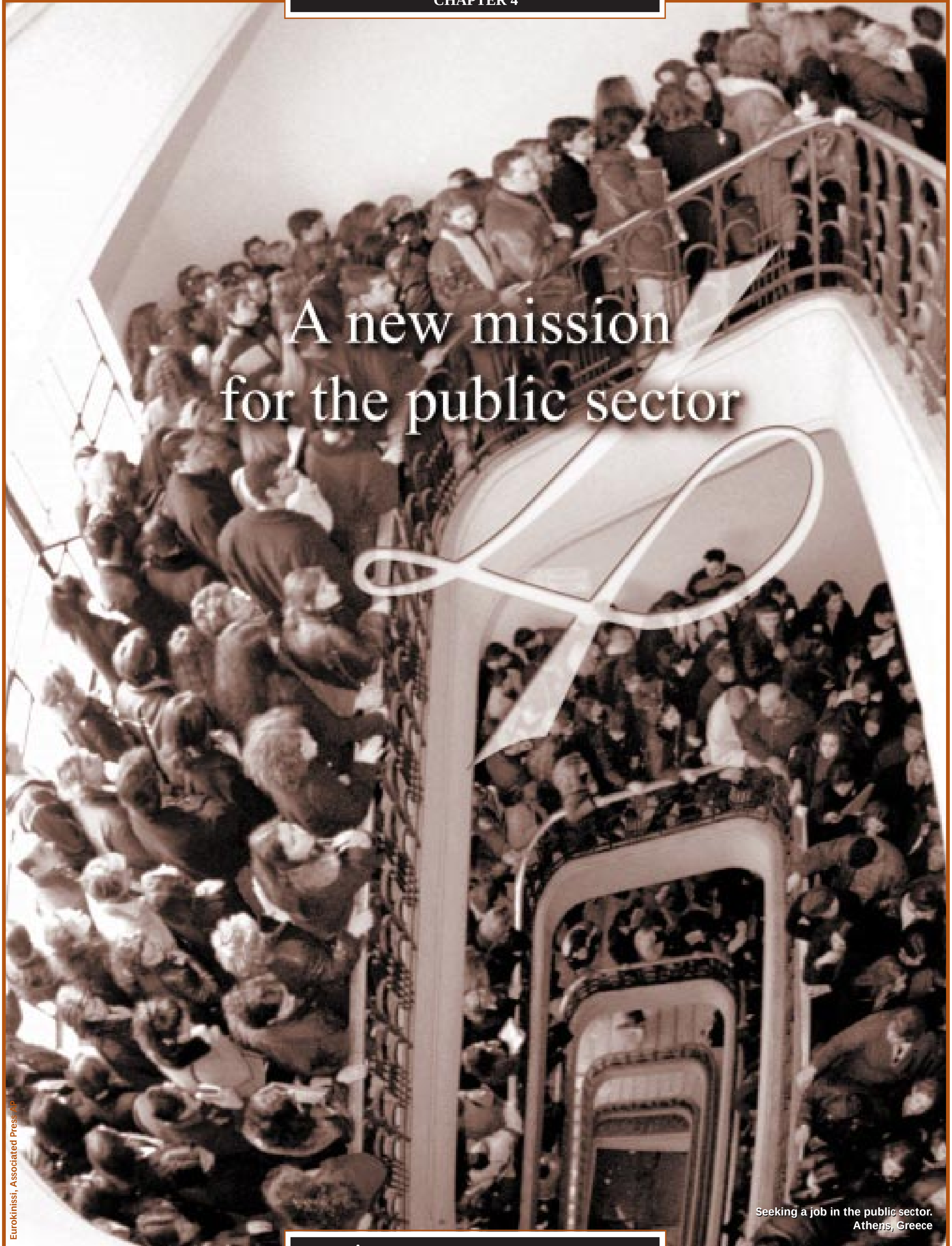
A new mission for the public sector



Seeking a job in the public sector.
Athens, Greece

Eurokinissi, Associated Press/AP

Many efforts were made in the 1990s to reform the public sector. In developing countries, inappropriate schemes often served to weaken the capacity for effective governance. But the tide may now be turning—with a more realistic appreciation of what states can and should achieve.

