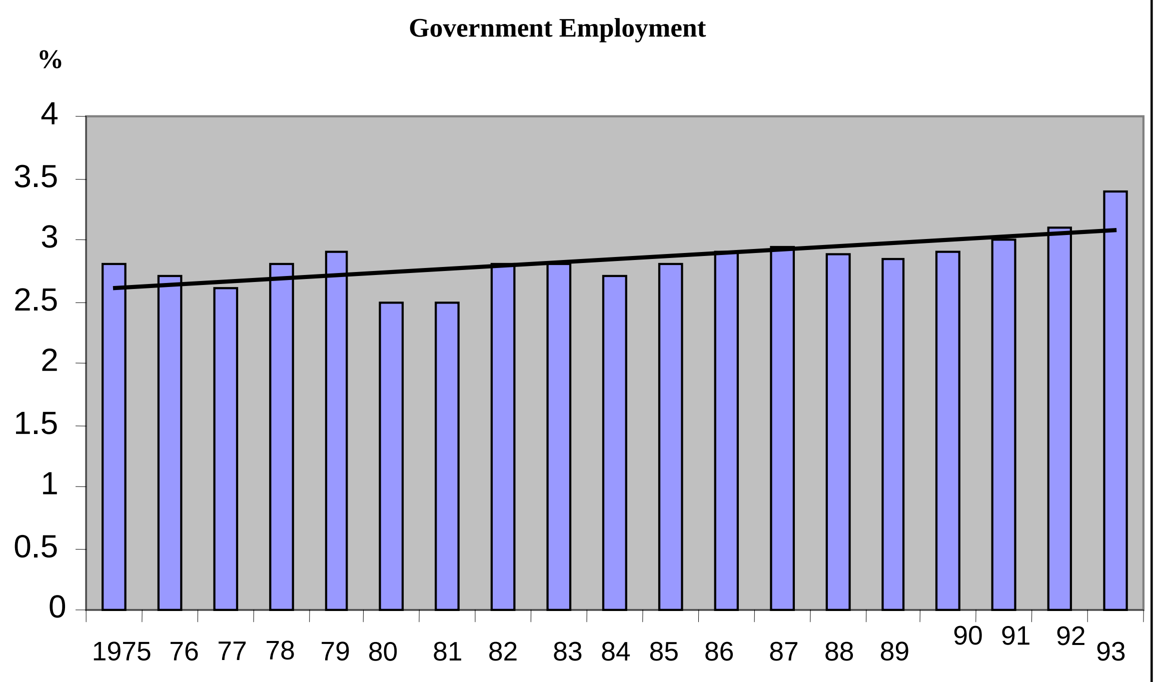
[13] See Van Ginnekin (1991), Lindauer and Nunberg (1994), Chaudhry, Reid and Malik (1994), and Haque and Sahay (1996).

during the 1975-85 period. Note that wage compression is observed for all the countries in the sample except Morocco and Benin.[14]

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 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 1975-1985, a period corresponding to that for which we have relative wage data.

Figure 2



Source: Haque and Aziz (1999).

This steady share of employment has occurred despite the fall in wages in the public sector relative to other sectors. The right-hand portion of Figure 2 suggests that the public sector started to grow in the 1990s after some years of fiscal restraint.

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[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).

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

E1.1 *Stabilization at the expense of public-sector efficiency*: 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.[16] It would seem that such programs protect employment at the cost of real wages.

Human Resource Management (HRM) in the Public Sector [17]

H1. Hierarchical, unified, and non-meritocratic structures: Perhaps because of the paternalistic nature of the state, civil service in most poor countries tends to be fairly rigid, often preventing entry and rewarding 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 the 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, 1996a and b).

Pay scales are typically organized in a pyramid of hierarchical grades that differentiate people and positions according to the skill level and knowledge required for particular jobs. 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 for that grade (salary scales for different grades often overlap). Each Roman numeral in the table represents a whole scale. Salary scales reward length of service and the accumulation of experience. Incremental (within

[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 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.

scale) salary increases are often standard, while promotion to the next grade is contingent upon satisfying certain requirements and receiving a positive job evaluation.

