

# PART THREE

## REINVIGORATING INSTITUTIONAL CAPABILITY

PARTS ONE AND TWO HAVE UNDERSCORED THAT THE STATE MAKES A VITAL CONTRIBUTION TO economic development when its role matches its institutional capability. But capability is not destiny. It can and must be improved if governments are to promote further improvements in economic and social welfare. This part of the Report discusses how this can be achieved.

State capability refers to the ability of the state to undertake collective actions at least cost to society. This notion of capability encompasses the administrative or technical capacity of state officials, but it is much broader than that. It also includes the deeper, institutional mechanisms that give politicians and civil servants the flexibility, rules, and restraints to enable them to act in the collective interest.

Three interrelated sets of institutional mechanisms can help create incentives that will strengthen the state's capability. These mechanisms aim to:

- Enforce rules and restraints in society as well as within the state
- Promote competitive pressures from outside and from within the state, and
- Facilitate voice and partnerships both outside and within the state.

Over the long term, sustainable institutions have been built on formal checks and balances, anchored around core state institutions such as an independent

judiciary and the separation of powers. These are essential for ensuring that neither state officials nor anyone else in society is above the law.

But rule-based government is not enough. State capability will also be improved by institutional arrangements that foster partnerships with, and provide competitive pressures from, actors both outside and within the state. Partnerships with and participation in state activities by external stakeholders—businesses and civil society—can build credibility and consensus and supplement low state capability. Partnerships within the state can build commitment and loyalty on the part of government workers and reduce the costs of achieving shared goals.

The flip side of partnership is competitive pressure—from markets and civil society and within the state itself. Such pressure can improve incentives for performance and check the abuse of the state's monopoly in policymaking and service delivery. Similarly, competitive or merit-based recruitment and promotion are crucial for building a capable bureaucracy.

This part of the Report starts with a look at ways to reinvigorate state institutions, by building the foundations of an effective public sector (Chapter 5) and, more broadly, by instituting formal checks and balances and controlling corruption (Chapter 6). Chapter 7 then examines how to sharpen competitive pressure, strengthen voice, and promote partnership by bringing the state closer to the people—an important means of which is decentralization, or the shifting of power and resources to lower levels of government. Finally, Chapter 8 discusses partnerships and competitive pressures that cross the boundaries of nation-states, and how countries can cooperate in providing collective goods.

## BUILDING INSTITUTIONS FOR A CAPABLE PUBLIC SECTOR

*Sire, a vast majority of civil servants are ill paid. . . . The result is that skilled and talented men shun public service. The Government of Your Majesty is then forced to recruit mediocre personnel whose sole aim is to improve their weak pecuniary situation . . . intelligent, hardworking, competent, and motivated individuals should direct Your Empire's civil service. . . . It is Your Majesty's prerogative to introduce the indispensable principle of accountability, without which all progress is retarded and work inevitably destroyed.*

—From *The Political Testaments of Ali Pasha*, Grand Vizier to Ottoman Sultan Abdulaziz, about 1871  
(quoted in Andic and Andic 1996)

**T**HE SAME PROBLEMS THAT PLAGUED SULTAN ABDULAZIZ haunt today's public bureaucracies. The history of development in Europe and North America in the nineteenth century, and that of East Asia in this one, have shown the economic rewards of building an effective public sector. But examples of this kind of institution building are all too rare.

Building the institutions for a capable public sector is essential to enhancing state effectiveness, but also immensely difficult. Once poor systems are in place, they can be very difficult to dislodge. Strong interests develop in maintaining the status quo, however inefficient or unfair. And those who lose out from present arrangements may be unable to bring effective pressure to bear for change. Even when the incentives are there to improve public sector performance, formidable information and capacity constraints often thwart the attempt.

How can governments with ineffective public institutions begin to put things right? The complex problems involved in building and managing a public bureaucracy do not lend themselves to clear, unambiguous solutions. But this chapter outlines some institutional building blocks of an effective public sector and discusses promising options for putting these in place. This focus on institutions is very different from the traditional approach of technical assistance, which emphasizes equipment and skills and administrative or technical capacity. The

emphasis here is on the incentive framework guiding *behavior*—what government agencies and officials do and how they perform. Few countries consciously set out to encourage bureaucratic corruption and inefficiency. But the mere existence of formal rules forbidding bribes, say, or the abuse of patronage will rarely be enough to root these things out. What matters is whether the actual rules and incentive mechanisms embedded in the system can translate the fine words into reality.

### **The foundations of an effective public sector**

Evidence across a range of countries has shown that well-functioning bureaucracies can promote growth and reduce poverty (Chapter 2). They can provide sound policy inputs and deliver critical public goods and services at least cost. During the nineteenth century most industrializing states modernized their public administrations. Early leaders included France, Prussia, and the United Kingdom. The success of the British civil service reforms in the last century provides an early example of the importance of nurturing effective, rule-based bureaucracies. As Box 5.1 describes, these reforms heralded the careful cultivation of a professional meritocracy, which helped pave the way for a half-century of English dominance over international commerce.

More recently, some East Asian economies have established and nurtured the foundations of capable bureaucracies. Many low-income countries, however, have been

### Box 5.1 Laying bureaucratic foundations: The Northcote-Trevelyan reforms in the United Kingdom

Until the early nineteenth century the affairs of the state in the United Kingdom were administered by public officials who owed their positions to political patronage and influence. There was no common system of pay, bribes augmented official salaries, and officeholders, who viewed their positions as property that could be sold, often engaged and paid their own staff. Although the system did not rule out advance by individual ability, it was not a basis for sound administration.

As the Victorian era progressed, however, the United Kingdom underwent a period of intense reform driven by social and economic change and the demands of an expanding, educated middle class. Universities, the armed forces, the judiciary, and central and local bureaucracies were all reformed.

The blueprint for civil service reform was the Northcote-Trevelyan Report of 1854, which advocated the creation of a modern bureaucracy based on a career civil service. Drawing on ideas advanced for the Indian civil service by Thomas Macaulay, Sir Stafford Northcote and Sir Charles Trevelyan proposed divid-

ing the government's work into two classes—intellectual (policy and administration) and mechanical (clerical)—and creating a career civil service to carry it out. Staff capable of performing the intellectual work would be recruited from the newly reformed universities; the best talent would be selected through tough competitive examinations supervised by a board of civil service commissioners.

Opposition was strong. Although a civil service commission was established in 1855, many government departments continued recruiting in their accustomed way until 1870, when patronage was abolished and the two grades were made compulsory for all departments. The Northcote-Trevelyan reforms were followed by reforms in the armed forces, the judiciary, and, later, municipal government. There were also extensive changes in the rules and restraints governing policy formation and implementation. By the end of the nineteenth century the United Kingdom had laid the foundations of a modern government and formally institutionalized the values of honesty, economy, and political neutrality.

unable to create even the most rudimentary underpinnings of a rule-based civil service. Their formal systems often resemble those of industrial countries on paper. But in practice informality remains the norm. Merit-based personnel rules are circumvented, and staff are recruited or promoted on the basis of patronage and clientelism; budgets are unrealistic and often set aside in any case by ad hoc decisions during implementation. At bottom, all these problems can be traced back to weaknesses in the underlying institutions: poor enforceability of the rule of law both within and beyond the public sector; a lack of built-in mechanisms for listening to, and forming partnerships with, firms and civil society; and a complete absence of competitive pressure in policymaking, the delivery of services, and personnel practices.

To tackle these problems at their root and lay the foundations of an effective public sector, countries need to focus on three essential building blocks:

- *Strong central capacity for formulating and coordinating policy.* This is the brains of the system. Politicians formulate visions and set goals, but for these to materialize they must be translated into strategic priorities. This requires mechanisms that lead to well-informed, disciplined, and accountable decisions. A constant challenge for all countries is to set rules that give politicians and

their expert counselors the flexibility they need to formulate policies, but embed their decisionmaking in processes that allow for inputs and oversight from stakeholders.

- *Efficient and effective delivery systems.* Here, too, reform involves setting the right balance between flexibility and accountability. For activities that are contestable (that is, where there is scope for actual or potential competition from various suppliers) and easily specified, market mechanisms and contracting out of services can often improve delivery dramatically. But for many other services there is often no substitute for delivery by the core public sector. Here giving citizens greater voice and allowing client feedback can exert pressure for better performance, but ultimately performance will depend on the loyalty of civil servants and their compliance with established rules.
- *Motivated and capable staff.* These are the lifeblood of the executive. Able and dedicated staff inject energy into the public sector. Uncommitted staff stifle it. Civil servants can be motivated to perform well through a range of mechanisms, including merit-based recruitment and promotion, adequate pay, and a strong esprit de corps.

Effective bureaucracies take decades to develop. And in seeking to build—or rebuild—the foundations of such a

bureaucracy, reformers must, as always, be conscious of what they are building *on*. For example, where countries have been unable to establish credible controls over managers' use of resources, giving them greater flexibility will only encourage arbitrariness and corruption. But certain reforms can generate early payoffs even in the worst systems. These are discussed further below.

### **Strengthening institutions for policymaking**

Politicians set goals and broad strategic directions. But sound institutional arrangements can determine whether the visions of political leaders get translated into effective policy priorities. They can make transparent the costs and benefits of competing policy proposals. And given that adequate information is inevitably in short supply, they can make sure that leaders are as well informed as possible, through processes that provide input and oversight from internal and external stakeholders. All these mechanisms will help produce better-informed decisions and raise the credibility of policymaking in general.

