THE REFORM OF PUBLIC SECTOR MANAGEMENT
Lessons from Experience

COUNTRY ECONOMICS DEPARTMENT

POLICY, RESEARCH, AND EXTERNAL AFFAIRS
THE WORLD BANK
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COUNTRY ECONOMICS DEPARTMENT

The World Bank
Washington, D.C.
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Institutional development and the performance of the public sector have a central place in development strategies and the World Bank's activities. Initially, the Bank focused narrowly on the operational effectiveness of the agencies in developing countries that were in charge of implementing Bank-financed projects. But a deeper understanding of the importance of institutional capacity led it to develop broader programs with longer-term perspectives. As development strategies grew more complex, so did their institutional requirements. Broadly based initiatives such as poverty reduction programs, for example, necessitated dealing with smaller, more dispersed and in some cases weaker agencies, such as those in rural development and education.

World Bank involvement in institutional development took a quantum leap in the early 1980s when it began to support policy reform programs through structural or sectoral adjustment operations. The institutional aspects of adjustment programs include support for public enterprises, as well as for central government agencies in charge of policy management. Historically, the Bank had worked with individual public enterprises in the context of sectoral operations. Now it began actively to support broader public enterprise reform programs, together with efforts to strengthen core government agencies, including those in charge of managing macroeconomic and trade policy.

Recently, the Bank has shown increasing concern about governance issues, defining institutions more broadly, to include the rules and regulations that govern society. With each widening of focus, the Bank has taken on additional responsibilities, but has continued its earlier institutional work. Improving individual agencies is still the bread and butter of institutional development activities.

The re-emphasis in development strategies on a larger role for the private sector has been interpreted by some to mean a reduced and minor role for the public sector in all areas. This is incorrect. What is required is a different, probably smaller, but nonetheless strategic role for the public sector. The fact is that good public sector management is a crucial ingredient in any development strategy based on markets and private initiative. Market-friendly strategies require a public sector of high quality capable of reacting to changing economic conditions. Indeed, it can be argued that market-supporting public sectors need to react faster than models based on government planning and dominance, in which public enterprises and cumbersome controlling mechanisms could plod along at a glacial pace. Tasks such as macroeconomic and sectoral policy management, and regulation of the financial system, require a first class technical staff, good information, and considerable wisdom. To achieve privatization, the public sector must be able to manage the process effectively. The benefits of good policy management, and the costs of mistakes, are enormous, as experience has repeatedly shown. Some developing countries lack even the minimum ability to undertake these
new tasks. Establishing that capability is a prerequisite for their development. For more advanced countries, the institutions are in place, but improving their operations is essential if they are to manage a more open economy or promote more sophisticated capital markets.

This paper, which summarizes the cumulative experience of the World Bank and its member countries in the last decade, should greatly help in the task of achieving effective public sectors in developing countries.

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Executive summary

Many governments in developing countries need more efficient and effective institutions if they are to conceive, implement, and sustain productive economic policies and projects. Effective public institutions are also necessary if the private sector is to grow and flourish. This paper: (1) evaluates the World Bank’s past and present efforts to strengthen the efficiency and effectiveness of public agencies in its borrower countries; (2) offers guidance and prescription on how to improve those efforts; and (3) suggests some areas for further work. For both failures and successes the paper tries to state why a particular outcome occurred, and what can be done to assure, or prevent, its repetition. The paper is not a statement of policy in the formal sense; its aim is to identify, analyze, and build upon emerging “best practice.”

Three themes are treated in detail:
- The management of public spending.
- Cost containment and improved institutional effectiveness in the civil service.
- Improved performance of public enterprises.

These themes do not represent all of public sector management. But they are the major areas in which the Bank has long been working — particularly since the advent of adjustment lending — and in which there is a record to analyze. The paper also examines the methods by which the Bank supports the implementation of proposed reforms.

The conceptual thread unifying the three themes under review is that their reform requires both the downscaling of public sector efforts and the strengthening of core central government organizations. In terms of downscaling the public sector, the paper addresses Bank-assisted efforts to reduce overextended public sectors: doing away with bad projects in public investment programs, reducing the number and cost of overstuffed civil services, and selling or liquidating inefficient public enterprises. (The sale or transfer of public enterprises to private owners is treated briefly; details are being addressed in a separate paper.)

The underlying concept is that the typical developing country has tried to do too much through the public sector, or has assigned to public agencies tasks for which they are ill-suited, or has retained activities in public hands when conditions justifying public management have changed. What is involved is nothing less than redefining the dimensions of the state, as attempts are made to manage less, but manage better.

