history of formal sector employment rely primarily on family and community-based support mechanisms in most societies. However, some more-formal programs providing transfers to the nonworking poor have had success. Bangladesh’s Vulnerable Groups Development program supplies grain to some half a million rural women and children, focusing on high-risk regions and relying on local leaders to identify the needy. A means-tested scheme for agricultural workers in India’s Kerala State provides a modest pension that supports the cost of home care for the elderly without supplanting strong informal support arrangements.

For formal sector workers and in richer societies, including many transitional countries, formal schemes of social assistance, disability payment, and pensions are often a major source of support for those who cannot work. Disability and pension systems in part take the form of insurance programs, linked to the labor contract by payments made by employers or workers. This linkage of benefits to contributions made by or on behalf of the individual is important; otherwise there are incentives to avoid payments, for example through going informal or casual. This can lead to insolvent schemes and redistributive transfers. Generous pension and disability plans can also provide incentives for individuals to withdraw from work earlier than they otherwise would. A recent World Bank study assessed the problems of linkage and distorted incentives with respect to pensions. It found that many schemes are unviable and that evasion is a major problem in countries such as Jamaica, Rwanda, Uruguay, and Turkey. Many countries in Eastern Europe and the former Soviet Union may be at the beginning of such crises. Another issue is targeting benefits to the truly needy. Means-tested benefits are often used in rich countries but impose heavy administrative burdens. More practical for most low- and middle-income countries are schemes that target an attribute closely associated with need, such as widowhood, single-parenthood, or the presence of a handicap or severe disability.

Most governments are heavily involved in providing income security, despite the risk of discouraging the expansion of formal employment. Many have had good results. Public works programs are often a powerful instrument for providing income security to unemployed informal sector and rural workers, and for complementing community-based arrangements and other basic safety nets for the poor. Low- and middle-income countries with limited administrative capacity do best with schemes based on severance pay for formal workers, preferably negotiated through collective bargaining, rather than unemployment insurance. Experience shows that these different types of schemes, as well as pension systems, are successful when they are largely self-financed, with a close correspondence between those who pay and those who benefit, and when they are designed to minimize incentives to leave the labor force or shift to informal or casual labor contracts.

### Chapter 14: The Government as an Employer

**Big government is out of fashion.** As countries around the world move toward open markets and less regulation, many are also reconsidering the role of the state in economic life. Although active government is necessary to support market-oriented, labor-demanding development, often this means less government, doing different things than in the past, and doing them better. The size of the government’s work force varies significantly across countries (Figure 14.1). But whereas every country has individual teachers, police officers, bureaucrats, and government clerks who are dedicated and efficient, the civil service as a whole is often regarded as poorly motivated and unproductive. Inspired by the East Asian economies, where efficient civil services have contributed to economic development, developing countries in Africa and Latin America as
The size of the civil service varies greatly across countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>Workers per 10,000 population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gabon</td>
<td>300</td>
</tr>
<tr>
<td>Argentina</td>
<td>200</td>
</tr>
<tr>
<td>Mauritius</td>
<td>100</td>
</tr>
<tr>
<td>Botswana</td>
<td>700</td>
</tr>
<tr>
<td>Peru</td>
<td>400</td>
</tr>
<tr>
<td>Bolivia</td>
<td>500</td>
</tr>
<tr>
<td>Egypt</td>
<td>600</td>
</tr>
<tr>
<td>Honduras</td>
<td>800</td>
</tr>
<tr>
<td>Indonesia</td>
<td>900</td>
</tr>
<tr>
<td>Kenya</td>
<td>1,000</td>
</tr>
<tr>
<td>India</td>
<td>1,200</td>
</tr>
<tr>
<td>Guyana</td>
<td>1,400</td>
</tr>
<tr>
<td>Nigeria</td>
<td>1,600</td>
</tr>
<tr>
<td>Mozambique</td>
<td>1,800</td>
</tr>
<tr>
<td>Myanmar</td>
<td>2,000</td>
</tr>
</tbody>
</table>

Figure 14.1 Employment in government and public administration. Countries are listed in order of descending GDP per capita at international prices. Data are for 1990 or 1991 except Nigeria (1984). Source: IMF and World Bank data.

well as the former centrally planned economies are seeking to improve the quality of their public sectors to make them more accountable, transparent, and responsive to the needs of society.

How can public services be improved? To answer that question, this chapter studies government pay and employment policies and incentive structures. It then discusses the kinds of reform that can improve the efficiency and responsiveness of public sector workers, and why economic and political barriers can make it hard to implement them.

Why do public agencies perform poorly?