Table 3: Cadres in Ethiopian Civil Service, 1990s

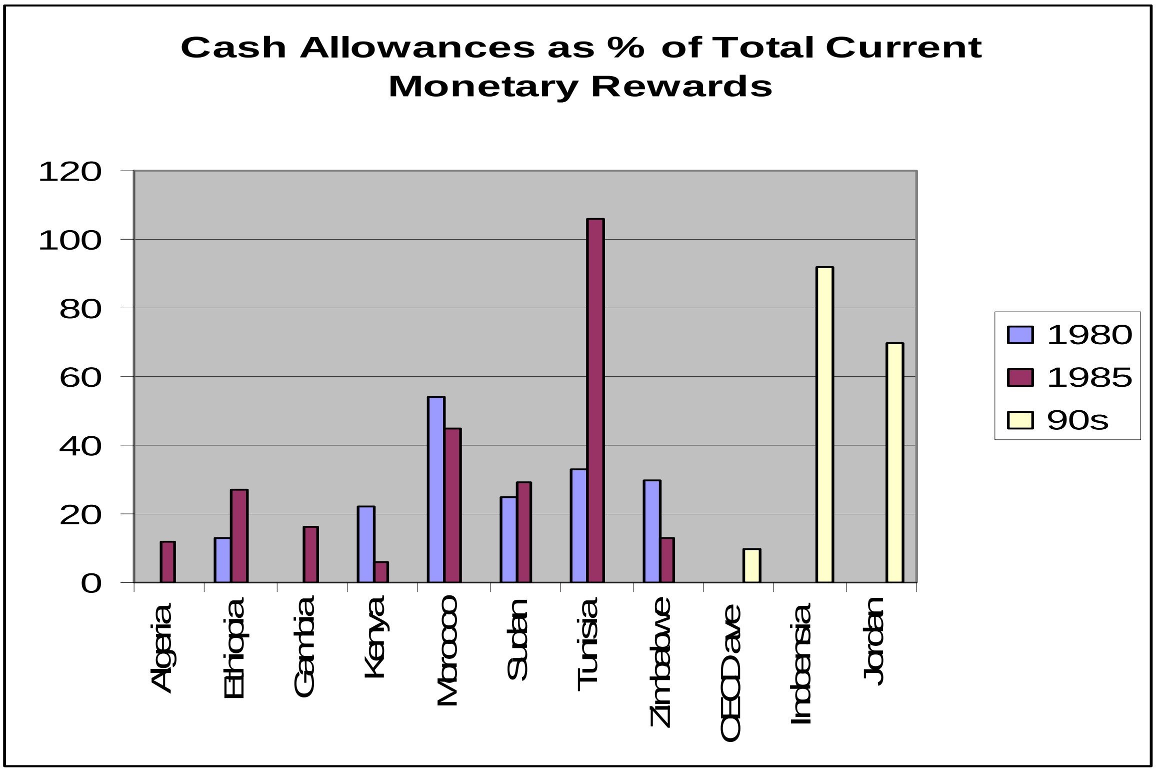
Salary scale	professional & scientific	administ.	sub-professional	clerical & financial	trades & crafts	custodian & manual
I						
II						grade 1
III					grade 1	grade 2
IV			grade 1	grade 1	grade 2	grade 3
V			grade 2	grade 2	grade 3	grade 4
VI			grade 3	grade 3	grade 4	grade 5
VII			grade 4	grade 4	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).

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 and the process of adjustment is emotionally and politically charged, often involving a commission that will recommend an adjustment for the service as a whole.

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. However, their importance is actually 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 shown on p. 20). 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, such perks are held to a minimum of about 10 percent, however, they 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.[18] Additionally, corruption gains have increasingly become attractive in public service adding an important aspect to Mukherjee and Manning's reward structure taxonomy that is presented in Box 2.[19]

Figure 3



Source: World Bank (1999).

[18] The preservation of perks is a major deterrent to reform (see Mil, 2003).

[19] Perks have an additional political economic dimension. When such large gains are received in this nontransparent manner by public servants, they are truly invested in preserving the status quo. Mere moderate salary increases may not move them from that equilibrium (see 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 and 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, future expectations, as well as contractual and intangible rewards:

		contractually-provided		**non-contractual/ intangible**
		monetary	**in-kind**	
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

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)

Source: Mukherjee and Manning (2002).