The concept behind strengthening core government organizations is that many borrower governments need to reinforce the institutions that formulate policy and advise the highest decisionmakers, that set standards and evaluate performance, and that supervise activities across sectors.

The main lesson drawn from Bank and country experience is that public sector management (PSM) reform takes root and flourishes only over relatively long periods of time. This makes it hard to see the results of interventions; and when results occur, it can be hard to trace their cause to a particular action. Results vary greatly, depending on a country’s administrative capability and how
receptive it is to externally supplied advice and resources. In countries with an appropriate alignment of skills, commitment, and incentives, rapid and progressive change occurs. Elsewhere, it will take years to develop the essential ingredients for strong institutions. In many countries the Bank must be involved in a supporting role for a long time to come.

The general messages of the paper are as follows:

- What has been tried so far has yielded positive results, often in very difficult circumstances. The results have been less than hoped for at the outset, but positive. Given the novelty of the exercise—the redirection and downscaling of the state—it is not surprising that the effort has been long and arduous.
- The main reason reform takes so long is that most PSM reform efforts run into sociopolitical obstacles that require patience and persistence to overcome.
- Bank and borrower understanding of PSM reform has advanced rapidly in recent years as the lessons from first efforts have been incorporated in subsequent programs.
- Given the strategic importance of more efficient public spending patterns and effective public sector management in developing countries, the Bank should strengthen its efforts at PSM reform.

Regarding public expenditure management, the Bank aims to improve public investment programming, to strengthen the budget process, and to support more generous allocations to operations and maintenance. Investment programming efforts have focused on reducing the number of projects and setting up a medium-term, "rolling" public investment program composed of projects analyzed according to their economic, financial, and social viability. In the main, the results have been positive. Many countries have eliminated poor projects, have improved the screening of proposed projects, have more closely matched planned efforts and implementation capabilities, and have improved the generation, coordination, and use of aid funds.

Strengthening budgeting procedures has proven more difficult, partly because of the widespread weakness of basic accounting procedures. Despite a few African and Latin American success stories, comprehensive budget reform packages have seldom succeeded. The management of public spending is at once a highly technical and an intensely political process; the challenge for the Bank and its borrowers is to put into practice methods that are both technically sound and politically and bureaucratically feasible.

Civil service reform consists of two complementary efforts: short-term measures to contain costs and medium-term programs to strengthen personnel management and improve the efficiency and effectiveness of public agencies. Initially, emphasis was placed on cost containment, using a variety of methods to identify surplus civil servants and encourage or require their resignation. Results have been mixed. Growth in civil service numbers and wage bills has been stopped in many countries and in some this is sufficient. But often cost containment and number reduction programs have been insufficient to bring about the degree of change needed or possible. Only a few (mainly African) countries in dire financial straits have effected major reductions in personnel; where this has been done the Bank’s involvement has helped in the transition. But many countries should and can go further in cutting costs.

Cost-containment deals with only part of the problem. Of equal if not greater importance are medium-term institutional reform efforts aimed at correcting the root deficiencies of poor performance in public agencies, by creating or updating personnel management systems (including performance evaluation mechanisms), improving training, linking pay to productivity, and offering incentives to attract and retain competent, skilled personnel. These endeavors are more recent in origin. These programs are beginning to have a positive effect.

To improve the management of public enterprises, the Bank strives to create policy and institutional frameworks that stimulate efficiency gains. This is the most active area of Bank involvement in public sector management, comprising more than 150 operations to date. These include:

- Efforts to downsize the public enterprise sector.
- Steps to improve the market environment of public firms and expose them to competition.
- Measures to improve government-enterprise relations.

The paper concentrates on improving the performance of enterprises remaining in the hands of the state (as privatization will be covered in detail in a separate paper).

The overall impact of public enterprise reforms has been positive. Few public enterprises are being created and never as a matter of course.
Through privatization, liquidation, and expansion of the private sector, public enterprises now play a much less significant economic role in many countries — in all regions — than they did in the recent past. Bank-supported programs have often led to improved productivity and profitability of firms and indeed of sectors. The reforms’ impact on budgets is less clear. Many countries have registered substantial declines in transfers from government to enterprises, but indirect financing methods — through the banking system, taxes, and other exemptions — cloud the picture.