The rules and norms embedded in the policymaking process should be designed to curb the kind of uncoordinated political pressures that can lead to poor decisionmaking and bad outcomes. If politicians or bureaucrats pursue only their own or their constituents' immediate interests as they are voiced, the result may be collectively undesirable, even destabilizing—there is no invisible hand in statecraft, automatically shaping individual initiatives toward a common good. The aim must be to build mechanisms to discipline and coordinate the policy debate and call competing policy proposals into question. In some countries politicians have delegated macroeconomic and strategic policy coordination to capable, relatively autonomous central agencies, whose activities are guided by consultative processes that are transparent to outsiders. In others, politicians themselves collectively restrain and challenge each other in established forums where decisions are made in common. But many countries have none of these mechanisms, and their absence reveals itself in incoherent strategic policies and macroeconomic instability.

Although the precise institutional arrangements vary, effective public sectors the world over have generally been characterized by strong central capacity for macroeconomic and strategic policy formulation; by mechanisms to delegate, discipline, and debate policies among government agencies; and by institutionalized links to stakeholders outside the government, providing transparency and accountability and encouraging feedback. As discussed below, systems in many industrial countries and in much of East Asia exhibit many of these characteristics. Their absence in many developing economies is a major obstacle to building a more effective state. Policymaking

capacity in these countries tends to be weak and fragmented, with few institutionalized mechanisms for input or oversight.

### *Policymaking mechanisms in industrial countries*

Many OECD countries have built up well-functioning policymaking mechanisms over time. At the heart of these systems are mechanisms for properly preparing policy proposals, estimating the costs of alternative proposals within a disciplined overall budget framework, ensuring their critical evaluation through consultation and debate, and reaching and recording decisions and monitoring their implementation. A vital complement to these mechanisms is effective capacity at the center of government—the Cabinet Secretariat in France, the Ministry of Finance in Japan, the Office of Management and Budget in the United States—to facilitate consultation and coordinate proposals among ministries before they are submitted.

There is always room for improvement. Australia is a good example of an industrial country that has introduced reforms explicitly aimed at making the policymaking process more transparent, competitive, and results-oriented. Several features of these reforms are of particular relevance to other countries: the emphasis on publicizing the medium-term costs of competing policies; the effort to facilitate debate and consultation on policy priorities, within hard budgets, both in the cabinet and among agencies; and the attention to results (Box 5.2).

The United States and some continental European countries have instituted other mechanisms for consultation and oversight in policymaking. Corresponding to the cabinet in a parliamentary system, congressional committees in the U.S. presidential system are the principal arena for policy debate and consultation. U.S. executive agencies, for their part, are governed by the Administrative Procedures Act of 1946, which imposes certain procedural requirements, enforceable in the courts, such as public announcement of new policies, while preserving flexibility in the substance of policymaking. This procedures-oriented approach to policy formulation allows legislators to shift the substance of policymaking to specialist agencies and other interested parties closer to the problem. This kind of decentralized mechanism uses citizen voice and the judiciary to ensure accountability, but with the inevitable side effect of slowing decision-making.

Many continental European countries rely on administrative law and specialized courts for judicial review of administrative actions. Citizens can challenge administrative decisions on legal grounds or for factual errors. The European Union has adopted this system for the European Court of Justice, allowing it to oversee decisions made by EU institutions.

### Box 5.2 Australia's mechanisms for transparent, competitive, and results-oriented policymaking

One of the main objectives of Australia's public sector reforms has been to institute a process for disciplining and coordinating policies and exposing them to vigorous debate. Some of the challenges the Labor government faced when it came to power in the early 1980s were similar to those confronting many developing countries today: the new government had to manage both an immediate fiscal crisis and the unsustainable long-term fiscal commitments of previous policies.

To discipline policy formulation and win political support for a resetting of national strategic priorities, the new administration decided to publish estimates of future spending under existing policies. These projections painted a bleak picture of unsustainable real growth in spending requirements, underscoring the need to scale back. Once the government had published these estimates, however, it became incumbent upon the government to continue to do so, to show the continuing declines in future commitments that it had promised. Indeed, succeeding projections fell markedly, in what became called the "falling man" pattern (see figure at left). Open financial markets imposed additional discipline.

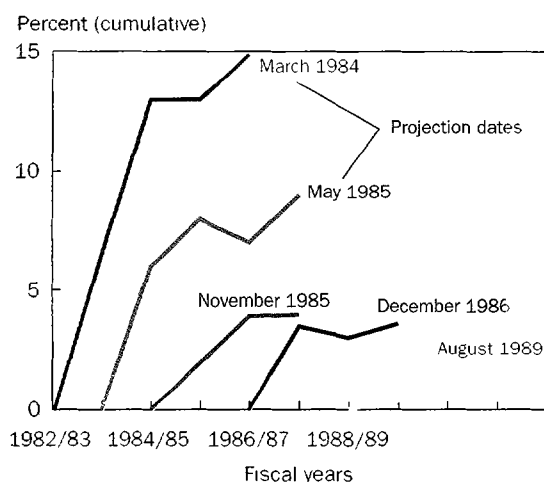
The reforms also required the government to publish a reconciliation table, showing how the projections for existing policies differed from those for the new policies. These measures helped make apparent the changes in the government's strategic priorities, as well as in the medium-term costs of new commitments. In

addition, the projections made resource flows to the line ministries more predictable, since the projected figures were automatically rolled over into the actual budget if no changes in policy intervened. This helped improve decisionmaking and the operational efficiency of line agencies.

The reforms also required that line ministries proposing any new policy, or any changes in existing policy that would increase spending, also propose offsetting savings (see figure at right). This ensured that spending stayed within the resource envelope agreed to in the cabinet. The cabinet focused on changes in strategic priorities—which new policies to adopt and which existing ones to cut—to stay within macroeconomic constraints. Policy proposals were debated vigorously within the cabinet, and all affected ministries and agencies were required to submit written comments on the soundness of other agencies' proposals. This helped legitimize and build consensus on policy priorities. Finally, the reforms focused attention on results, through mandated periodic evaluation of new and existing policies and through reporting on performance and outcomes.

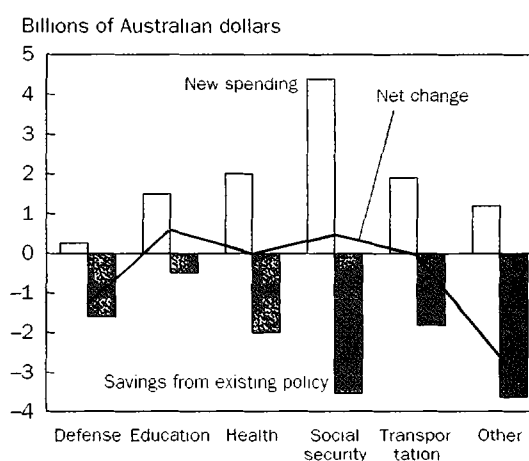
The results? Australia's deficit of 4 percent of GDP in 1983 became a surplus by the end of the decade. Accompanying this achievement were significant changes in the composition of public expenditures, reflecting both broad strategic shifts identified by the cabinet and changes in priorities within ministries, often identified by the line agencies themselves.

Projected growth in total spending



Source: Adapted from Campos and Pradhan 1996, Dixon 1993

Changes by category, 1983/84 to 1992/93



*Elite central agencies in East Asia*

The successful East Asian economies have adopted a procedural approach to policymaking that shares some key aspects of systems in industrial countries. Several East Asian leaders have formulated long-term visions for their countries; examples include, in postwar Japan, the Liberal Democratic Party's declared aim to catch up with the West, and more recently, in Malaysia, Prime Minister Mahathir Mohamad's Vision 2020. They have then worked to create the institutional arrangements needed to translate their vision into a highly focused set of strategic priorities. Powerful elite central agencies have been delegated the authority to develop policies that will achieve the leaders' long-term objectives. Although relatively autonomous, these agencies' deliberations have always been embedded in processes—such as public-private councils—that provide input and oversight from private firms.

These elite agencies often play an immensely important role in setting their countries' economic course. The Ministry of International Trade and Industry (MITI) in Japan and the Economic Planning Board in the Republic of Korea are considered the prime movers behind their countries' industrial policies and use of administrative guidance. In Thailand the Ministry of Finance, the budget bureau, the central bank, and the National Economic and Social Development Board—the so-called gang of four—act in unison to cap spending and control inflation. In Indonesia the Ministry of Finance and the planning agency Bapennas have been the guardians of the purse and the brains of the civil service. These central agencies are staffed by professional and capable employees recruited on the basis of merit, often through highly competitive examinations.

The delegation of macroeconomic policy to competent and reputable technocrats has recently been a common feature in several Latin American countries as well, including Argentina, Colombia, Mexico, and Peru. The effects on performance have been noticeable. This delegated policymaking, combined with the kind of hierarchical and transparent budget procedures described in Chapter 3, was important in reducing inflation in these countries during the late 1980s and early 1990s. Chile, in particular, appears to have developed the kind of esprit de corps among senior officials that has long fostered partnerships in the Indonesian technocracy and Japan's MITI, among others. Most striking are the parallels between Chile's group of high-level advisers—the Chicago boys—and Indonesia's Berkeley mafia and Thailand's gang of four.

As already noted, although the central agencies in East Asia had considerable flexibility in policymaking, they were embedded in a larger network of deliberation councils and external think tanks. In Japan, Korea, Malaysia, Singapore, and Thailand, information about the costs of industrial policies was distributed through a range of

public-private deliberation councils, which would expose costly programs to rigorous review. Such transparent and institutionalized consultation mechanisms gave those outside of government power to restrain or even veto its actions, while preserving flexibility for policymakers to adapt to changing circumstances.

Deliberation councils require substantial technical capability if they are to use the information supplied by private participants to make coherent policy. There is also the problem that such councils exclude broader segments of society from their deliberations. If a country's private sector is small, deliberation councils can all too easily degenerate into well-oiled mechanisms for unproductive rent extraction. This probably explains why African versions of deliberative councils—such as the francophone countries' experiments with economic and social councils—have generally been ineffective (with the notable exception of Botswana's). If such councils are to support sustainable development, they will need to be complemented, as they were in East Asia, by attempts to win legitimacy from society more broadly.