H4. Training: The World Bank Administrative and Civil Service Reform website (www1.worldbank.org/publicsector/civilservice) provides some limited evidence of training in developing countries, which shows that it is not a priority item. In surveys, most employees reported limited or no formal training for their job and claimed to have learned on their own while on the job. Assessing training is exceedingly important due to today's rapidly advancing technology, for without continuous training, public sector work skills will erode faster than their private sector counterparts who are presumably being forced by the market to keep their skills current.

H5. Aged Immobile Public Sectors: Historically, civil service pension schemes were established as a reward for long service. Hence most benefit designs for these schemes are "backloaded" – with few rights in terms of transferring pension 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 labor mobility, prohibiting the ability to attract new workers through natural attrition, which is vital for the modernization of the civil service. Beginning in the 1980s, many industrialized countries realized the civil service needed to be modernized, and started a trend to integrate civil service pension systems with national social security systems. Such integration occurred to varying degrees in different countries. In the most comprehensive sense of the term, total integration takes place when civil servants are treated no differently than private sector employees, as in Argentina and Peru, and throughout Eastern Europe where preferential schemes no longer exist. A less comprehensive 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 can be found in the UK, Japan and other industrialized countries.[20] Countries that have not switched to pension reform and have not introduced mobility into and out of the civil service have the problem of an aging civil service. In many of these countries, the average age of civil service workers has been increasing over the years, while the motivation to work and the skill level, due to limited training opportunities, has been declining.[21]

IV. Learning from Incentives and Organization Theory

Much research has been conducted in the theory of incentives in organizations in the realm of neoclassical economics which can be used to understand civil service reform. Basically, these theoretical developments are based on two important assumptions:

- The fundamental point of departure for understanding any human behavior is the

[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 United States 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 as portability of pensions and some inducement could make retirement fairly desirable for an older, unmotivated, skill-obsolescent public servant.

recognition that ***selfishness*** is inherent in all human actions. This viewpoint is fundamentally opposed to the commonly held view derived from the 19th century liberal belief that the government is a benevolent protector of the poor. Public servants, as the name implies, were considered to be ***selfless***, kind and caring, devoid of the need for worldly goods and desires. They would, therefore, work for the common weal with no concerns about family and the future. Clearly this view is incompatible with the paradigm of selfishness.

- ***Information is costly*** to collect and 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; and
- *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 the delegation of some decision-making authority to the agent. Agency problems emanating from conflicts of interests, which arise out of selfish behavior in the presence of incomplete information, are common or endemic in 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:

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

Proposition 1: Incentive Compatibility

Even when effort is not directly observable, rewards based on observables (output, monitoring) can motivate self-interested individuals to work hard (Holmström, 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 employee is putting into a job, the employer promises to pay according to observable criteria that are closely linked to effort. Hence, we observe contracts that offer formal incentives such as piece rate wages, bonuses, and 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 wage increments and bonuses on the basis of relative performance evaluation.

These contracts rely on the 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 task assembly-line work, making craft-related items or harvesting agricultural produce. Most jobs, however, may require more than one task such as teaching, which involves the 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. Holmström and Milgrom (1991) have shown that in the case of multitasking, it is difficult to determine adequate pay for performance contracts, thus 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. (Holmström and Milgrom, 1991; Dewatripont, Jewitt and Tirole, 1999a and b).

It is not surprising that firms invoke other methods to buttress pay for performance in order to be able to balance out performance over several tasks. However, monitoring and subjective evaluations can also lead to several biases, such as nepotism and extra power to supervisors, and therefore need to be carefully implemented.

Not only do most real life situations involve multitasking but 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 could be an incentive (Holmström, 1982b). Another important vehicle for inducing good effort that is observed very frequently is career ladders. People work hard and reveal their talents in the early stages of their career in order to rise up the ladder. Career concerns are powerful extrinsic motivators for workers – extrinsic because the contract pays only for past performance; a promotion in the future is based on the evaluation of the employer.