Between 1945 and 1980, the public sector expanded at an unprecedented pace. Most people wanted the state to play a central part in national development. The OECD countries wanted government to redistribute wealth, protect the vulnerable and stimulate economic demand. The developing countries wanted states that crystallized national identity and built modern economies. Meanwhile, the Soviet Union and the countries of Eastern and Central Europe had already built states that controlled virtually every aspect of their citizens' lives.

During the 1980s and 1990s, however, some states disintegrated and many were affected by free-market reforms. In a globalizing world, public sector reform became a central preoccupation of citizens and governments. The previous chapter looked at governance from the vantage point of democracy. This chapter looks more closely at public sector management—at the state's ability to deliver the public services needed in the twenty-first century.

Pressures for reform

Over the past two decades, states have come under pressure from many different directions. But four main issues seem to have predominated.

- *Rising deficits*—Governments all over the world had been sinking deeper into the red. In the 1960s the OECD countries managed to keep their budgets more or less in balance, but by the 1970s their annual budget deficits were rising to 4 per cent, and by the 1980s to 6 per cent or more. The situation was even worse in developing countries. In Asia, countries managed to keep their deficits down to 3 per cent, but by the 1980s many countries in Latin America and Africa were facing deficits above 10 per cent. This caused increasing alarm. Many people accused the deficits of stifling economic development, and they demanded cuts in government expenditure.
- *Financial globalization*—More governments now finance their activities not by borrowing directly from a specific bank or institution, but by issuing bonds. This can trigger an international chain of events. Thus the city authority in Jakarta might finance public works by issuing a bond, which is then funded in Amsterdam, serviced in London and ultimately held by a pension fund in New York. This extended intermediation may smooth the process of fund raising, but it also weakens the links between borrowers and lenders. Lenders who have less direct contact with borrowers will require more general forms of reassurance, which they can only get if they feel that the borrowing institutions are operating in a sound and transparent fashion. The growth of international finance thus tends to foster a standardized, and fairly small, public sector that is well integrated into the global economy.
- *Economic ideology*—In the 1980s, many economists became increasingly critical of the public sector, which they accused of sustaining inefficient and unaccountable monopolies—whether in industry or in service delivery. This was the stance of the Bretton Woods institutions; and since they held the purse strings, they were in a powerful position to impose these ideas on debtor countries. The international financial institutions advocated privatization, decentralization and market delivery of public services. They also argued that governments should reorganize their civil services and demanded that they control their expenditure

and reform their tax systems in order to achieve balanced budgets.

- *Democratization*—In today's more democratic atmosphere, citizens have been demanding more and better public services. Yet at the same time, the revenue base of many states is shrinking. This leads to a search for more efficient ways of using public funds. It also generates struggles between potential winners and losers. The disruptive demands of more open societies have created a more fluid and uncertain environment for public policy.

Fiscal stability

The most pervasive and far-reaching reforms in both industrialized and developing countries are those that aim for fiscal stability. Governments have made some changes on the revenue side. But most have concentrated their budget-balancing energies on cutting public expenditure, which is typically expressed as a proportion of GDP. During the 1960s, in most countries this proportion was maintained at around 20 per cent. But by the 1980s the figures had risen rapidly. Most developing regions were averaging around 25 per cent, while the industrialized countries were averaging considerably more.

Public expenditure targets

There were also differences in the pattern of expenditure. By and large, the developing countries were devoting their funds to capital expenditure (30 per cent), public sector wages (25 per cent) and government administration (20 per cent), and spending relatively little on education (11 per cent) or health (5 per cent). The industrialized countries, on the other hand, were devoting more of their expenditure to social security transfers and social services (45 per cent)—with a particular emphasis on health.

So when it came to cutting expenditure, industrialized countries attempted to reduce expenditure on welfare. They tried various approaches, sometimes reducing benefits, and sometimes making an effort to limit the number of potential claimants—through reforming their labour markets, for example, so as to maximize employment, if at lower wages. Even so, the industrialized countries did not succeed in cutting expenditure by much. Indeed, in the 1980s they seemed to be spending more—public expenditure rose from 45 to 47 per cent of GDP. Governments faced stiff resistance to cuts in the public services on which their citizens had come to rely. While they did not manage to cut the totals, however, they did change the distribution—devoting more to welfare payments, while trying to restrain expenditure on health.