*Weak capacity and fragmented policymaking in developing countries*

Many developing countries, especially in Africa, Central America, and the Caribbean, lack the critical mass of effective capacity and internal coherence to formulate and coordinate macroeconomic and strategic policies. Central capacity is weak, stretched thinly among a handful of senior officials who must attend to numerous tasks. These strains are compounded by problems in the bureaucracy: low pay at senior levels, rampant political patronage, and an absence of meritocratic recruitment and promotion.

One especially costly consequence of weak central capacity is an inability to make budget forecasts based on sound and realistic assumptions. This undermines transparency and predictability in decisionmaking. For example, in recent years the difference between budgeted and actual recurrent expenditures has averaged more than 50 percent in Tanzania and more than 30 percent in Uganda. Transparency and coherence are also compromised by the use of extrabudgetary funds (equivalent to more than half of total federal expenditures in Nigeria, for example) and by long lags in the production of financial accounts and audits. Often decisionmakers will have little sense of the costs or outcomes of policies. Partly as a result, budgeting focuses almost exclusively on the allocation of inputs rather than the results they are intended to achieve.

In aid-dependent countries donors sometimes alleviate, but too often worsen, the problem of weak central capacity. To the extent that their policy advice supplements weak capacity at the center, they help solve the short-term problem at hand. But such advice does nothing

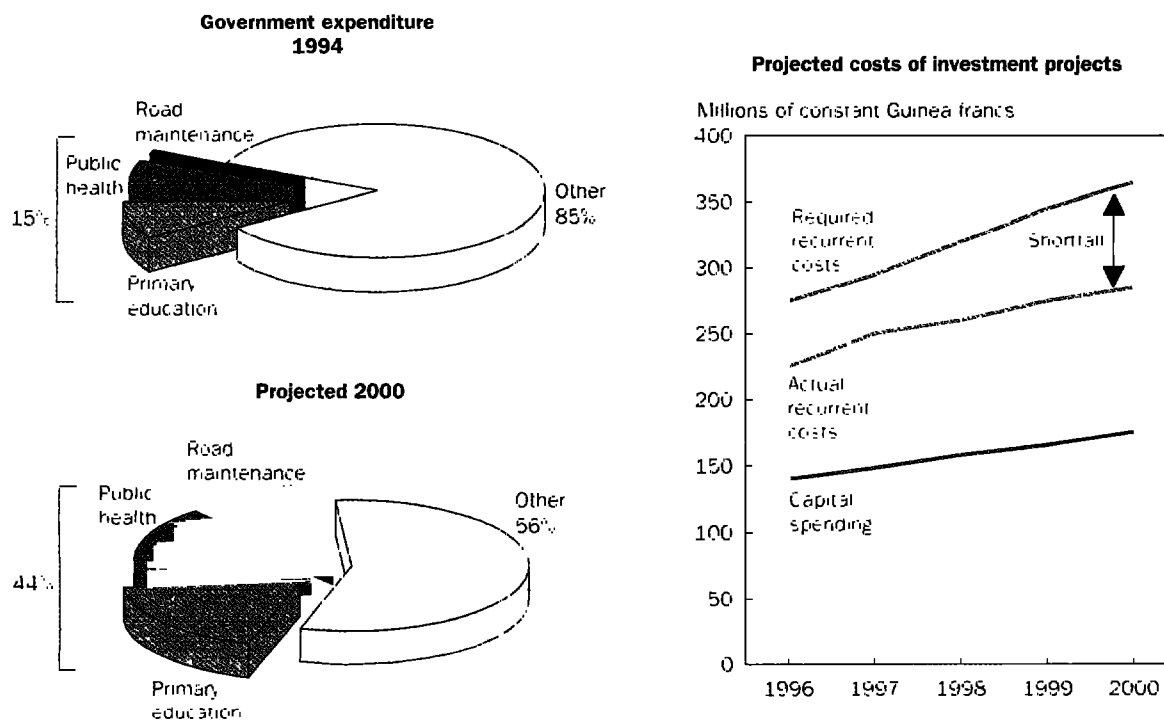
to build long-term capacity if politicians fail to recognize the need ultimately to rely on local experts. Donors may also fragment central capacity for policy formulation, entering with ministries into bilateral deals on multiple projects without determining whether their cumulative effects are collectively sustainable or mutually consistent. In many countries public investment programs have become passive repositories of donor-driven projects, whose recurrent costs after completion continue to accumulate, contributing to an expansionary fiscal bias. Lack of coordination between the ministry of planning and the ministry of finance sometimes further impedes the integration of capital and current expenditures.

All these problems seriously erode the capacity to coordinate, challenge, and discipline decisionmaking. Guinea provides a case in point. Although the government has designated primary education, public health, and road maintenance as spending priorities, funds often end up being allocated to other areas instead. And no system exists for costing out policy proposals or subjecting them to rigorous scrutiny. An exercise to cost out Guinea's policies to meet the government's stated priorities revealed that the share of priority programs in total spending

would need to triple over the succeeding four years, implying drastic cuts in other expenditures (left panel of Figure 5.1). Moreover, the recurrent costs of donor-led investment projects were shown to be unsustainable (right panel of Figure 5.1). The same inadequacies play out across the developing world, as newly built roads fall into disrepair, and schools find themselves without textbooks and health centers without drugs.

Several initiatives have been launched to address these problems, but all are still in their early stages. The Africa Capacity Building Initiative seeks to strengthen the capacity of African governments in policy analysis through a more professional civil service, improved information systems, and enhanced external inputs from African universities and civil society more broadly. Governments and donors have also launched sectoral investment programs to coordinate donor assistance. The Agricultural Sector Investment Program in Zambia replaces 180 individual donor projects. But although they consolidate fragmented policies in a shared arena, such efforts can create coordination problems of their own as capacity remains weak. Malawi and Uganda are among those countries moving to the next, crucial level of reform: developing a

**Figure 5.1 Guinea's policy goals and spending allocations do not add up**



Source: Adapted from World Bank 1996d.



systematic process to set strategic priorities across sectors and within aggregate spending constraints. Colombia is instituting ex post evaluation systems to assess whether policies and programs already in place are achieving their intended outcomes.

*Policy coordination in transition economies*

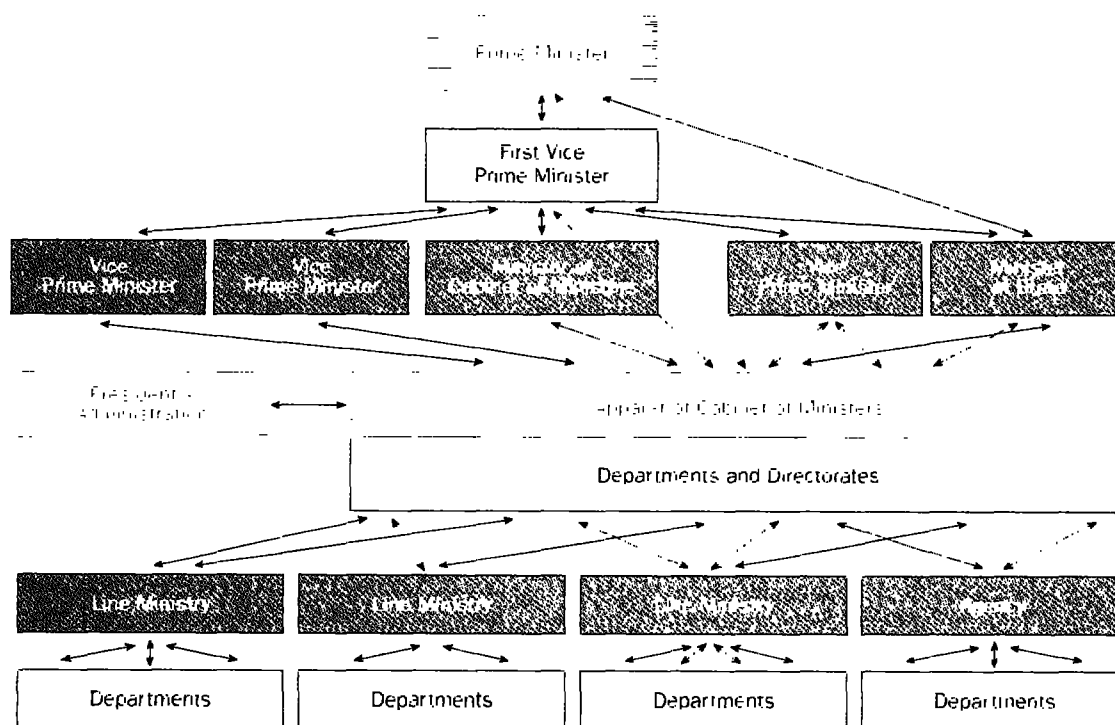
Although the shortage of administrative expertise is not as much of a problem in the transition economies of Central and Eastern Europe and the former Soviet Union, their experience shows the equal importance of mechanisms that can channel that expertise into coherent policy. When the communist regimes in these countries collapsed, so did the centralized decisionmaking apparatus for coordinating the activities of ministries and departments. As a result, confused and overlapping responsibilities and multiple rather than collective accountability emerged—a sure-fire formula for policy disaster.

Ukraine exemplifies such problems in the extreme. Following independence in 1991, a central machinery of government was established which reflects many of the features of a former Soviet system. Decisionmaking

remains highly centralized. The Apparatus of the Cabinet of Ministers has retained responsibility for policy formulation and coordination and directs the activities of central government departments. The number of central government bodies remains large (over 110), their responsibilities often overlap, and lines of accountability are unclear (Figure 5.2). The cumbersome structure makes coordination difficult, delays decisionmaking, and reduces transparency. However, efforts to reform this system are now under way following the adoption of a new constitution in July 1996.