Poor provision of essential public goods and services is widespread. Why are public employees, especially those in low- and middle-income countries, often so unproductive? Most of the answers lie in the connection between the special character of public service, which makes monitoring hard and output difficult to measure, and the history of ill-chosen and shortsighted personnel policies adopted by governments. Demoralized school teachers do not provide quality education. Doctors often have to supplement inadequate public salaries and so are unavailable for poor patients. And some bureaucrats are more interested in receiving commissions on procurement contracts than in ensuring the efficient execution of vital infrastructure projects.

Measuring the quality and quantity of public service provision is difficult, as is evaluating workers on the basis of their personal achievements. In such areas as health and education, public service providers are encumbered by multiple objectives—ensuring equity, addressing poverty—that their private counterparts may not face. And, as in other "street-level" bureaucracies—the police force, courts, agricultural extension agents, and irrigation—direct, continuous supervision is impossible because these workers interact with the public on a daily, one-to-one basis. Therefore it is hard to measure and reward each worker's contribution. The problem is compounded by the fact that public workers have enormous opportunities for rent-seeking behavior and shirking of responsibilities (Box 14.1).

Poor government wage and employment policies exacerbated these problems during the economic crises of the 1970s and 1980s. Many governments used their limited resources to hire more people rather than ensure adequate pay and other resources for those already on the public payroll. Often the basic pay systems collapsed, and public sector workers were forced to live on nontransparent sources of remuneration, from benefits in kind and perks to moonlighting and corruption. In some cases, foreign donors supporting particular project staff have compounded the problem by bypassing civil service rules and offering special remuneration packages. Low pay reduced the loyalty and dedication of many civil servants and lowered the incentive for talented and honest workers to apply for, or remain in, public sector jobs. Low pay also led many public workers to try to exploit their positions for financial gain, while overstaffing made it even harder to monitor effort. Lack of complementary inputs and supplies provided an excuse for poor performance. The problems of many countries' public sectors were summarized in a 1982 report by a Ugandan government commission: "The civil servant had either to survive by lowering his standard of ethics, performance, and dutifulness or remain upright and perish. He chose to survive."

Low public sector wages are a relatively new phenomenon. Government workers in many countries once earned more than their urban private sector counterparts. In Tanzania in 1971 a government worker earned about 14 percent more than a private sector employee with the same schooling and work experience, while in Kenya in 1970 the estimated differential ranged from 11 to 16 percent. The fall in the real pay of civil servants was caused by the fiscal crises that affected most low- and middle-income countries in the late 1970s and the 1980s. Faced with mounting constraints on resources, governments should have lowered or
Box 14.1 How does the principal-agent problem apply to public employment?

Why are public employees more likely to shirk or be inefficient than employees in the private sector? One set of explanations falls under the general heading of the "principal-agent problem." When any economic actor (the principal) employs others (agents) to carry out tasks on his or her behalf, the principal faces the challenge of ensuring that the agents work in a way that fulfills not just their own personal objectives but that of the principal as well. Private organizations tackle the principal-agent problem using four broad methods—identification, authority, peer pressure, and rewards—but many governments find it difficult to adopt and adapt these methods.

The identification method, important for organizations in Japan and other East Asian countries, relies on convincing individuals to take the goals of the firm as their own—to identify with the firm. But for identification to work with civil servants, a level of social cohesiveness and belief in the value of public service is required. The authority method relies on employees agreeing to do as they are ordered. Since this only works when the results to be achieved are very specific, and when management is indifferent about the method used to achieve them, this method is inapplicable for most government activities. Peer pressure relies on transferring responsibility for monitoring from the management to workers in groups, by making payment to each member of a group partly a function of the whole group's performance. Finally, the reward method, widely used in Western economies, relies on management inducing workers to advance the organization's objectives through personal incentives such as raises, bonuses, and promotions.

The peer pressure method, and to some extent the reward method, both require that the principal be able to evaluate group performance and identify individual contributions. This is a daunting task even in a private firm. For the civil service the problem is magnified by the difficulty of measuring productivity—ensuring that individual judges are supplying adequate justice, or that policemen are providing good security, poses unique problems.

The examples of successful civil services in East Asia and many industrial countries have shown that the principal-agent problem is not insurmountable. Most successful public sectors have relied on a mixture of the identification and reward methods. Where a public sector ethos has collapsed, however, it will often be difficult to restore identification in the short run, although this will probably be part of the long-run solution. Tackling problems of rewards will be necessary for both short- and medium-term gains.