Developing countries were more successful at cutting expenditure, as indicated in table 4.1. They also reduced fiscal deficits. Latin America did so first—achieving stability by the early 1990s. Other regions brought deficits under control during the mid-1990s, chiefly by reducing expenditures. One reason why they had more "success" is that they did not face such powerful popular resistance—those who

Table 4.1 – Public expenditure as a percentage of GDP

	1980	1990	1997
Sub-Saharan Africa[a]	25.5	26.3	22.3
North Africa	39.0	29.4	30.4
Latin America	n.a.	24.5	23.6
South and East Asia	29.4	37.3	26.2[b]

Notes: [a] Excludes South Africa; [b] Data are for 1996
Sources: World Bank, 1998f; ECLAC, 1997; ADB, 1998

suffered most had few options for expressing their dissatisfaction. Governments also had their resolve stiffened by the IMF and the World Bank. When giving structural adjustment loans, the Bretton Woods institutions applied a fairly consistent set of conditions. Table 4.2 summarizes these and indicates the priority given by the World Bank to expenditure reforms.

One of the main instruments of these reforms in developing countries has been the public expenditure review. This is generally prepared for loan recipients by World Bank staff or foreign consultants. More than 200 reviews were carried out between 1987 and 1998. Another important technique has been "cash budgeting"—which means that finance and line ministries are permitted to spend only what they have in the bank: they are not allowed overdrafts. In Zambia, for example, a monitoring committee meets daily to ensure that this discipline is being followed.

Such techniques have certainly cut deficits: in Zambia during the first year of cash budgeting, a deficit of 69 billion kwacha was turned into a surplus of 24 billion kwacha. But here, as elsewhere, such techniques may be unsustainable. At times they have caused wild fluctuations in expenditure, provoking political crises. In 1993–94, for example, the Zambian government had to violate these principles—intervening to lend money to traders in order to stave off a food crisis.

Budgetary discipline can also distort patterns of expenditure and make it difficult to achieve consistent planning. In Zambia, the expenditure overruns of the office of the presidency in 1994 were roughly the same as the 12 per cent shortfalls experienced by the Ministry of Health. Similarly, in Uganda, expenditure overruns by the president's office were almost equal to the combined shortfalls of the Ministries of Agriculture (51 per cent) and Education (29 per cent).

Table 4.2 – World Bank loan conditions, 1980–94

Condition	Number of countries where imposed
Expenditure reforms	126
Social-sector restructuring	60
Privatization and marketization	43
Streamlined budgetary processes and accounts	42
Civil service reform	42
Poverty alleviation	10
Participation	1
Others	26

Source: World Bank, 1997b

Expenditure cuts in the social sector

One of the main targets for cuts has been the social sector. For a group of 21 countries in Africa, social expenditure between 1980 and 1990 fell from 4.6 to 2.7 per cent of GDP. The World Bank also cut some of its social spending. A comparison of 1972–82 and 1982–88 shows that its education expenditure (in 1990 dollars) fell from $0.5 per person to $0.3. Following widespread criticism, the Bank subsequently rethought its policies. Now it requires borrowing countries not only to reduce expenditures, but also to restructure them, with more emphasis on basic education and primary health care. This appears to have had some effect. The IMF has concluded that 32 low-income countries receiving structural adjustment loans have been devoting more resources to health and education: between 1985 and 1996, they increased their real per capita expenditure on these services by an average of 2.8 per cent per year—though even this is a small increase when set against overall

needs. Given the new policy focus by the World Bank and the IMF on basic education and health provisioning, these gains may also have been achieved by shifting funds from tertiary education.