Some Central and Eastern European countries with similar although perhaps less severe problems have initiated promising reforms of their central decisionmaking mechanisms. Poland and Hungary have both introduced reforms to streamline multiple and conflicting responsibilities and speed decisionmaking. In Georgia, streamlining has removed overlapping and conflicting positions, and the fate of draft laws is now decided in the presence of all members of the president's economic council before submission to the parliament. Such reforms have aided consultation and coordination in central government

**Figure 5.2 Decisionmaking in Ukraine is bogged down by overlapping responsibilities**



Source: adapted from World Bank 1997

decisionmaking. But most countries have a long way to go to build the institutional capability needed to respond effectively to the many demands of transition.

### Reforming institutions for delivery

The best-designed policy will achieve little if it is badly implemented. Poor quality, high cost, waste, fraud, and corruption have marred the delivery of services in many developing countries. More often than not, the problems can be traced back to a belief that government ought to be the dominant—if not the sole—provider.

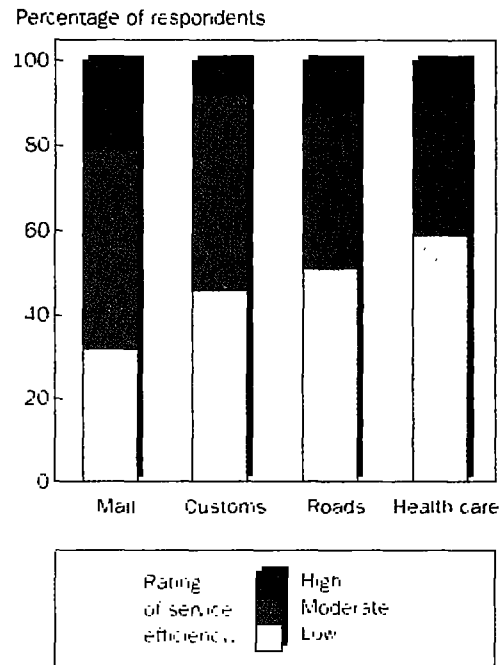
The expansion of the state under the state-dominated development strategies outlined in Chapter 1 has provided countless opportunities for politicians to exploit their positions for political gain (Box 5.3). More broadly, governments have simply overextended themselves, with disastrous results. Examples abound of services not being delivered or being delivered badly. Power system losses in low-income countries are more than twice those in other

### Box 5.3 The mushrooming of Bangladesh's government

Since independence in 1971 the government of Bangladesh has effectively doubled in size. The number of ministries increased from twenty-one to thirty-five over twenty years, and between 1990 and 1994 the number of departments and directorates went from 109 to 221. Public sector employment increased from 450,000 in 1971 to almost 1 million in 1992—a compound rate of increase of 3.6 percent a year, compared with population growth of 2.5 percent during the same period. Civil service pay has fallen considerably, especially for those at the top. The base pay of a permanent secretary (the most senior civil service position) has declined by 57 percent in real terms since 1971.

New ministries, divisions, and departments were created in part to meet emerging needs such as environmental protection and women's issues. But the state has also spread its wings into commercial activities. Growth has often been stimulated by political considerations. The increase in ministries allowed new ministerial positions to be handed out to more intraparty groups—and, of course, created more lower-level jobs to be dispensed. Aside from its budgetary effects, this expansion has stretched implementation capacity, compounded coordination problems, and made regulation more intrusive. It has also created vested interests that have blocked efforts at rationalization and reform.

**Figure 5.3 Most firms rate government services poorly, but some services score higher than others**



Source: Private sector survey conducted for this Report

countries. In China nearly 1 million hectares of irrigated land has been taken out of production since 1980 because of insufficient maintenance. Only 6 percent of domestic businesspeople surveyed for this Report in fifty-eight developing economies rated government service delivery as efficient, while 36 percent rated them very inefficient. Mail delivery fared reasonably well, followed by customs and roads; health services scored the worst (Figure 5.3). These results indicate a broader pattern: the lower-rated services are delivered by government departments (as opposed to state enterprises) and produce outputs that are harder to measure and monitor.

What is needed is better management of the principal-agent relationships inherent in service delivery. In many countries delivery suffers because neither the principals (the politicians) nor the agents (the bureaucrats) live up to their side of the bargain. Politicians interfere in the day-to-day operations of public agencies; services are delivered through government departments whose managers have little operational flexibility and whose resource flows are unpredictable. Even where managers have been able to get around these rules, they have had few incentives to achieve better results. In the many countries where the

public sector has assumed a monopoly role in the delivery of many services, external pressures for better performance are eliminated. And few countries have set credible restraints to hold managers accountable for their use of inputs or for the achievement of measurable outcomes.

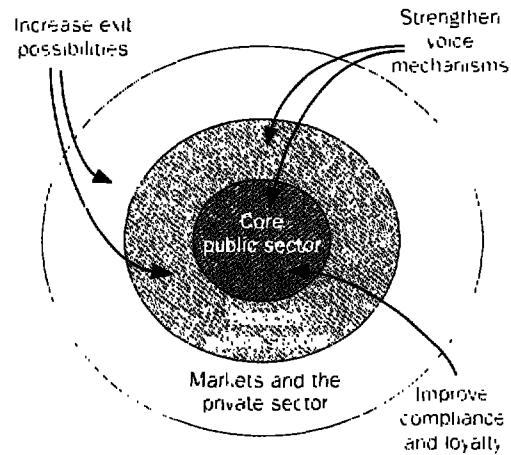
#### *Institutional mechanisms to improve delivery*

Governments are experimenting with a range of institutional mechanisms to improve service delivery. Greater use of markets is creating competitive pressures and more exit options—alternatives to public provision for users seeking better quality or lower cost. Also expanding these options is the practice of contracting out service delivery to private firms or NGOs. Some governments are setting up performance-based agencies in the public sector and entering into formal contracts with these agencies, providing them greater managerial flexibility while holding them accountable for specified outputs or outcomes. Others are relying on more traditional bureaucratic forms in the core public sector, emphasizing accountability in the use of inputs, meritocratic recruitment and promotion, and the cultivation of an esprit de corps to build loyalty and improve performance. Finally, user participation, client surveys, published benchmarks, and other mechanisms for increasing citizen voice are providing external pressures for better delivery.

These initiatives can be classified into three broad categories: expanding exit options, strengthening voice, and improving compliance and loyalty. Which of these apply depends on the incentive environment through which the service can be delivered (Figure 5.4). Markets and contracts with the private sector offer primarily exit options for better performance. In the broader public sector—including corporatized state enterprises and performance-based agencies—exit options are fewer, but voice begins to become influential. For activities whose outputs are difficult to specify and that are not contestable, the core civil service remains the agency of choice, but it provides no realistic exit options and has considerably less flexibility in financial and personnel management. Here the more relevant instruments switch to citizen voice, the loyalty of the civil service, and well-specified rules for them to follow.

Recently, the so-called new public management reforms in industrial countries have sought to move delivery away from the core public sector (the center of the circle in Figure 5.4), primarily by using market mechanisms and formal contracting. New Zealand provides the most dramatic example. Beginning in the early 1980s, commercial and other contestable activities were hived off, corporatized, and often privatized. The remaining large, multipurpose ministries were split up into focused business units headed by managers on fixed-term, output-based contracts with considerable autonomy (including the right to hire and fire). These reforms helped turn a

**Figure 5.4 Three strategies for improving government service delivery**



budget deficit equivalent to 9 percent of GDP into a surplus during the 1980s and cut the unit cost of delivery by more than 20 percent in some agencies.

Several developing countries are now emulating these reforms. But what is feasible in New Zealand may be unworkable in many developing countries. It takes considerable capability and commitment to write and enforce contracts, especially for difficult-to-specify outputs in the social services. Which mechanism will prove most effective in improving performance depends on both the characteristics of the service and the capability of the state to enforce internal and external contracts (Table 5.1).

For instance, for services that are contestable—such as most commercial products and, more recently, telecommunications and electric power generation—market mechanisms can generate powerful competitive pressures for improved delivery. For services whose outputs the state can specify and enforce at low transactions cost, contracting out to private firms and NGOs is an attractive option. Countries with strong capability and commitment are setting up performance-based agencies and formal contracts even for complex activities within the core public sector, such as defense, education, and health care. But countries with little capability to enforce complex contracts, and weak bureaucratic controls to restrain arbitrary behavior under more flexible management regimes, need to proceed with caution.

#### *Using competitive markets to improve delivery*

Overstretched and with budgets increasingly tight, governments are relying more on market mechanisms to improve the delivery of contestable services. At the same time, a flood of innovation at both the technological and the policy level has been pushing back the boundaries of

**Table 5.1 Mechanisms to improve service delivery**

Environment	Service characteristics and state capability		
	Contestable	Easy to specify outputs and enforce performance	Difficult to specify outputs and enforce performance
Private sector	Strengthen markets through credible regulation Create markets, e.g., by issuing vouchers	Contract out to for-profit or nonprofit agencies	
Broader public sector	Enhance internal competition Set hard budgets, and privatize state enterprises	Set up performance-based agencies Corporatize state enterprises and establish enforceable performance contracts Strengthen voice mechanisms	
Core public sector			Ensure clarity of purposes and tasks Improve compliance with rules Strengthen voice mechanisms

what can be considered contestable. Chapter 4 showed how deregulation and the unbundling of activities in state-dominated industries such as electric power generation have led to significantly lower unit costs and a rapid expansion in services.

Other recent innovations such as vouchers and capitation grants have even increased the scope for competition in the provision of some social services. Experience remains limited, however, and confined largely to education. Chile's capitation grant system allows students to enroll in any school, public or private; schools receive a payment from the state based on enrollment (Box 5.4). Private enrollments have increased, but the program's effects on school performance are not yet clear. Vouchers are promising but carry a risk of increasing social polarization if not properly regulated.