Experience demonstrates that public enterprise performance can be improved without changing ownership — by assigning the firms clear commercial goals, imposing a hard budget constraint, giving managers the means and power to attain these goals, exposing the enterprises to competition, rewarding the managers who achieve objectives and sanctioning those who do not, and allowing persistent poor performers to go out of business. This process of “commercialization” subjects public enterprises to roughly the same conditions and signals as a profit-maximizing firm operating in a competitive market. It yields positive results. But governments have a problem making performance improvement measures endure; the strategy has its limits. Therefore, in some countries and circumstances privatization is proving desirable, not only to effect performance improvements, but also to lock in the hard-won gains.

The instruments used by the Bank to promote public sector management reforms have been technical assistance — supplied by specially recruited personnel or by Bank staff themselves — training, and studies and policy dialogue through the Bank’s analytical and sector work. The dilemma of technical assistance is that it appears indispensable but difficult to use well. The more a country needs technical assistance the more salient are the conditions that mitigate against its effective use. The deficiencies of technical assistance delivery have been well studied by the Bank, and a set of corrective mechanisms proposed; but these have proven difficult to implement. All suppliers of technical assistance are caught between the acute need to move rapidly on a variety of fronts, and an increasing recognition that documented success comes about slowly, by concentrating on a restricted set of problems.

To improve the quality of technical assistance the Bank should:

- Devote more effort to the design stage of technical assistance actions, and set up monitorable achievements.
- Intensify supervision of technical assistance components and projects.
- Assess more rigorously both the selection and the performance of consultants.
- Make greater use of resident and regional mission staff to work with governments and other donors on technical assistance matters.
- Improve assessments of the borrower’s ability and determination to put the technical assistance to good use.

In terms of lending instruments, experience reveals that there is often a poor fit between the long time frame needed to effect PSM reforms and the rapid disbursement periods of adjustment operations. This suggests that project loans might be the preferred mechanism for PSM efforts. But the magnitude of adjustment operations has often proved useful in persuading governments to undertake politically sensitive reform. The solution adopted has been to parallel adjustment operations with related “development management” or “public sector reform” projects.

The benefits of improved public sector management are enormous: lower costs, more effective production and delivery of goods and services by public agencies, heightened project impact, better policy formulation and implementation capability, more sustainable projects and programs, and an improved environment for the effective functioning of the private sector. In the wide range of areas touched by Bank support, the gains have been numerous and significant. But they have also been fewer than projected, difficult to conceive and implement, and slow to come to fruition. The reason is that public sector management actions reveal, and highlight, tensions between economic benefits and political costs. Governments tend to be either in extreme crisis, or well advanced on the road to prosperity, before they muster the resolve to tackle these painful issues. In countries where this is the case, overcoming the obstacles to reform requires detailed knowledge of the sociopolitical context that is difficult and costly to obtain, and even more difficult to apply.

To improve this record, the Bank should concentrate its efforts on (1) designing effective institutional development strategies adapted to country needs; and (2) stimulating government commitment to associated policy reform and capacity-
building efforts. This would require, among other things, greater weight to PSM issues in the country dialogue; more thorough reviews of the sociopolitical context; more systematic attention to PSM issues in economic and sector work; and more rigorous management of PSM-related investment and technical assistance operations. This calls for specialized skills and the exercise of development diplomacy. In addition, because technical assistance funding forms a considerable part of official development assistance, Bank aid coordination efforts should work to help orient such flows to high priority areas of PSM.

Given the limited resources that the Bank can devote to PSM efforts, not every existing public agency merits restructuring or even perpetuation. The key conclusion is that the Bank must be more selective in the choice of organizations to be assisted. The Bank should focus more explicitly on countries and activities in which the chance for reform is high because government is committed and ready to change. In other countries, special efforts should be devoted to diagnostic work and the creation of a climate favorable to reform through country dialogue, policy dissemination work, and capacity-building activities.
Introduction

Purpose

This paper assesses the efforts of the World Bank to improve management in the public sectors of its borrower countries. It identifies the problems that created the need for Bank involvement, reviews the steps taken and the instruments used by the Bank to help correct these problems, and assesses which of these steps have accomplished their goals, and which have not. For both successes and failures it tries to state why a particular outcome occurred, and what can be done to assure, or prevent, its repetition. The paper responds to expressions of the Bank’s Board of Executive Directors concern about weak institutional capacity in borrower countries, and to a specific Board recommendation that the Bank give greater emphasis to institution building in both appraisal and implementation.

The paper’s specific objectives are threefold:

• To evaluate the Bank’s practical achievements in strengthening public agencies.

• To offer governments and Bank staff guidance on the design and implementation of reform programs.