The social effects of privatization

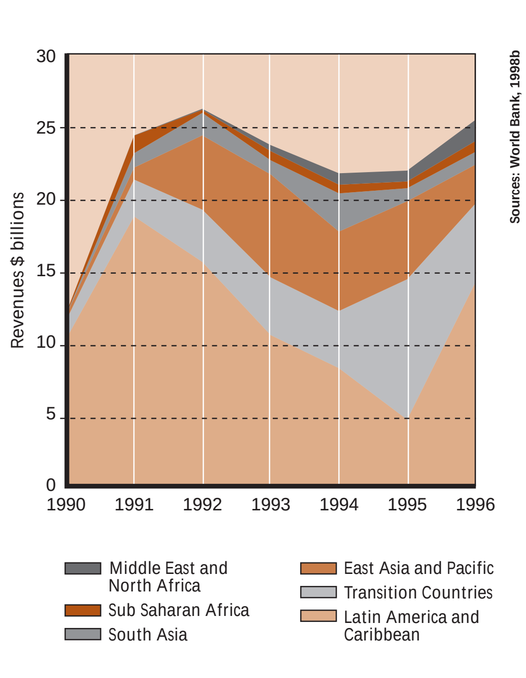
One of the priorities for governments carrying out structural adjustment has been to privatize public enterprises—partly as a way of raising funds and partly to reduce subsidies paid to loss-making enterprises. Between 1990 and 1996, developing and transition countries divested $155 billon of their assets to the private sector (figure 4.1). Governments in Latin America led the way—accounting for more than half of these sales, which they used largely to finance their deficits. Sales in Africa were much slower. The transition countries were more active but did not raise much revenue, since governments effectively gave away many enterprises via voucher schemes or sold them at low prices to a privileged elite.

There is a sound case for privatizing many manufacturing enterprises, which will generally perform better in the private sector. But the case is less strong for public sector utilities. These are frequently monopolies that, after privatization, may be tempted to raise prices, with disastrous consequences for the poor. In principle, this danger can be minimized through a strong regulatory system. But even industrialized countries have had problems regulating private utilities, and developing countries find it even more difficult. In Argentina, for example, the regulators have proved less powerful than the utility companies and have effectively been colonized by the interests they were designed to control.

Another damaging social outcome of privatization is unemployment. Public enterprises in developing countries usually account for a high proportion of formal sector employment—22 per cent in Africa. Prior to sale, governments frequently lay off workers as a way of making the company more attractive to buyers, and afterward the privatized companies continue the process as a way of cutting costs. To stave off potential backlashes, many Latin American governments have required guarantees of continued employment—most of which seem to have been honoured. The more militant workers have also been able to protect employment to some extent. But this has not been easy. Despite the fact that trade unions in Ghana strongly opposed workforce reduction, employment in the country's 42 largest state enterprises was cut by almost two thirds between 1984 and 1991.

Welfare implications of a shrinking public sector are even greater in the transition economies, since enterprises there provided not just employment, but also extensive welfare services—from health care to pensions. The disappearance of public enterprises has not only cost jobs, but also removed much of the social infrastructure in these countries.

Figure 4.1 – Privatization revenues



Carlos Eduardo, Associated Press AP

Street theatre at a demonstration against privatization of Brazil's telecommunications system. Brasilia, Brazil

Privatization has also altered the social landscape because the process has frequently been distorted in favour of powerful groups. In transition countries, privatization has often benefited managers and workers in the most viable enterprises. After privatization in Russia, one sample of 314 firms suggested that almost two thirds of the shares were in the hands of "insiders". In developing countries, privatization can benefit individuals from more powerful ethnic groups. In Malaysia, for example, there were concerns that Chinese business groups would take most advantage of sales, so the government allocated a 30 per cent quota to the indigenous Malays. More recently, white South Africans have been taking advantage of privatizations to buy up assets in Mozambique and Zambia—acquisitions that may eventually cause a racial backlash.

Managerial efficiency

In addition to privatizing many public sector activities, governments have also attempted to improve managerial performance. In doing so, they have frequently been guided by the "public choice" theories in vogue in the international community. These approaches analyse political and bureaucratic processes by applying principles of economics. Public choice theorists argue, for example, that civil servants have few incentives to improve performance or reduce costs, and that the only way to get them to perform better is through reforms that introduce techniques and disciplines from the private sector.

Most reforms aim to break up bureaucratic activities into more manageable parts, which may be insulated from political control in the hope of achieving optimal services. They are part of the technocratic revolution discussed in chapter 3, and have a number of common elements.

- *Agencies*—Central ministries continue to set policy, but divest responsibility for carrying out these decisions to autonomous agencies. Agencies generally operate in a corporate fashion,

with a chief executive and a board of directors.