Indeed, greater use of market mechanisms must be accompanied by effective regulatory capacity. As discussed in Chapter 4, this is not always easy to achieve. The difficulties of regulation are even more daunting in social services than in, say, infrastructure. For instance, the private delivery of health care services is unregulated in many developing countries (Brazil is a notable exception) because regulating the vast number of small-scale providers is beyond the government's capacity.

#### *Contracting out to the private sector and NGOs*

In those areas where competition in the market is not feasible, it may still be possible to foster competition for the

market: governments can contract with private firms, selected through competitive bids, to provide services. Contracting out is now a widespread practice in many industrial countries. Victoria State in Australia provides a particularly dramatic example: each local council contracts out at least half its annual budget through competitive tender, including complex community care services.

In developing countries, where both markets and state capacities are weak, options for contracting out are fewer. Still, where outputs are easily specified and direct competition is impossible, competition managed through such arrangements as service contracts, management contracts, leases, and long-term concessions can yield efficiency gains. In Brazil, for instance, contracting out road maintenance to private contractors led to savings of 25 percent over the use of government employees. Leases have increased the technical efficiency of water supply in Guinea and of the operation of Port Kelang in Malaysia.

Governments are also contracting out the delivery of social services, especially to NGOs. Even though outputs here are difficult to specify, governments have taken this route where NGOs are perceived to be committed to high quality or where, because of their religious or ideological orientation, they can better serve certain groups (for example, the Netherlands has long contracted with NGOs for education services). In Bolivia an arrangement with a local church organization to manage public schools is producing promising results (Box 5.5). And in Uganda the government is entering into partnerships with NGOs to

### Box 5.4 Vouchers and school choice

Vouchers can increase the scope for competition in providing education. Students are given vouchers funded by public tax dollars but redeemable at any school, private or public. Letting parents choose the school their children will attend should induce schools to compete for students.

Opponents of vouchers claim that they would lead public school students—especially the better ones—to leave in droves, gutting the public system. Such an outcome would be wasteful and might lead to even poorer education for those who choose to remain. Yet in a 1993 pilot program in Puerto Rico, the 18 percent of students who did transfer to private schools were largely offset by the 15 percent who transferred from private to public schools—hardly a mass exodus. Puerto Rico's experiment was so successful that in its second year the number of applicants jumped from 1,600 to 15,500.

Public funding for private schools is nothing new. In the Netherlands two-thirds of students attend publicly funded private schools. When Chile reformed its education system in 1980, the Ministry of Education

began providing capitation grants—fixed payments per student enrolled—to both public and private schools. Because the per-student payment was based on the average cost of education in the public sector, and expenditures per student were 70 percent less in the private sector, private schools eagerly vied for students. By 1986 primary enrollment in private schools had more than doubled, from 14 to 29 percent of total enrollment, and enrollment in private secondary schools had increased almost fourfold. The effects on school performance are not yet clear.

Vouchers also present potential risks. The ones most commonly cited are increased stratification among services and polarization among users. Some analysts have criticized the unfettered rush toward school choice in the former Soviet republics, arguing that it will exacerbate social tensions in rapidly polarizing societies. The underlying concern is that, in the absence of national controls, school curriculums will become divisive and parochial, and an essential role of the state—that of ensuring social cohesion—will be undermined.

deliver both preventive and curative health services previously in the public domain.

Like regulatory contracts and vouchers, however, contracting out is not a panacea. In general, contracting works best where outputs are easy to specify and markets are strong, so that the effectiveness of alternative suppliers can be readily judged. For activities that are complex or nonroutine, contracting out will inevitably incur higher transactions costs. Contracting is also prone to corruption and mismanagement, much as are contracts within the public sector. The Inspector General of Uganda, to take but one example, reported several instances of fraud in contracts with the private sector, including payments for roads that were never built or maintained.

Finally, competition in contracting does not necessarily mean that the private sector will outperform the public sector. In one of the most extensive U.S. experiments in public-private competition, the Public Works Department of Phoenix, Arizona, developed innovative strategies and outperformed private competitors on several contracts between 1984 and 1988. Competition provided the stimulus for reform in that case, but equally important was the strong partnership forged between management and labor through quality circles and labor-management productivity committees to build on workers' expertise and jointly identify competitive solutions.

#### *Improving delivery through the broader public sector*

Notwithstanding the growing opportunities for private participation, the public sector will inevitably continue to deliver a large number of services. Here the challenge is to create an enabling environment that provides incentives for better performance.

**INTERNAL COMPETITION.** Some industrial countries are experimenting with ways to increase competition within the public sector, to improve delivery of services for which neither market competition nor contracting out is feasible. In the United Kingdom, for example, an internal market has been created within the national health service by transforming local health authorities and groups of general practitioners into purchasers of hospital services on behalf of their patients. This arrangement has created competition among hospitals, acting as a decentralized mechanism for reallocating resources. Although internal competition can enhance efficiency, it is important to ensure that equity concerns are safeguarded in the process.

Decentralization of delivery—moving resources and responsibilities to lower levels of government—is another potentially powerful means of introducing internal competitive pressure, particularly for the provision of local public goods with few interjurisdictional spillovers or economies of scale. Local governments get the flexibility to match supply to local preferences or demands, while

### Box 5.5 Contracting with NGOs for better schooling in Bolivia

In an experimental program in Bolivia, the government contracted with the church-based *Fey Alegria* to manage a certain number of mostly secondary public schools. Before agreeing to do so, *Fey Alegria* demanded (and received) the right to appoint principals and teachers and to allow teachers to work both the morning and afternoon shifts rather than the three-and-a-half hours allotted for instruction in the public schools.

In all other ways *Fey Alegria* schools are identical to other Bolivian public schools. Although hand-picked, teachers receive little special training and are paid the same salary as other public school teachers. *Fey Alegria* schools receive no additional money for books or supplies and their curriculums and teaching methods are the same as those used in other public schools.

The only comparative advantage *Fey Alegria* schools have is an exceptional esprit de corps among students, parents, and staff. Teachers and students flock to *Fey Alegria* schools, with many families paying extra fees for their children to attend. On the rare occasions when innovative teaching methods have been tried (such as a mathematics course transmitted over a public radio station), they have also proved popular, both in the schools and throughout the community. This public-private partnership between government and a religious NGO appears to be so successful that the government is studying it as a possible model for national education reform.

local accountability and interjurisdictional competition in supply provide potential restraints. But as discussed in Chapter 7, appropriate institutional preconditions need to be in place if decentralization is to improve efficiency and equity.

**PERFORMANCE-BASED AGENCIES.** The so-called new public management reforms in industrial countries have sought to break up the core public sector into a series of distinct business groups or special-purpose agencies. In general these agencies have greater managerial flexibility in the allocation of financial and human resources and greater accountability for results. Sweden and some other Nordic countries have long separated cabinet ministries from agencies with specific purposes. In the United Kingdom nearly two-thirds of the civil service has now been moved

into executive agencies charged with specific delivery functions. These changes have been accompanied by substantial devolution of managerial authority and accountability for results. In Australia, Denmark, Ireland, and Sweden, for example, detailed and itemized administrative costs have been consolidated into a single budget line item, making it possible for managers to reallocate resources in accordance with changing priorities and needs.

Among developing countries, Singapore has perhaps the longest head start in creating focused business units. As early as the 1970s the Singaporean civil service was organized around the concept of statutory boards. Elsewhere, Jamaica has selected eleven pilot agencies for conversion into executive agencies.

But countries with inadequate controls over inputs and weak capacity need to proceed with caution. The industrial countries that have now relaxed detailed control over inputs did so from a position of strength, having developed over many years a series of credible restraints on arbitrary behavior. For the many countries that have not yet succeeded in instituting credible controls over the use of inputs, greater managerial flexibility will only increase arbitrary and corrupt behavior. Furthermore, writing and enforcing contracts, particularly for complex outputs, require specialized skills that are often in scarce supply.

Some of these concerns are borne out by a recent study of state enterprises, which found the overall record of performance contracts in developing countries extremely disappointing. Yet while performance contracts have not succeeded in most developing countries, many have sought to create performance-based agencies for easily specified and high-priority tasks such as road maintenance or tax collection. These agencies are typically set up as enclaves within the civil service, with greater managerial flexibility, better pay, and greater accountability for results. In Sub-Saharan Africa, for instance, performance-based agencies have been created to achieve tax collection targets in Ghana, Uganda, and Zambia. Other countries appear ready to follow suit.

In these instances, enclaving tax collection has been considered a prerequisite for boosting a government's capacity to raise revenues and improving incentives for the rest of the civil service. The results have been impressive. Ghana was the first country in Sub-Saharan Africa to introduce a performance-based approach to tax and customs revenue collection. Total revenues nearly doubled in the first five years, from 6.6 percent of GDP in 1984 to 12.3 percent in 1988, largely thanks to better collection. But the scheme was not without its problems. The rest of the civil service chafed at the special treatment afforded tax collectors, and the Ministry of Finance objected to its loss of authority. The program could not have gone forward without strong support from the top.

More troublesome has been the establishment of development project enclaves in several aid-dependent countries, each with its own system of remuneration and accountability. Often, donors have created these enclaves with little if any systematic consideration of the nature of the services provided or of the optimal sequencing of institutional reforms. And they have often created disparities.

As discussed in Chapter 9, enclaves are usually designed as quick fixes. Although they have sometimes accomplished short-term goals, they can create obstacles to deeper institutional reform. Where output is easily specified—tax revenues collected, for example—enclaves may be useful as an experimental stage of reform that can then be progressively extended, and as a demonstration that reforms can be effective. But it is important to employ systematic criteria in selecting which agencies to hive off. And although they are a useful first step, enclaves cannot substitute for the longer-term institutional reforms needed to create a motivated, capable civil service.