Frozen public employment. Many did the opposite. Worried that rising urban unemployment would create serious economic and political problems, they responded to economic slowdowns by trying to absorb larger numbers into the public sector. Somalia's per capita GDP fell between 1975 and 1990, but the number of Somali civil servants rose from 20,000 to 44,000 during the same period. Although Ghana's government revenue fell from 15 percent of GDP in 1970 to 6 percent in 1983, public employment more than doubled. The problem was made worse in several countries by guarantees of public sector employment for university graduates, those discharged from military service, or graduates of certain training institutions.

This combination of falling government revenues and increasing government employment meant that real earnings had to fall. Declines in the real salaries of government workers became a widespread phenomenon in countries with macroeconomic difficulties (Figure 14.2). In Zambia the salary of an undersecretary in 1986 commanded just 22 percent of its 1976 purchasing power. In El Salvador during the 1980s, real salaries of civil servants declined by 48 to 89 percent, depending on rank. Although some reduction in government pay was warranted to bring salaries in line with the market and to reflect macroeconomic adjustments, such enormous declines undoubtedly reduced the quality of public services.

The quality of public services deteriorated further because of salary compression, as the salaries of professional and skilled staff were allowed to fall more quickly in real terms than the earnings of those in lower grades. Tanzania provides an example. In 1969 the top public sector salary was thirty times the lowest government wage. By the mid-1980s this ratio had collapsed to six to one. Similarly, a Zambian assistant director received seventeen times what the lowest-paid public employee earned in 1971, but only 3.7 times as much in 1986. This was not the result of any market evaluation of experience or education. Rather it was a reflection of policymakers' sense of fairness and of political realities that made higher salaries easier to cut. Drastic changes in relative pay had significant consequences for the hiring, retention, and performance of senior civil servants and the most highly skilled employees, and hence for the productivity of those under their supervision.

Reductions in expenditures on materials and supplies led to a further deterioration in the quality of public services. Civil servants were not provided with the tools they needed to carry out their work. Many public hospitals in low- and middle-income countries have excellent physi-
Civil service pay has fallen sharply in Egypt and Ghana. 

Poor working conditions in the public sector have led the best and the brightest members of the labor force in many countries—in Africa, Eastern Europe, and South Asia—to look for jobs in the private sector, or even to leave their countries. Most recently, civil service employment has declined—by 36 percent in Jamaica between 1982 and 1988 and by as much as 23 percent in Guinea between 1985 and 1989. But the quality of civil servants may be declining as well. A root cause is the inability of public employment structures to adequately reward the most highly skilled workers. Reductions in employment also often fail to protect the most able, relying instead on across-the-board cuts.

Improving the quality and accountability of public workers

Improving the performance of government workers, although difficult, is not impossible, as the well-functioning bureaucracies of some East Asian and industrial countries prove. Some of the issues and the different approaches used to tackle them can be illustrated by considering government irrigation workers in India and the Republic of Korea.

Being an irrigation patroller is a full-time job in India. Selected by the engineer in charge of the project, the patroller supervises canal gates far from his own village and knows that, although he will be transferred to another posting within six years, he cannot be fired easily. Suspicious that the patroller is not performing his duties, his supervisor takes every occasion to berate him and the five other patrollers under his supervision.

The Korean patroller is a farmer from one of the villages served by the canal. He supervises the canal gates part-time for six months during the year. Selected by his village chief, the patroller knows that his daily wage depends on his being renominated by the chief. He has one supervisor, who is from the same locality but works in another part of the Farmland Improvement Organization. The supervisor drops by unannounced once or twice a week for lunch, to see whether the patroller is having any problems.

Irrigation patrollers are crucial for the functioning of canal irrigation systems in both countries. Patrolling canal banks, they open and shut water gates, diverting the flow of
water to the areas that most need it. The nature of the job makes it practically impossible to monitor performance in any direct, objective way. But shirking or corruption on the patroller's part can have serious consequences for the local harvest. The Korean and Indian approaches to monitoring effort have very different results. The Korean civil servant operates under a number of checks and balances, lacking in the case of his Indian counterpart, that control any desire to shirk responsibilities. As part of the local farming network, the Korean patroller is directly accountable to his chief and to his peers—if he slips up, his own family and friends will suffer, and he will lose his job. He is further discouraged from shirking by the random pattern of monitoring and by his desire to meet his colleague's expectations. The Indian worker, on the other hand, has no real disincentive to shirk his duties. Not a farmer himself, he works for a community that is not his own, and he can only be fired for major transgressions. Moreover, his adversarial relationship with his supervisor encourages him to malingering.

The quantity and pay of civil servants are not, therefore, the only variables that affect the quality of public services. Governments also need to ensure that they select the right people, reward them for hard work, and hold them fully accountable for their actions, and that the quality of civil servants' work is subjected, whenever possible, to the discipline of the marketplace.