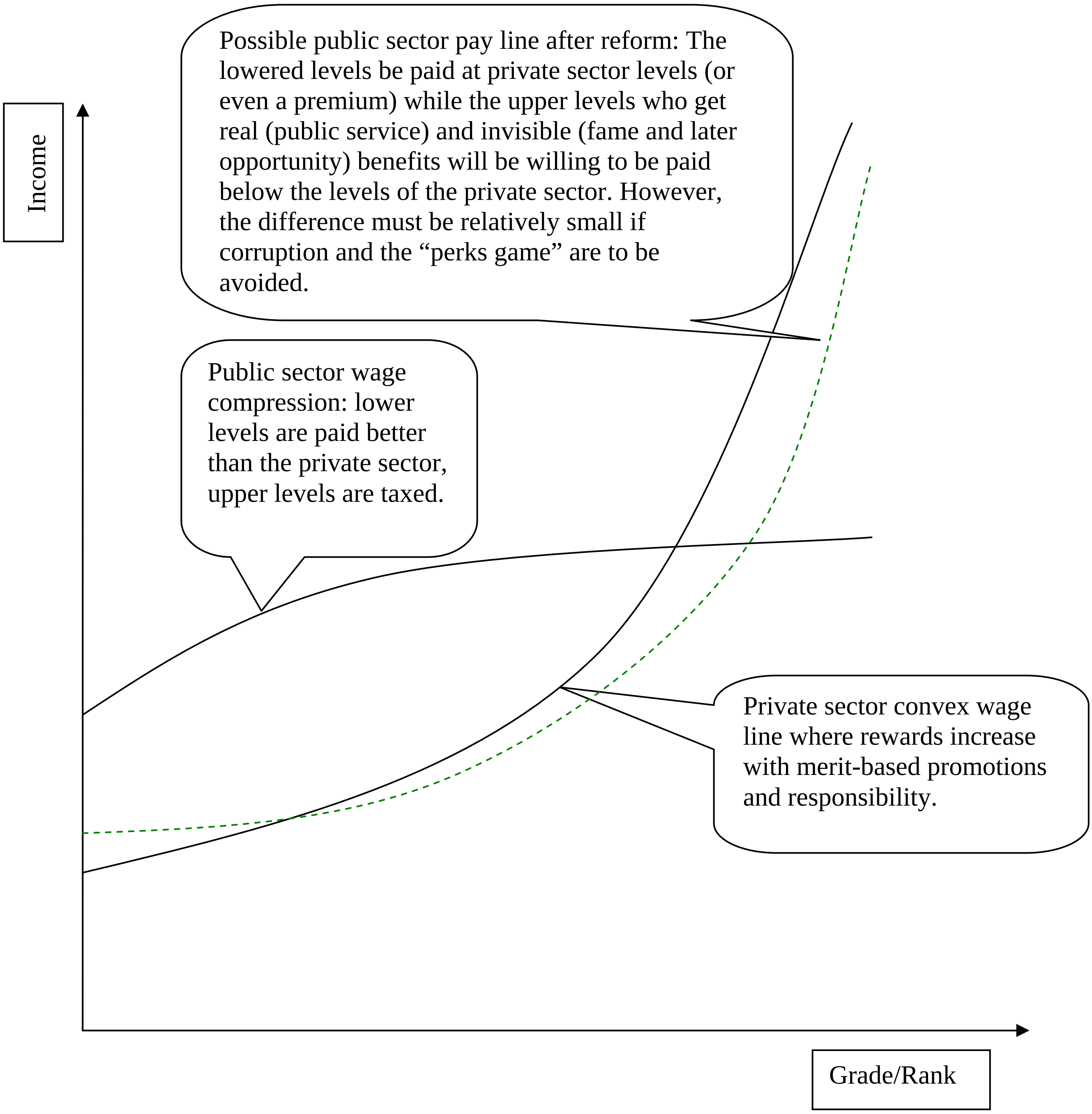
Proposition 4: Extrinsic Incentives

Promotions and career concerns motivate workers and reveal their talents for future rewards. (Fama, 1980; Holmström, 1982a). Promotions and career ladders are then 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 a general proposition on wage structures.

Proposition 5: Convex Wage Structures

Returns on 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 4). This runs contrary to the liberal egalitarian thesis and suggests that to induce higher productivity we must live with higher inequality.

Figure 4. Public Sector Wage Reform



For the career concerns system to work the promotion process must be credible, and 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 employees work harder to reveal themselves when young and move 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, performance is very easily measured through profitability of shareholder value and the set of employers are all commonly interested only in that measure. The public sector has no such clear measure and also has many masters to answer to. The executive, the legislature, the broader public and, within the public, the particular interests groups that they serve all have expectations and goals. How should this be handled?

Proposition 6: Common Agency

When an agent (e.g., in the civil service) must answer 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.