#### *Improving delivery through the core public sector*

Contracting out, setting up performance-based agencies, and ensuring formal accountability for results are not viable options for many services in countries with weak capacities. The challenge is particularly acute for street-level bureaucracies whose operators (police, irrigation patrollers, health workers, teachers, extension workers) interact daily with the people they serve, are geographically dispersed, are granted substantial discretion, and produce outputs that are difficult to monitor and are not subject to competitive pressure.

Experience across a range of countries suggests that a combination of mechanisms can boost incentives to perform in such areas. A study comparing irrigation agencies in India and Korea revealed that the Indian organization provided few incentives for conscientious work, whereas the Korean agency was full of such incentives. Korean irrigation patrollers had greater clarity of purpose and were subject to random monitoring from three separate agencies. Supervision techniques in India sought to discover grounds for punishment; in Korea they sought to solve problems. With staff from all parts of the organization traveling frequently up and down the canals in Korea, there was more external pressure from farmers, and stronger partnerships could be built for better performance.

PERFORMANCE ORIENTATION AND PREDICTABILITY IN RESOURCE FLOWS. An important starting point in raising the emphasis on performance within public sector organizations is greater clarity of purpose and task. Colombia, Mexico, and Uganda are introducing performance measurement to orient managers to achieving desired results. Whereas some countries (New Zealand is one) have stressed outputs as performance measures, others (Aus-

tralia, Colombia, Uganda) are emphasizing outcomes—the impact of outputs on beneficiaries—combined with ex post evaluation.

But even with greater clarity of purpose and task, public sector managers will not perform well if the flow of budgeted resources is highly uncertain. This brings home the downstream importance of building effective policy-making mechanisms at the center, as discussed earlier in this chapter. A credible medium-term expenditure framework, such as that in Australia (see Box 5.2), provides greater consistency between policies and resources and therefore more predictability in the flow of resources to units downstream. Malawi and Uganda are beginning to institute such frameworks.

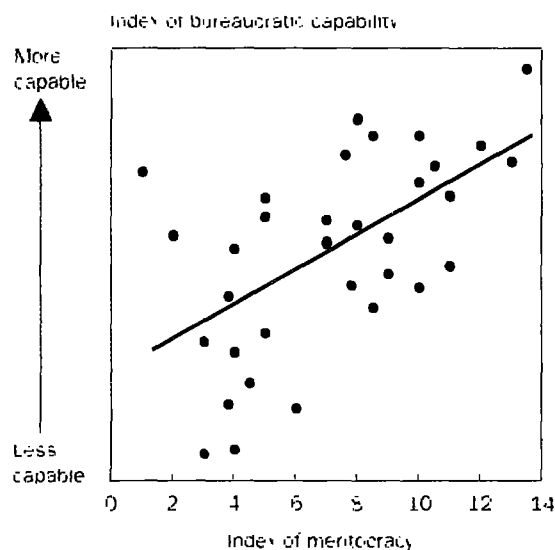
FINANCIAL AND MANAGEMENT CONTROLS. Because public sector outputs are often difficult to measure and monitor, financial control and accountability are needed to keep managers honest, prevent the poor use—or abuse—of public resources, and improve service delivery. An expenditure tracking exercise in Uganda revealed that a significant portion of funds allocated for basic social services never reach the intended health clinics or schools, particularly in rural areas. In many countries public financial accounts and audits are outdated and inadequate and therefore do not provide credible restraint.

To improve the transparency and quality of their financial accounting and auditing systems and reduce lags, countries are modernizing their financial information systems. Countries as diverse as Bolivia, China, Indonesia, and Moldova are writing sound accounting principles into law, backed by strong professional associations both within government and in the private sector.

Although systematic evidence about the effects of these reforms is not available, some useful policy lessons can nevertheless be gleaned. Modern, computer-based information systems can both improve transparency and strengthen aggregate control while reducing the need for controls on specific transactions. Controls on inputs can be broadened sequentially as systems are expanded and trust is built up: countries can gradually move away from detailed, ex ante line-item controls to broader budget categories, salary scales with broader bands, and greater latitude in procurement and recruitment. The shift from ex ante to ex post transaction-specific input controls should proceed carefully and only as controls over budgetary aggregates are improved, as agencies demonstrate that they can be trusted with greater autonomy, and as ex post controls build strength through improved accounting and auditing capacities.

But experience also suggests that moving from a highly centralized, transaction-specific control regime to a more decentralized one can encounter resistance. For instance, in Ecuador a plan to devolve payment controls, although

**Figure 5.5 Recruiting and promoting on merit improve bureaucratic capability**



Note: Results are based on a regression using data from thirty-five developing countries during 1970-90, controlling for other variables including income and education. See the Technical Note for details. Source: Evans and Rauch 1993.

proposed in 1995, has yet to be implemented, largely because of central agencies' fears of fiscal indiscipline. Trust needs to be built up first by strengthening systems of performance measurement and ex post input controls. As these systems become more credible, resistance to the changeover will fade, and managers can be provided greater flexibility, with stronger accountability for results.

**LOYALTY, MOTIVATION, AND COMPETENCE.** Better systems of monitoring, accounting, and auditing alone will not suffice to improve the delivery of many services. Mechanisms for enhancing the loyalty, motivation, and competence of the civil service are also needed. Loyalty promotes staff identification with an organization's goals and a willingness to take a longer-term view of responsibilities. Loyalty is essential in the core public sector, where activities are not easily specifiable or monitorable, and exit has no meaning.

The civil services of France, Germany, Japan, and Singapore all seek to ensure that the loyalties of a small group of professionals are fundamentally aligned with the interests of the state. Job security in the civil service was meant to foster this alignment of interests. It has worked in some contexts but not in many others. As discussed in the next section, the experience of successful countries suggests that building this commitment, and motivating

and attracting capable staff, require long-term career rewards, adequate pay, and mechanisms to instill an esprit de corps through, for instance, strong partnerships between management and labor.

**STRENGTHENING MECHANISMS OF CITIZEN VOICE.** Instituting credible bureaucratic controls takes time. Meanwhile, where internal monitoring and enforcement capacity are weak, clients and beneficiaries can exert powerful pressures to improve performance, and so help reduce monitoring costs until these capacities are built up. Coproduction and other forms of government partnership with the community in providing services, even if indirect, create incentives to press for better service. Feedback mechanisms such as the client surveys used in India, Nicaragua, and Uganda increase transparency and improve accountability by making more people aware of the agency's performance. Citizen charters, in which agencies publicly commit themselves to minimum standards of service provision—as applied in Belgium, Malaysia, Portugal, and the United Kingdom—can be a fulcrum for increased external and internal pressures to meet performance targets, and help focus the attention of clients and staff on service quality. Chapter 7 puts the use of voice and participation in the broader context of raising state capability.

#### **Fostering motivated, capable staff**

Whether making policy, delivering services, or administering contracts, capable and motivated staff are the lifeblood of an effective state. Efforts to build a competent and dedicated civil service usually focus almost exclusively on pay. Pay is certainly important, but so are other things, such as merit-based recruitment and promotion and esprit de corps. Meritocratic recruitment and promotion restrain political patronage and attract and retain more capable staff. A healthy esprit de corps encourages closer identification with an organization's goals, reduces the costs of making people play by the rules, and nurtures internal partnerships and loyalty.

A recent cross-country study shows why these things matter. The authors found that an index representing meritocratic recruitment and promotion and adequacy of pay was correlated with economic growth as well as with investors' perceptions of bureaucratic capability, even after allowing for income and educational differences (Figure 5.5). Clearly, then, finding the right institutional recipe for recruiting and motivating capable staff can reap sizable rewards.

#### *Merit-based recruitment and promotion*

Making a meritocracy of the civil service helps bring in high-quality staff, confers prestige on civil service positions, and can do a great deal to motivate good performance. In many countries (Japan and Korea, for example)



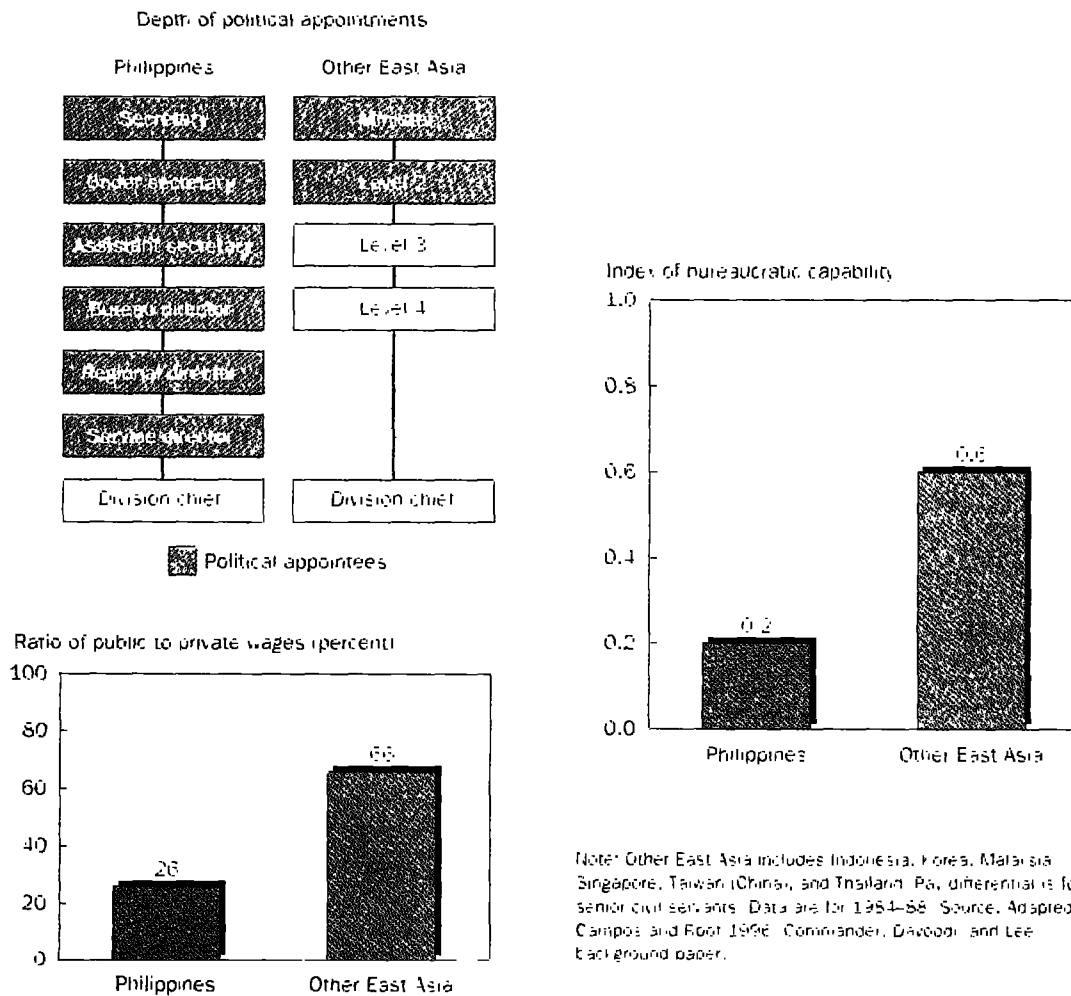
a national civil service entrance examination uses tough standards to winnow the more skilled from the less skilled applicants. In others, academic (often college) performance is the primary filter. Pressure to perform is sustained after recruitment by specifying clear objectives and criteria for upward mobility and offering rewards for meritorious long-term service. In Korea, for instance, promotion is based on a formula that combines seniority with merit-based elements. Where instead promotions are personalized or politicized, civil servants worry more about pleasing their superiors or influential politicians, and efforts to build prestige through tough recruitment standards are undercut.