• To map out the issues and areas where prescription can only be partial because knowledge is insufficient, and where more work and reflection are needed.

The last is important. Despite years of varied and intensive effort, the Bank is not in a position to pronounce definitively on all aspects of public sector management reform. The reason is simple: administrative or institutional improvement is invariably a long-term process. In the short run, it can be hard to see the results of interventions. In the medium to longer run, when effects do emerge, it can be difficult to trace their cause to a specific intervention.

But this much is unquestioned: Governments need effective public institutions if they are to conceive and implement progressive, developmental economic policies and projects and if they are to create and sustain flourishing private sectors. This has never been in doubt. The issue has always been, how to endow borrower governments with such a capacity? For a brief time, many assumed that merely adopting a new goal would automatically elicit the organizational capacity to achieve it. This proved illusory. Donors and the Bank then shifted to creating project management units to substitute, with external resources, for weak local institutions. These tended to disappear when the flow of external resources ended. The Bank has now embarked on the more realistic albeit more long-term and difficult process of helping governments take charge of their own management. In some countries, where the alignment of skills, commitment, and incentives is appropriate, rapid and progressive change is occurring. In others, it will take years of Bank involvement to provide the ingredients for strong institutions.

The problem is difficult, but not intractable, and dealing with it will take longer than is desirable. But the importance of dealing with it is
Background and scope

Economic growth and development are not solely a function of increases in the factors of production. A substantial part of growth in total output is explained by noneconomic determinants, including "better management, organization and work procedures...." From an early date the Bank has undertaken to develop managerial capacity in the individual ministries, government agencies, and autonomous public organizations responsible for implementing the investments that it finances. Over the years the Bank and its borrowers have amassed considerable experience in diagnosing the problems of public agencies and project units, and proposing and implementing programs to improve the performance of different institutions. Indeed, before 1980, except for some efforts in training and civil service education, the Bank's approach was limited to improving particular agencies or enterprises.

The world economy fell into recession in the early 1980s. Part of the Bank's response was to introduce structural adjustment lending, to deal with the balance of payments needs arising from the shock of deteriorating terms of trade, and to reform macroeconomic policy. The range and severity of economic problems encountered in the adjustment process highlighted the need to improve public sector management (henceforth, PSM) at a higher level than the individual agency. The Bank broadened its involvement because it realized that:

- Implementing changed policies required effective, competent, core organizations.
- Effective investment lending required an appropriate macroeconomic framework and an enabling institutional environment.
- Macroeconomic adjustment required the downsizing of many governments that were financially and administratively overextended.

Concern with individual agencies and enterprises was by no means abandoned. Efforts have continued to improve performance and lower costs in the literally hundreds of specialized public agencies and units with which the Bank deals. But in the 1980s the Bank also used its adjustment programs, and related technical assistance, to address issues of public sector overextension, and improve management of the enabling environment, concentrating on factors that cut across economic sectors. In particular, it sought to create or strengthen the core agencies responsible for financial policy, management of the civil service, and the supervision of public enterprises. These are the three fields dealt with in this paper.

No claim is made that these agencies encompass all of public sector management. Many other important, related issues exist, including the appropriate degree of administrative decentralization, measures to create and strengthen proper legal institutions, and the sociocultural roots of administrative-managerial behavior. But the Bank does not yet have a great deal of operational experience with these issues. And they are being analyzed elsewhere in the Bank.

The conceptual thread that unifies the three themes under review is that they require the restructuring and strengthening of core central government organizations. The paper addresses efforts to downsize overextended public sectors. The typical developing country has tried to do too much through the public sector — or has assigned to public agencies tasks for which they are ill-suited, or retained activities in public hands when the conditions justifying public management have changed. The principal message from experience, then, is that the state should manage less, but manage better. To that extent, governments need strengthening. Development requires better formulation of policy, the setting of standards, and the supervision of activities across sectors. In particular, developing countries need:

- Better management of public spending (better systems for formulating and managing budgets, generating revenues, controlling costs, and investment planning).
- Civil service reform (containing the growth and costs of government and making the civil service more efficient and effective).
- Better management of public enterprises (creating policies and institutions that will make public enterprises more efficient).

Conditions relating to one or more of these aspects of PSM were included in nearly every adjustment operation approved in the 1980s. But although the adjustment process sparked the identification of PSM as an important issue, many of the innovations developed have also been found useful in project lending. Thus, many activities using project instruments addressed PSM in the
In all, more than 120 Bank Group operations presently in execution or under preparation include PSM components in these three areas.