V. Incentives in the Design of Public Sector Reform

What can we learn from this review of incentives theory? Comparing the state of the public sector HRM policies and its incentives in Section III with the brief summary of the incentives in organization literature in Section IV, several lessons can be drawn for initiating reform in the public sector.[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 an incentive structure conducive to good civil service. As a result, there has been an increase in the importance of external perks and emoluments (H3). The difficulty in providing adequate incentives to civil servants may lie with the effort to maintain rigid and uniform pay scales across the civil service. This also makes wage setting very difficult and politically contentious (H2).

The public sector product is extremely heterogeneous ranging over services such as health, education, sanitation, justice, and security (police). Most CSR efforts seek to maintain a notion of a unified civil service that attempts to maintain uniform pay scales and performance measures. Proposition 1 states 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. How can this be dealt 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 and a monitoring agency (such as a civil service

[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” (Haque and Aziz, 1999). See Box 3 for the these principles and how they were applied in the UK. Note how these principles are derived from the incentives theory. The conjecture offered by this paper is that the reason 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.

department) can keep these under review to see how these systems are evolving in relation to each other.

No doubt equity and some measure of budget control is required to ensure that financial stresses and strains do not develop across the public sector. Some review processes can and should be put in place. For equity purposes, market valuation of various job 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, and so on, and held accountable for their objectives. Promotions, job assignments, and other personnel decisions must reside firmly in their hands, although subject to some external oversight.[24]

Lesson 2: Perks

Perks should be eliminated as they are not related to job performance. High-powered incentives require that all payments 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 growing perks are also difficult to sustain and they create grounds for further rent-seeking. In addition they run the risk of being valued less than it costs the government to provide them. For all these reasons, eliminating perks through 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 work in public service is strong in some people. Light (1999) has shown using a US-based survey that even today the young would like to work in public service and are joining NGOs only because they find government not attractive enough and too bureaucratic to fulfill this ambition. Heckman, Smith and Taber (1996) show how motivated public servants perform the job purely for the sake of service.

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

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; Heckman, Smith and Taber, 1996). The government can indeed attract those who are motivated by giving them the opportunity to do public service. 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 which earns a poor transparency rating from 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 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 discussed in Lesson 1, corruption or rent-seeking may be the primary incentives attracting those who have a proclivity for these activities.

Corollary to Lesson 3: Allocation of Talent

The orientation of the public sector (rent-seeking, power hoarding) will attract the commensurate talent. (Murphy, Shleifer and Vishny, 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; to the extent that such equilibria have led to civil strife.

The public sector need not pay a fully-competitive wage compared to the private sector because of the self-selection between the business-minded and those who choose to work in public service, and also because public sector employment could also be a sign of 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 must be efficient and earn respect based on 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 it is recognized as credibly efficient and skill-enhancing (Spence, 1973).

Experience gained in the public sector can be valuable in the marketplace especially if the sector provides valuable market training. A good example of this is the way armies are marketing themselves as employers in advanced countries. They recruit on the basis of their training and the claim that their training has market potential as it teaches skills such as engineering, broadcasting, and so on. Moreover, acquiring army veteran status shows that a person has the discipline and motivation to go 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 show that in a dynamic job market these entrants know that they will probably not work for just one employer or perform one skill for their entire career (Light, 1999). Consequently, training and improvements are an important component of their demands. But as we have seen, governments in developing countries do not seriously invest in this area (H4 in section III).

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 the entry level, entice top recruits 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 private sector. The reform can be graphically envisaged in Figure 4. 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 doted line. The difference will have to be carefully monitored and maintained to ensure adequate staffing quality in the public sector.

Wilson (1990) noted that government agencies face the risk of being assigned multiple tasks. The risk of multitasking is large and must be dealt with by "mission setting." He provides examples of agencies such as the Tennessee Valley Authority, the National Forest Agency, and Texas prisons that have achieved good results by setting clear missions. Consequently, this leads to our next major lesson for PSR.

Lesson 5: Missions and Autonomy

Clear (legislated or well-publicized) missions for government 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."[25] The "culture" of an organization needs to be changed to see what these critical tasks are and how to deal with them.[26] 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 pursuing multiple goals. He stresses the need to focus on a subset of tasks even at the expense of other tasks. The pursuit of such focus may cause well-run agencies to resist being assigned new tasks as "conglomerate agencies can rarely develop a sense of mission; the cost of trying to do so is that few things work well."[27] Therefore, we 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 a government agency 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, and focus only on price stability. As a result, almost all countries have implemented laws to this effect. Inflation everywhere has come down and this improvement can, in part, be attributed to this development. Since inflation is under control and is seen to be a result of central bank independence, such independence 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 since agencies 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

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[25] Wilson (1989) pp. 25, 32-34

[26] Ibid, p. 93.