Meritocracy has not yet become established in many countries. Instead the state has often become a massive source of jobs, with recruitment based on connections

rather than merit. Figure 5.6 shows that political appointments run much deeper in the Philippines than in other East Asian countries. This, combined with poor pay, has resulted in lower bureaucratic capability, which has also worsened over time. The Philippine government is undertaking reforms to introduce greater meritocracy in its civil service. Of course, political appointments can be quite extensive in industrial countries, such as the United States, as well. But countries with weak institutions and inadequate checks and balances are better off relying on more transparent and competitive mechanisms.

Even countries that have managed to install merit-based recruitment and limit political appointments can suffer from rampant political interference in employee transfers. In India, for example, senior civil servants are transferred frequently: the average tenure of field officers in some states

**Figure 5.6 Lack of meritocracy and poor pay in the Philippines' civil service have lowered capability**



can be as low as eight months. Partly as a result, the once-legendary Indian civil service is no longer perceived as a model of efficiency and effectiveness.

Merit-based recruitment and promotion systems are of two broad but not mutually exclusive types: mandarin systems and open recruitment systems. Mandarin systems, such as those found in France, Germany, and Japan, are closed-entry, hierarchical systems with highly competitive entrance requirements (Box 5.6). Where well-qualified human resources are in short supply, mandarin systems may well be the preferred basis for a more selective approach to personnel development. Open recruitment systems, such as those in New Zealand and the United States, provide a more flexible, decentralized, and increasingly market-driven system of civil service recruitment. Open systems give more flexibility to managers to match job requirements with available skills, including hard-to-find technical expertise, although at the cost of making it

more difficult to maintain professional standards and esprit de corps.

#### *Adequate compensation*

As countries build prestige for their civil service through merit-based recruitment and promotion, government employment becomes more attractive. But if civil service compensation trails far behind that in the private sector, prestige alone will not make up the difference.

A rough benchmark for evaluating the adequacy of public sector compensation is the gap between public and private sector compensation, discounted somewhat to adjust for the fact that civil service employment is generally more secure. Precise comparisons are tricky, given differences in benefits and perquisites, job requirements, and the like. As a rule, however, civil servants nearly everywhere are paid less than their private sector counterparts. In the Philippines, for example, public pay averages 25

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#### **Box 5.6 Cultivating the best and the brightest: Mandarin versus open systems**

Most countries have adopted one of two broad approaches to meritocratic recruitment. The first, called the mandarin system, is a hierarchical system with entry limited to promising candidates at the outset of their careers. "Mandarin system" traditionally referred to an elite group of civil servants in certain East Asian bureaucracies; in its more modern sense it refers to a "corps-career" system that also includes lower and middle levels of the civil service. Recruitment is centralized and highly selective, generally on the basis of a rigorous entrance examination. The successful candidates are placed on a fast track into the best jobs in government. For the most part these recruits, who are mostly generalists by educational background, are hired into a career stream or corps rather than for specific jobs.

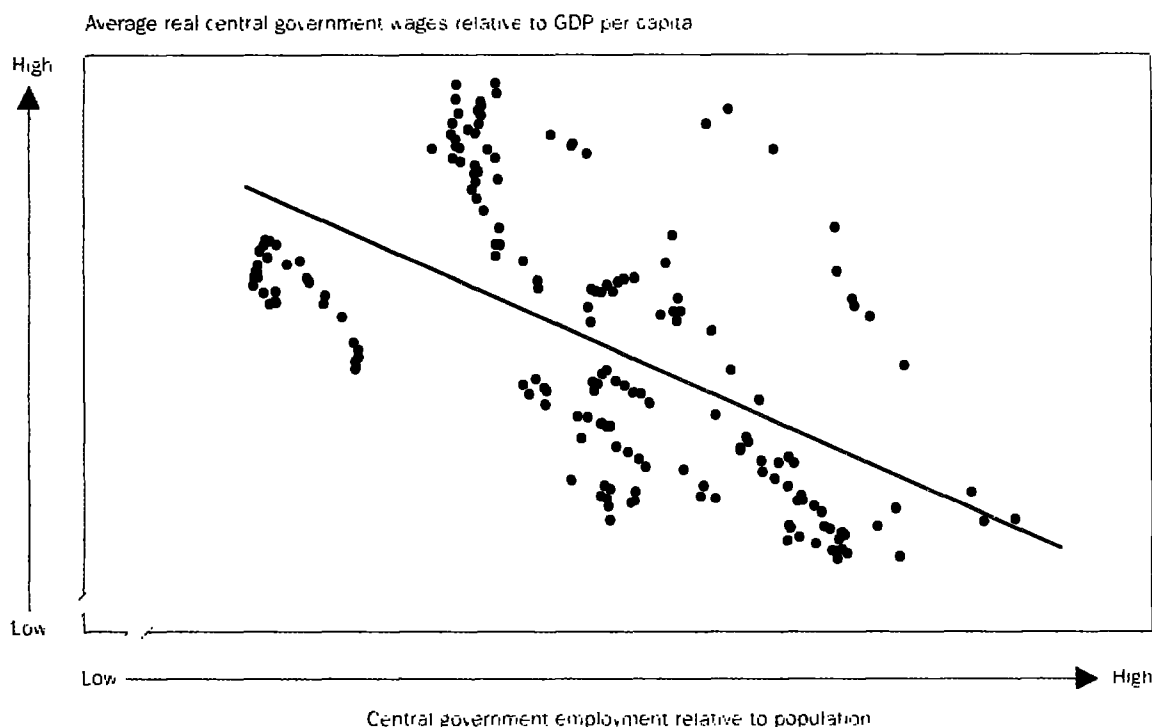
France and Japan best exemplify the mandarin system. At France's National School of Administration, future high-level cadres are put through a one-year professional internship followed by fifteen months of coursework. Japan's Tokyo University produces that country's administrative elite, most of whom have a legal or generalist education, possibly supplemented with in-service technical training. Variants on the system are found in Singapore, where two-year cadetships rotate promising recruits, and Germany, where a "practicum" system offers practical, on-the-job internships for outstanding candidates.

The second system, known as open recruitment, is a more flexible, decentralized, and increasingly market-

driven approach to civil service recruitment. The U.S. system, for example, in stark contrast to the mandarin model, permits entry at any point in the hierarchy, without age restrictions. Centralized competitive entrance examinations have been replaced with profession-specific exams, and managers have been granted more autonomy in hiring. The United States, like Australia, complements its horizontal recruitment system with a Senior Executive Service aimed at building an elite group from within the civil service.

The boldest approach to open recruitment and career development is found in countries pursuing the "new public management" reforms. These countries have significantly devolved recruitment responsibilities. In New Zealand, for example, agency managers can hire staff at market salaries.

Countries with critical shortages of well-qualified human resources may find mandarin systems useful for establishing a selective rather than a comprehensive approach to personnel development. Moreover, a prestigious corps can have spillover effects, motivating other parts of the civil service to perform well. Open recruitment, on the other hand, gives managers greater flexibility in finding candidates with needed skills including hard-to-find specialist expertise. And open systems discourage insularity in the civil service by bringing in, at all levels, staff with fresh perspectives and new ideas. The downside is that professional standards are less easy to maintain across the service, as is esprit de corps.

**Figure 5.7** In Africa, as public employment has risen, wages have fallen

Note: Data are panel data for twenty African countries for the period 1972–93. Both axes are scaled logarithmically. See the Technical Note for details. Source: World Bank staff calculations based on data in Kraay and Van Rijckeghem 1995 and World Bank data.

percent of private wages; in Somalia the figure is 11 percent. (At the other extreme, public sector salaries in Singapore average 114 percent of those in the private sector, and in fact senior Singaporean civil servants are better paid than their U.S. counterparts.) The gap is widening in some countries. In Kenya, for instance, the disparity between public and private wages grew by 3 percent a year during 1982–92. Contributing in many countries to the relative erosion of public sector wages were fiscal austerity measures during the 1980s that tended to lower real wages rather than employment.