- *Contracts*—Agencies deal with ministries and each other on a contractual rather than an administrative basis. The new management systems also include performance contracts between governments and service providers, requiring that the latter achieve specific targets.
- *Quasi-markets*—This involves creating a buying-and-selling relationship in what had previously been one department. Thus, within a health service, doctors and local health bodies can be allocated a budget to buy services for their patients from hospitals.
- *Contracting out*—This is regarded as the most advanced stage of reform. Governments may, for example, hire companies or NGOs to manage hospitals or water systems, or even prisons.

These ideas took hold in the industrialized countries in the 1980s with the advent of neoliberal governments in the United States and the United Kingdom, and they seem to have been pursued with greatest vigour in New Zealand. They have been slower to arrive in developing countries, but are likely to become much more prevalent now that they are being advocated by the World Bank and have become the standard prescription of international management consultants.

In the early years, these ideas of decentralized management were confined to one or two sectors. One of the first targets has typically been the tax-collection office. Many countries have now separated this office from the national civil service. The staff have different rules of employment and are paid according to performance (box 4.1).

But donors are requiring far broader reforms. Tanzania began following this path in the 1990s: it has reduced the number of ministerial departments by around one quarter and now has 47 agencies. Uganda has been going through a similar process: it has removed around half the functions of many ministries and created more than 100 new agencies. By the end of the exercise, 54,000 Ugandan civil servants will have lost their jobs.

Box 4.1 – Tax reforms in Peru

By 1990, a bout of hyperinflation and serious macroeconomic mismanagement had reduced Peru's tax revenues to 4.9 per cent of GNP. The tax office, with 3,000 staff, was riddled with corruption.

Under strong external pressure, the new government introduced a radical reform and created a new tax authority, SUNAT, independent of the Ministry of Economy and Finance and accountable only to the presidency. Two thirds of the previous staff were dismissed and replaced by recent graduates on short-term contracts, who were evaluated every six months. SUNAT also introduced a new, simplified tax system and a strictly level playing field for the treatment of taxpayers. This produced swift results; and by 1993, the tax ratio had risen to 13 per cent of GDP. SUNAT became an elite corps of the civil service.

Since then, however, some of the old problems have returned. As the macroeconomic situation improved, some of the pressure was reduced; and SUNAT started to acquire traditional features of public administration—with evidence of favouritism to certain taxpayers. The government repeatedly changed the head of SUNAT, which weakened managerial cohesion. In 1997, plans for a wider reform of public administration were abandoned.

In Latin America, the reforms have been more piecemeal. Brazil has tried to create a range of agencies, but the results have been meagre. By 1999, there was still only one executive agency—the National Institute of Measurements and Technical Norms. Reforms have met stiff opposition from well-organized public sector unions, not only in Brazil but in many other Latin American countries as well.

The results of reform

Do these reforms work? Most evaluations have taken place in industrialized countries. In New Zealand, for example, the reforms are considered a success—having reduced costs and improved public sector performance and efficiency. In the United Kingdom, the conclusions are more mixed. Though some agencies have performed well, others have been severely criticized: thus the child support agency, which gathers payments from separated fathers, has been roundly criticized, and more recently the passport agency has been through a major crisis. The "internal market" in the National Health Service has now largely been abandoned.

These experiences may be contrasted with those of the Netherlands. Here, too, the government embarked on a process of "agencification" but changed tack when it became concerned about the lack of democratic control over agencies. Public sector reforms subsequently went ahead, but they were based less on market principles and more on proper supervision of agencies, democratic accountability and social pacts with trade unions. Reforms in labour markets combine flexibility with generous welfare protection for workers if things go wrong. As a result, the Netherlands has gained many of the benefits of a more efficient public sector, including good rates of economic growth and low inflation, without heightening social divisions. It currently has the second lowest unemployment rate in the industrialized world.

Experience in developing countries has been more limited. Efficient agencies and decentralized management can only succeed if there is close monitoring based on sound budgeting and regular flows of accurate information. In most developing countries these capacities are weak, and governments frequently fail to establish clear objectives. Managers may then be able to manipulate information on performance indicators. In these circumstances, decentralizing the systems may foster arbitrariness or corruption. Gross abuses have been detected in Ghana; and in Zimbabwe, the performance management system had to be discontinued because ministers feared that civil servants would use it to create personal empires and ethnic enclaves. Nigeria's reforms in the late 1980s gave far greater powers to heads of ministries but did not create adequate systems to monitor their performance.