The subject matter of this paper is closely linked to — is an important part of — the concept of "governance." The paper examines what the Bank has tried to do in its member countries to create and sustain competent, cost-conscious public organizations, capable of devising and implementing rational, appropriate, and productive economic policy and action. The link is apparent: governance is a common theme now partly because public organizations in many countries seem to be ineffective and too expensive. And as each of the sections of the paper reveals, government commitment to and "ownership" of reform are essential to sustained progress. But important as the PSM issues are, they are not the whole of "governance." This paper does not deal with either the public's role in determining policy and actions, or the methods by which public officials are held accountable (or not) to the population. It is simply an account of what has been tried, and accomplished, in improving the public administrations of Bank borrowers, with specific suggestions on how to consolidate gains and avoid revealed problems.
Public expenditure management

Summary: Under adjustment operations the deterioration of public finances has been stopped and reversed, and public expenditure management has been strengthened. The task ahead is to improve the effectiveness and relevance of expenditures. This means substantial reconfiguration of budgets and the strengthening of financial accountability.

The challenge

In industrialized or developing countries, successful management of public spending requires competence in three areas: (1) setting a framework for public expenditures consistent with macroeconomic policies and objectives; (2) planning expenditures within that framework; and (3) executing those plans efficiently and effectively, so that objectives are achieved, money is spent wisely, and the use of public resources is accounted for.

At the center of this process is the government budget. How well government budgets are formulated and executed is important everywhere. In most countries, government budgets absorb substantial domestic and foreign resources. They touch all sectors of the economy and involve many tiers of administration, and the products of government spending should — but do not always — complement private sector activity. Government budgets condition how state employees behave, and determine the tasks they perform and how effectively they perform them. So budgets are central to the public sector incentive system.

One problem with the management of public spending is that it is both a highly technical and an intensely political process. The focus here is on its technical rather than political aspects, in keeping with the Bank’s role and expertise. But the politics invariably intrude. Setting and implementing spending policies involves command over resources, which inevitably means satisfying — or failing to satisfy — the material interests of different constituencies. Most public expenditure programs reflect the influence and to some extent the needs and desires of the bureaucrats who prepare and carry them out. In many developing countries public expenditures are shaped by the actions of donors. The challenge for the Bank and its borrowers is to develop principles and methods that are both technically sound and politically and bureaucratically feasible.

Before the 1980s, the Bank was concerned mainly with sector policies, programs, and projects. It has long been interested in public sector financial aggregates, but viewed them primarily in terms of macroeconomic objectives, such as the need to improve government savings and mobilize additional resources for social and economic investment. But with deteriorating economic performance in the late 1970s, and the advent of adjustment lending, Bank involvement deepened. At first the Bank focused on the Public Investment Program (PIP), embarking on a long series of Public Investment Reviews (PIRs). It became clear that in many countries investments could not be treated in isolation from the rest of the budget — that revenues as well as capital programs had to be reviewed. So Bank work on public spending broadened. Increasingly, PIRs have given way to
broader Public Expenditure Reviews (PERs). As a consequence, the Bank expanded its assistance to cover a wider range of public financial management issues: the establishment and implementation of a fiscal policy in line with macroeconomic realities, improved screening of projects, the forecasting and management of the public debt, local government finances, spending on operations and maintenance, subsidies and transfers to public enterprises, and aspects of public pay and employment policy. In this section of the paper we review borrower and Bank experience in those areas in which most Bank efforts have been concentrated: public investment programming, operations and maintenance expenditures, and strengthening the budget process. (For an overview of Bank interventions in support of public financial management reform, including their content and regional distribution, and the types of lending instruments employed, see figures 1.1, 1.2, and table 1.1.)

Public investment programming

In the late 1970s, the Bank’s interest in governments’ ability to manage their investment programs stemmed from concerns about the size and comprehensiveness of Public Investment Pro-

Figure 1.1 Government financial management operations, by region and lending instrument, FY 1986–91

![Diagram showing the distribution of financial management operations by region and lending instrument from 1986 to 1991. The diagram includes data for Africa, Latin America and the Caribbean, Europe, Middle East, and North Africa, and Asia, with bars indicating the number of operations for each region.]

Note: Structural Adjustment Loans include other policy-based operations such as Economic Recovery Credits. Source: Public Sector Management and Private Sector Development Division, Country Economics Department.