[27] Ibid, p. 371.

"common agency problem" that is endemic in government. A central bank, a regulatory agency or even a public sector school has to answer to many masters – the parliament, executives, communities, and there is always the possibility of being captured by special interests.

Lesson 6: Decentralization, Delegation and Devolution

The incentives literature shows that 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 decentralized fashion to allow maximum interface, both in terms of evaluation and payment, and between the immediate beneficiaries of the service and the providers of 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 their kids attend even though the government subsidizes the schooling. In every area, solutions such as this, which truly provide community level control of the valuation as well as the financing of the public sector, will elicit a more responsible performance from it.

VI. BEYOND ECONOMICS

We have seen that public sector reform in developing countries has been driven mainly by macroeconomic budgetary considerations, but for it to succeed we may need to understand microeconomics and its incentives theory. However, remaining confined to economics when reforming the most important, and in many cases the largest, sector of the economy – the public sector – would also be folly. For it to succeed many disciplines need to be combined. In connection with our subject – incentives and HRM – management and sociological literature offer fairly interesting ideas and suggestions.[28] In my view, there are at least two ideas that have not made an impact on

[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.

this area especially in poor countries and have not been used in the CSR/PSR literature. These are the roles of professionalization and leadership in successful public sector reform and management.

Lesson 7: Professionalization

Professionalization of public services is important for several reasons:

1. Needless to say, in these days of the knowledgeable worker, public sector employees must have the requisite skills. The days of the generalist in charge of government or even an agency are gone.
2. Professions are communities that share knowledge standards, a culture of work and arrange peer reviewed contests to encourage 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 multitasking problems. Because professionals are networked in the profession and expect rewards through the peer review process, they are properly incentivized.
3. Professionalizing an agency and networking it with the professional community creates additional protection of autonomy since direct interference in professional and professionally observed work is much more difficult. Wilson (1990, 199) also acknowledges this fact: “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.”

Professionalization of public services places the agency, its mission and its tasks under scrutiny of the profession. Professionals employed by the government are also disciplined by professional peer pressure and incentives of external professional mobility. [29]

For professionals to be attracted to the public sector, their incentives both monetary and non-monetary have to be set correctly. As previously noted, public

[29] Dewatripont, Jewitt and Tirole (1999b) formally model professionalism as a specialization in a single task and hence it requires 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 professionalization as a protective device.

sectors in many developing countries are monolithic with limited entry possibilities especially in senior positions. Moreover, as the World Bank (1999) OED report has alluded, the extensive use of consultants for policymaking purposes leaves limited room for professionals to take pride in their work. An important incentive for professionals is to see their work flourish and for it to be associated with their 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/hers.

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

One important element of the new HRM in the public sector should then be to open recruitment at all levels to professionals. Concomitantly, this new approach would encourage both inward and outward mobility from the public sector. The current practice of guaranteeing lifetime public sector careers would have to be given up to meet 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, 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 being too skewed in the direction of older workers. As we have seen, younger workers who are more energetic and career conscious are keen to upgrade their skills and stay modern.

Lesson 8: Leadership

The more successful civil service reform programs (e.g., in Singapore) have resulted in younger groups taking leadership of the service and it is important that local professionals be allowed to take leadership of thinking, research and policy in their environment. This would mean that in the new arrangements, the well-funded consultant would have to follow the lead of the professional in government. Perhaps some of this funding could, as Haque and Khan (1999) argue, even be directed toward building leadership for reform in the agencies that need to be modernized.

For 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 professional standing from it. Without these leaders, the reform is merely a technical exercise and we should not be surprised if it is unsuccessful.