Public accountability

Accountability is a central problem with the use of agencies. In theory, this is provided by market discipline: bad providers will be punished by users, who will spend their funds elsewhere. In practice, these new "markets" frequently fail—allowing powerful interest groups and managers to take advantage of their positions and offer low-quality services.

In the industrialized countries, this has led to calls for additional forms of accountability. The UK government, for example, created a Citizens' Charter, which seeks to ensure that service users have full information on the performance of service providers and have adequate means of redress. This is now being adopted in other countries. The system of ombudsmen that started in Scandinavia also offers ways of receiving public complaints and forwarding them to governments. Another approach is the service delivery survey, which is being carried out in a number of developing countries by the NGO CIET-International.

The most advanced application of this technique is in Indian cities, where citizens' views are sought on a wide range of services, from the telephones to the police.

Capacity building

Reforms in most developing countries soon run into capacity problems. Even when governments and bureaucracies are committed to reforms, they often lack the skills or experience to carry them through.

If anything, these skills are disappearing. The next generation of senior officials should now be passing through the universities and institutes of public administration. But in the poorest countries, most systems of tertiary education are in crisis. Buildings are decaying, equipment is non-existent and teachers are joining the private sector, taking on extra jobs or migrating abroad.

It is ironic that the World Bank, which is a champion of decentralized public sector management, has done much to undermine the very institutions needed to make it work. Structural adjustment has eroded education systems generally, but it has been particularly hard on tertiary education. This has been evident in Africa, where World Bank lending for universities fell steeply. In the period 1969–79, it was $0.38 per capita; by 1980–87, it was down to $0.10.

Not surprisingly, many governments have had to rely heavily on expatriate staff. This is partly because of the unpopularity of structural adjustment programmes, but it is also because there have not been sufficient numbers of skilled local people. In the 1980s, Africa had around 100,000 resident foreign advisers—who cost roughly 35 per cent of foreign assistance to the region.

Since the 1990s, the World Bank, UNDP and other donors have been trying to address the problem—putting greater emphasis on capacity building and local "ownership" of projects. There has also been much talk of rebuilding African universities and research institutes.

Kent Gilbert, Associated Press AP

Protest by public employees for a fair wage increase. San José, Costa Rica

But not much has happened. Many of the resources are being channelled through the new African Capacity Building Foundation, based in Harare. By 1998 this foundation, which has close institutional ties to the World Bank, had supported 36 projects in 29 institutions in 20 countries. But the funds are meagre in relation to the need, and even these do not seem to have been used very effectively.

One of the most important issues that capacity building programmes will have to tackle is the level of salaries. It is significant that the developmental states in Southeast Asia were able to call on a skilled cadre of public servants. They also paid them well. In Singapore, for example, many civil servants earn more than their counterparts in the private sector. Public servants in low-income, crisis-ridden states, on the other hand, have seen their real wages fall steeply. As a result, they are not only more open to corruption, but also have to spend more time on second or third jobs just to earn a living wage. Yet the problem is not just low pay. Systems of remuneration can be quite opaque—and there is often no clear relationship between pay and responsibility or performance.

Some governments have started to address these issues. Uganda, for example, has been trying to clarify its payment system by including the real market value of additional benefits, such as housing, transport or health benefits. One of the most radical options would be performance-related pay. Malaysia is one of the few governments to have tried this.

In the past, systems of remuneration also suffered from compression—a narrowing of differentials between top and bottom. Immediately after independence, many African countries moved toward more egalitarian pay structures. Recently, however, this trend has been reversed: in Ghana, for example, between 1984 and 1991 the ratio between the salary scales of the top civil servants and those in the lowest grade increased from 2:1 to 10:1.

Steps toward wage decompression have often been linked with retrenchments. Governments that wish to escape from the low-wage, low-morale, corruption trap would prefer to employ fewer people but pay them better. Uganda, Bolivia and to some extent Ghana have attempted this, but with some difficulty. In addition to resistance from civil servants, there can be high severance costs. And frequently, those who retire subsequently reappear as consultants.