One way of ensuring that the civil service attracts the best employees is to combine good salaries with an objective, merit-based selection procedure, such as a system of entrance examinations and interviews. India does well in this regard. University graduates are recruited into officer ranks by national and state public service commissions, which interview candidates and design examinations for different government departments. Although the large number of applicants means that some interviews take less than five minutes, the examination and the interview add a merit-based element to recruitment.

Public sector workers also need to be rewarded for their achievements and held accountable for their failures. One powerful way of motivating public sector workers involves linking promotion to performance—this runs directly counter to the tradition of civil service promotions being unrelated to merit. The Indian civil service is typical. Promotion within the officer cadre is based solely on seniority. Officers are recruited in groups, and within each group seniority is determined by the ranking assigned by the public service commission on the basis of the initial examination and interview. This seniority ranking is carried by officers for the rest of their careers, and it is rare for an officer to be promoted out of order.

Bureaucracies in the successful East Asian countries have introduced merit as a basis for determining promotion, linking incentives for individual performance with encouragement for teamwork. Promotion of officers in the Korean civil service is based on a formula that assigns weight to both length of service and individual merit. The judgment of merit is partly subjective and partly objective and includes test scores from training courses, performance assessments by supervisors, and records of awards for outstanding job performance or other public service. In addition, assemblies, group meetings, sports, and competitions among units are used to strengthen teamwork. Such actions reinforce the sense of each administrative unit as a group.

Promotion systems based on merit have traditionally been difficult to organize in the public sector, because managers cannot objectively measure the performance of individuals or groups who provide public services for which no standard of market value exists. One solution is to decentralize some public activities and encourage the private sector to provide public goods. Not all public goods can be supplied in this way, but it is often important to subject civil servants to some form of market discipline. Reforms of the Chilean education system provide an example. Ownership of public schools was first transferred to the municipalities, which were given full responsibility for managing them and paying the teachers. This decentralization made the civil servants more directly accountable to the populations they served. Next, central government support to public schools and subsidized private schools was reformed, with amounts based on the number of students enrolled. By setting the payment per student 10 percent higher than before the reform, the government ensured that private schools were able to provide free education and that the public schools had to compete for central government financing. School administrators and teachers, who remained public employees, could now be easily monitored, and the improved schools attracted more students and more government funds. However, this reform program was imposed by a military government against a backdrop of repressive labor policies, so its implementation involved a high social cost.

Politics and public employment reforms
The need for public employment reform is recognized in many countries. Yet governments are often reluctant to undertake serious changes. Governments oppose reforms that include laying off redundant public employees and decompressing wages, on the grounds that they are not politically feasible, since lower level workers are usually the main losers. Some governments also argue that, because urban unskilled public workers constitute an essential part of the regime's support, penalizing them would have great political cost. There are several examples of strong political opposition to civil service reforms. Efforts to downsize the Brazilian civil service, for example, have met with formidable opposition and have been constrained by constitutionally guaranteed employee rights. Jamaica's powerful civil
service union successfully opposed significant pay restructuring that would have rewarded the upper tiers at the expense of lower ones.

In many cases, however, the political risks incurred by regimes undertaking public pay and employment reforms have been overstated. Argentina, Ghana, and Guinea have lowered public employment by 16 to 23 percent without much political opposition, regime destabilization, or social upheaval. Why is there often surprisingly little opposition to reform? One reason is that wages and benefits in public employment have already fallen dramatically in countries that are in particular need of reform. The less the job is worth, the less the opposition to retrenchment—the costs of adjustment have, by and large, already been borne. Thus even modest severance pay may be adequate to compensate for large-scale retrenchments. In addition, evidence indicates that the usual targets of civil service reforms are the large number of unskilled workers occupying the lower ranks of the civil service, who are relatively powerless. In most countries public workers are insufficiently organized to mount a viable protest to proposed cuts.

Some governments avoid reforming the civil service for fear of disrupting their system of patronage, which is sometimes necessary for their political survival. The organization and functioning of bureaucracies are usually closely related to the generation and distribution of the economic privileges required for politicians to stay in power. Governments often rely on the resources they command in the civil service to fragment opposition and build patron-client linkages of support. Civil service reforms are perceived by these governments as a serious threat.

Many governments are realizing that increasing exposure to international competition requires well-functioning, flexible bureaucracies. To be an effective employer and ensure public services of high quality, governments need to reform their pay, recruitment, and promotion policies and make more extensive use of the private sector in delivering services. However, implementing these reforms, which often imply downsizing the public workforce, is difficult because political and economic needs often conflict. Success requires a high degree of political commitment.