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 central leadership – most often the finance minister – of the reform process. For reform to be successful, 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. Therefore, leadership has to be defined in modern management parlance. The emphasis must be on learning, creativity, vision and consensus building, passion, risk-taking, leading and gaining trust (see Kotter, 1996; Bennis, 1989). Leaders must be able to build an organization beyond themselves and their tenure. They should not be judged only by their title and their privilege but by the professional quality of their team and its commitment to change. Additionally, leaders must build a dynamic learning organization that will continually accept change. Finally, the organization should be resilient to changes in leadership in particular and should be able to survive the leader(s) who created it.[30]

Leadership backed by competent teams will also insulate the reform from political interference which is crucial for its success. Such insulation will also enhance the

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[30] The roles of the charismatic leader and the routinization of charisma into bureaucracy were 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 discuss is instrumental, goal-oriented leadership and not quite the singular charisma that Weber was talking about. The ability to lead teams is something that can be acquired, though with dedication and passion, rather than inborn.

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 diffused and autocratic structures can stifle team development. The US government did adopt a mechanism for inducing better team behavior by instituting an award for good team performance in 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 program to make government work better and achieve results Americans care about.”[31] 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 Botswanian government introduced a productivity and quality improvement program in l993 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 views with emphasis on horizontal team-based organizations that are contrary to the practice of development policy which seeks to concentrate power in the hands of reform leadership such as the finance minister. We can therefore conclude that when designing and implementing public sector reform, we must go beyond economics into management, sociology and other social sciences without losing sight of incentive economics. Without the correct motivation, reform will remain unimplemented and on paper.

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

CONCLUSION

Civil service reform has traditionally focused on downsizing and changing 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 satisfactory and that change has been severely resisted from within the civil service. It is the contention of this paper that we can learn from the incentives theory as well as from other branches of social sciences and management in order to design a PSR reform that will be incentives compatible and that has a greater chance for success.

Such reform will have to use incentives in such a way that the public servant's welfare is improved while also improving the efficiency and productivity of the government. For this, rewards must be aligned with productivity and the old monolithic, uniform, and non-meritocratic human resource management of the civil service must be abandoned and replaced with a new method of management that is much closer to the practices in the private sector.[32] The Thatcher reforms of the 1980s 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 extrinsic rewards (experience), recruits may be willing to accept a discount, but it cannot be as large as some countries are used to offering their public sectors. For the public sector to offer such rewards, it must credibly be seen as efficient and skill-enhancing.[33] 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 the entry level, entice top recruits 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; seniority is no longer the basis for promotion.

[32] 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).

[33] Imaginative training initiatives have also been started in a number of countries. In Mauritius and the United Kingdom training is being tailored to job 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.

There are two 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. 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 and 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 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. This approach of greater autonomy with a strong sense of mission is now widely accepted in the operation of central banks, which by law are given independence to focus on price stability. This model has yet to extend beyond central banking.

Decentralization of public sector management is also recommended to prevent excessive politicization of any public sector organization or agency. As much as possible, such an agency should be managed and paid for by the users of its output. New Zealand, for example, considered abolishing its Department of Education which dominated both policy-making and the delivery of education services in favor of decentralizing education at the community level.

Another illustration of this principle of decentralization is distancing 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. As a result, 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, and hence unites staff with a clearer sense of mission.

Box 3: Thatcher Reforms

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

1. Separate service delivery and regulatory functions into discrete chunks, each one called an Executive Agency.

2. Allow agencies to have control over their budgets, personnel systems and management practices.

3. Pay agency CEOs adequately in order 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. Allow 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. Set annual performance targets for each agency.

6. Reevaluate all agencies every five years to review their performance and relevance.

Results:

1. The creation of 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 the agency does not perform well, it may be abolished, privatized or restructured at its five-year review.

Overall, the British civil service shrunk 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 operated on 4.7 percent less financing in 1994-95 than they had the year before.

Haque and Aziz (1999).

Looking beyond economics, PSR is a process that is continuous and spread out over considerable time. It also has to permeate a large number of public sector organizations, agencies and units. It is only natural then to look everywhere for local leaders of the reform and as much as possible use modern management principles to guide it. Too often and to its detriment, reform has been centralized around a high-level office and around a few individuals. 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 and long-term vision. Rather than pursue a uniform reform program throughout 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.[34]

Reform must, however, be based on the recognition that people are at the heart of public service. As a result, managing human resources must be at the center of any CSR effort, rather than technology or market forces. The people 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. Also, it is 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.

[34] For example, reform could begin with key economic agencies, such as the central bank, finance ministry, customs and taxation, and 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 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 can radiate change.

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