In many African countries, public employment has not merely been maintained in the face of rising fiscal pressures—it has actually risen, especially at lower skill levels (Figure 5.7). Governments have become employers of last resort and dispensers of political patronage, offering jobs to family, friends, and supporters. As a result, individual wages have often been low even though the overall wage bill has been high. Moreover, growth in the wage bill has often outpaced expenditures on operations and maintenance, leading to the familiar stories of teachers without textbooks and extension workers without bicycles.

The contrast between the size of the wage bill and the relative level of wages shows through in another major problem, which will not be solved by across-the-board increases. This is the relatively low level of remuneration for senior officials. In many countries the wages of higher-level civil servants are allowed, often for political reasons, to erode by more than those of the lower echelons; this wage compression makes it even harder to attract and retain high-quality staff at the vital senior levels. A study of ten African countries found that, on average, the ratio of the salaries of the highest- to those of the lowest-grade civil servants had declined from thirteen to one to nine to one during the 1980s.

Prompted by a desire to raise public sector salaries, and by the need to correct aggregate fiscal imbalances, some countries have embarked on initiatives to reduce employment, decompress the wage structure, and raise average pay in the civil service. These efforts have met with mixed success. A study of civil service reform in fifteen countries in various regions between 1981 and 1991 found that wage bill reduction and salary decompression had been achieved in fewer than half the cases. Employment had

been reduced in more than half, but reversals were sometimes reported later, and the cuts were rarely adequate to finance substantial salary increases for higher-level staff. In Peru, for instance, some 250,000 workers were cut from the civil service over three years, but 163,000 of them were subsequently rehired; in addition, poor targeting of the cuts resulted in the departure of the most qualified staff.

This mixed and often disappointing experience with civil service reform nevertheless provides some lessons for future efforts. First, strategies have focused exclusively on pay and employment and, within those issues, on reducing numbers (the wage bill and employment). These are important, but so are other, complementary elements: merit-based recruitment and promotion, performance measurement and orientation, mechanisms to improve accountability, and *esprit de corps*.

A more careful sequencing of reforms is called for, starting with wage decompression. Even within constrained overall wage bills, wages at the top of the scale can be raised relative to lower levels, to attract more qualified people and concentrate scarce skills in strategic areas. In governments that are considerably overstaffed, reforms have been too modest to downsize them to sustainable levels. And they have tended to be one-shot reductions rather than a steady program to redimension government over the longer term.

Inevitably, pay and employment reforms will face political obstacles, although fears of political backlash have often been exaggerated. Some countries have viewed civil servants as partners in reform and have consulted extensively with them to find politically acceptable solutions. For instance, in the province of Santa Fe, Argentina, a close dialogue between the governor and the local civil service union helped the parties agree on measures for modernizing provincial public administration, including expenditure cuts of some 10 percent. In addition, the experience with civil service reform has helped develop a good set of technical tools—civil service censuses, functional reviews, better-designed severance packages—for managing and implementing reforms more effectively. But civil service reforms will generate losers, who can be important constituencies of the political leadership and therefore a force to be reckoned with. The political economy of reforms is discussed further in Chapter 9.

#### *Building esprit de corps*

Effective and capable bureaucracies share a commitment to their organization's objectives. This *esprit de corps* includes a common understanding about what is desirable and undesirable behavior, manifested in formal and informal norms and grounded in a set of objectives, and a devotion to upholding the honor of the group, based on this common understanding. An *esprit de corps* gives

members a sense of purpose and belonging and imposes self-discipline that guides members toward achieving the group's objectives. King Arthur's Knights of the Round Table, the samurai in Japan, and even the mafiosi of past generations all embodied some form of *esprit de corps*. A few of today's civil services are also said to do so, including those in Chile, France, Germany, Japan, Korea, and the United Kingdom. Most, however, do not.

It is not impossible to build an *esprit de corps* within the bureaucracy from scratch. Singapore's civil service is now well known for its coherence and sense of purpose, even though these characteristics barely existed in the early 1960s. Getting there was difficult, but the steps were straightforward enough. Each year prospective recruits are taken from the top 200 (less than 5 percent) of the graduating class at the National University of Singapore (and more recently the Nanyang Technological University) and put through a one-year training program. Their education and training give the recruits a common understanding of what is expected of them as civil servants and help build trust among them. The country's meritocratic promotion system gives officials a stake in achieving their agency's goals. The single-mindedness of Singapore's leadership and its continuous efforts to imbue the civil service with its desired values help strengthen the bond among civil servants. Some of Singapore's lessons are now being learned in Botswana, in twinning arrangements that emphasize the two key ingredients of teamwork and group performance.

Worker dedication and commitment are not confined to the industrial countries and East Asia. In Brazil's poor northeastern state of Ceará, steps to increase worker commitment dramatically improved the quality of public services delivered (Box 5.7). The state government promoted a sense of calling among workers and conferred new prestige on their jobs. These feelings were reinforced by innovative practices such as worker participation and self-managed worker teams, multitasking, and flexibly organized or specialized production. These practices involved greater worker discretion and flexibility, greater cooperation between labor and management, and greater trust between workers and customers. Such experiences also underscore the importance of nonmonetary rewards—recognition, appreciation, prestige, and awards—in motivating staff, over and above the adequacy of pay and meritocratic recruitment and promotion.

#### **Strategic options: Steps toward an effective public sector**

Some developing countries lack the most basic underpinnings of a professional, rule-based bureaucracy. Even reform-minded leaders cannot translate their goals into reality because the machinery linking policy statements to

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**Box 5.7 Building worker dedication: Good government in Brazil's Ceará State**

In 1987 the state government of Ceará in northeastern Brazil confronted a crippling fiscal crisis, superimposed on a legacy of mediocre administrative performance. Yet within four years the fiscal crisis had been overcome, and the quality of services had improved dramatically. Vaccination coverage for measles and polio more than tripled, from 25 percent to 90 percent of the child population. The state's public works program employed more than 1 million unemployed farmers during droughts. And its business extension and public procurement program for small firms was saving more than 30 percent over its previous overall expenditure.

Much of the credit for this success is owed to the civil service itself. The state government contributed in an unusual and sometimes inadvertent way to public workers' newfound dedication. Using rewards for good performance, public screening methods for new recruits, orientation programs, and sheer boasting through the media about its successes, the state created a strong sense of mission around key programs and their workers. Highly motivated workers carried out a

larger variety of tasks than usual, often voluntarily. Granted greater autonomy and discretion, workers were able to provide more customized service. This greater discretion did not result, as it often does elsewhere, in greater opportunities for rent seeking because of pressures to be accountable. Workers wanted to perform better in order to live up to the new trust placed in them by their clients. This in turn was the result of the more customized arrangements of their work and the public messages of respect from the state. At the same time, the communities where these public servants worked monitored them more closely. The state's publicity campaigns and similar messages had armed citizens with new information about their rights to better government and about how public services were supposed to work. Thus government played a powerful role in monitoring, but it did so indirectly.

These mechanisms created a virtuous cycle in which workers reported feeling more appreciated and recognized, not necessarily by superiors, but by their clients and the communities where they worked. This, in turn, reinforced their dedication to the job.

action has ceased to function. As a result, a vast gap has opened up between what the state says it will do and what it does—between the formal rules of public institutions and the real ones. The first step toward building a more effective public sector in such countries must be to close these gaps: to reestablish the credibility of the government's policies and the rules it claims to live by, making sure they operate in practice. This includes setting hard budget limits, implementing budgets and other policies as approved, making the flow of resources predictable, instituting accountability for the use of financial resources, and curbing rampant political patronage in personnel decisions.

Where these preconditions are absent, the new public management must be introduced cautiously. If informal norms have long deviated significantly from formal ones (with regard to personnel practices, for example), simply introducing new formal rules will not change much. Where countries have been unable to establish credible controls over inputs, giving managers greater flexibility will only encourage arbitrary actions and corruption. And where specialized skills are in short supply, performance contracts and other output-based contracts for complex services may absorb a large share of scarce bureaucratic capacity to specify and enforce them. Nevertheless, countries can begin by providing greater clarity of purpose and

task and by introducing performance measurement on a selective, sequential basis. When output measurement is strengthened and credible controls over inputs are instituted, managers can be granted more operational flexibility in exchange for greater accountability for results.

Instituting a professional, rule-based bureaucracy will take time. In the meantime some other measures can be implemented more quickly, some of which can generate early payoffs. Well-functioning policymaking mechanisms make transparent the costs of competing policies and encourage debate and consultation among all stakeholders. Using the market to deliver contestable services—too many of which are now the sole domain of government—can lower costs and improve service quality. Likewise, contracting out easily specified activities through competitive bids can reduce the burden on overstretched capacity and build partnerships with markets and NGOs to improve efficiency. And reformers need not rely only on internal controls: creating more points of access for feedback from firms and the people who use public services can do a lot to generate external pressures for better performance while internal capacity and enforcement mechanisms are still developing.

As previous chapters have stressed, getting the state out of the business of providing many of the goods and

services it now provides will still leave it plenty to do. Where it is no longer a direct provider, the state must become a partner and facilitator, regulating markets, enforcing contracts, and pursuing all the essential roles outlined in Chapters 3 and 4. That means attracting and keeping capable staff. Rule-based restraint on political patronage in recruitment and promotion, and more competition through meritocracy, will be necessary to build this capability. In countries where rapid employment expansion has taken place in the lower echelons, reforms to reduce employment are inevitable. But the relative attrac-

tiveness of salaries at the upper end can be raised, to attract capable staff, even within constrained wage bills, in part by reducing excess employment among the rank and file.

There is bound to be opposition to these and other reforms from those who stand to lose. But as discussed in Chapter 9, windows of opportunity for reform can open and widen. Reform-minded governments should seize these opportunities to build consensus, address the obstacles to change, and initiate and sustain reforms to build an effective public sector. The resulting reinvigoration of public institutions will generate large payoffs.