Low pay is also associated with the more general problem of financing recurrent costs. On the whole, donors prefer to invest in new physical or social infrastructure, such as schools or hospitals, leaving recipients with the burden of maintaining them and paying salaries. For projects in the poorest countries, it has been estimated that annual recurrent costs can be up to 70 per cent of the initial investment. Seeing the possibility that their projects will collapse, some donors have had to create and finance parallel structures within bureaucracies, just to keep their projects alive. Zambia's Educational Materials Project, for example, was largely run by an enclave of foreign experts.

In its Public Investment Programme, the World Bank has tried to address these issues by urging ministries to develop budgets that reflect operating and maintenance costs. But this is not an easy task.

The future of public sector reform

Developing countries do need to reform aspects of their public sectors. Many have done so, reducing the size of their workforces and cutting budget deficits. The range of reforms is outlined in box 4.2.

But if reformers want to make greater progress in future, they will need to look more closely at local circumstances and apply more appropriate remedies. Many of the principles of reform assume that there is some standardized

Box 4.2 – Public sector goals and reforms

Public sector reforms around the world have four main goals. International agencies attach primary importance to fiscal reform and managerial efficiency, but have paid less attention to capacity building or accountability.

1. **Fiscal stability**
   - Expenditure reduction
   - Privatization
   - Tax reform

2. **Public accountability**
   - Citizens' charters
   - Ombudsmen
   - Service delivery surveys
   - Plural parliaments
   - Press freedom
   - Independent judiciary
   - Mass-based political parties
   - Civic action

3. **Capacity building**
   - Human resource development
   - Policy analysis and monitoring
   - Management of recurrent costs
   - Management of public investment
   - Pay reform

4. **Managerial efficiency**
   - Decentralized management
   - Executive agencies
   - Quasi-markets
   - Corporate boards of directors
   - Performance contracts
   - Contracting out

or ideal form of government—and that even if this has not yet been achieved, there is some global process of convergence as all countries move from Old Public Administration (OPA) to New Public Management (NPM).

Many of the poorest countries have yet to achieve the OPA stage. They lack a professional civil service and rely more on patronage and informal systems. In these circumstances, trying to transform the existing arrangement into an NPM system may create little more than an empty managerial shell.

These reforms also assume that there is a right size for the state: small. It is argued, for example, that state expenditure will always crowd out private investment. Certainly, over-expenditure and excessive borrowing can undermine price stability. But where there has been little industrial development, state expenditure can also build the infrastructure that will attract private investors.

Another argument is that state growth will require higher taxes, which will undermine incentives and discourage people from keeping their funds in the country. However, most of the poorer countries have very low rates of both corporate and income tax. All governments should try to keep their budgets balanced; but when the poorer countries are in trouble, it is more likely to be because of their weak position in global markets—as they are blown off course by collapsing commodity prices.

Reforms of the public sector cannot simply be managerial or technocratic exercises. They need to be firmly grounded in what citizens see as the mission of their state. The state's mission will inevitably vary according to local circumstances and the stage of development. At its heart, the mission is not managerial; it is social. People want to move toward societies that are more prosperous, equitable and harmonious. Having ambitious managerial targets may be a part of this—but only a small part. Indeed, focusing too rigidly on market reforms is likely

to perpetuate the incidence of failed states, civil wars and developmental stagnation.

The basis for any reform must be broad political consensus. While public sector reforms may appear technical, they are always highly political and conflictual. Few governments in crisis-ridden developing countries had a popular mandate for the policies that the IMF and the World Bank required them to carry out. Most of these countries are also grappling with complex problems of democratization—trying to lay the ground rules for the way their societies are governed.

Even industrialized countries that have entrenched democracies and single-party governments have struggled with these changes. Many of the developing and transition economies have not only fragile democracies, but also fragile governments. In most cases, the leading parties in government do not have parliamentary majorities. Given the fractured nature of political systems, and the ambiguous or contentious mandates of governments, it is hardly surprising that there is only a weak commitment to reform.

The reform of public services can only succeed when it is an integral part of overall democratic reforms—each reinforcing the other. This means having parliamentary parties that pursue broad social interests, supplemented with a free press and an independent judiciary. The aim should be to deepen and defend the civil rights of citizens, who will then be in a much better position to demand the highest standards from their politicians and from all public servants.