Figure 1.2 Components of government financial management reform operations, FY 1986–91

![Diagram showing the percentage distribution of financial management reform operations, with components such as Budget management, Tax administration, Accounts/auditing, Procurement, Public investment programs, External debt management, and Structural Adjustment Loans.]

Note: Numbers in parentheses refer to the number of operations containing the corresponding reform component. Since most operations contain several financial management reform components, the percentages refer only to the component’s share of the total number (212) of reform components. Source: Public Sector Management and Private Sector Development Division, Country Economics Department.

grams, the quality of the projects, and how effectively they were being implemented. These concerns were documented in a growing number of Public Investment Reviews carried out from the early 1980s on. PIRs typically recommend more realistic assessment of the amount of funds that will be available for investments of all sort, and a tighter approach to formulating and implementing public investments. Planned investments by the public sector typically exceed both available finance, domestic and external, and domestic implementation capacity. Resources are spread thinly over too many projects, stretching out implementation and delaying benefits. In many countries, there is no comprehensive picture of public investments and thus no estimate of their impact on macroeconomic targets or of their financial implications. Where they exist, investment programs lack focus — and cuts, when they occur, tend to be across the board. Governments find it hard to state which projects should proceed and which should receive no further funding. This failure to assign priorities keeps alive projects of minimal value and delays the completion of critical activities. In addition, many governments have included in their investment programs costly and non-viable projects.

The Bank’s approach is twofold: First, it recommends concentrating scarce resources on fewer projects that can be implemented within a reason-
Table 1.1 Countries with Bank-supported programs for government financial management reform,

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program of key projects, those considered crucial to economic recovery. The idea is to assure these projects of prompt counterpart funding and to protect them from general budget cutbacks. To ensure a link between the PIP and the annual budget process, the Bank recommends that the PIP be “rolled over” (updated) annually, and made an integral part of the government budget preparation system. At the same time, governments are being encouraged to strengthen project preparation and programming capacities in line and core departments. Three-year rolling PIPs have been specified by many Bank borrowers, large and small, from Mexico to Lesotho.

The results of these efforts have been largely positive. Many countries now prepare PIPs. These have provided a solid foundation for mobilizing substantial additional resources at aid donor meetings. Better screening criteria have been introduced. Many egregiously bad projects have been eliminated. The composition of the PIPs has improved and the PIPs more closely match implementation capacity in many of the countries concerned. In general, there is a sound basis for the Bank’s urging that PIPs be comprehensive, and it should continue to do so, particularly for off-budget items and aid-financed spending that take place outside the government’s financial system. But several problems persist:

- PIPs have been scaled back, but there are still too many projects. This is partly because governments are reluctant to drop projects and partly because of aid’s “soft-budget” effect: line departments put forward many projects in hopes of attracting donor support, while down-playing or ignoring longer-term issues of financial sustainability. In countries where the rapid growth of the government payroll has squeezed non-wage operating costs, aid projects are often a substitute budget, and line ministries are reluctant to reduce the number of projects in the PIP lest they diminish their prospects of attracting aid. All this points to the need to strengthen aid management capacity in the recipient governments and to instill more discipline among the donors. Improving aid management depends on better project documentation and programming and closely linking mechanisms for aid coordination with the budget function. Disciplining donors is a matter of coordination through such formal gatherings as consultative group meetings and through informal contacts between the Bank and other donors — and some progress has been evident on these fronts.

- The screening criteria recommended by the Bank have usually been successful in eliminating indifferent and bad projects. Now there is a need to move upstream in the project generation cycle. Some projects can be screened by economic analy-
sis but many cannot, given the limited number of skilled technical staff. Moreover, it is seldom possible to compare rates of return across sectors. Thus, there is no scientific methodology for deriving an optimum PIP. The pragmatic solution is to enhance capability for preparing sector strategies, to clarify sectoral resource envelopes, to develop an institutional memory of successful approaches, and to strengthen policy analysis.3

- In some countries, the project cycle has lost definition; in some others, it was never firmly rooted. In some countries donors dominate project formulation, leading to problems of project scale and design consistency. Where projects are funded from local resources, the documentation needed to calculate costs and benefits is often absent.
- Structural adjustment programs have been effective in cutting expenditures. They have been less successful in helping countries design investment programs suitable for their long-term needs. More work needs to be done developing and applying methods to improve inter- and intrasectoral allocation criteria and programming.
- Core programs have been useful (see box 1.1, "Restoring public expenditures in Ghana"). They push governments to prioritize expenditures and to devise more effective mechanisms for channeling domestic counterpart resources to important aid-financed projects. This improves aid management. But not all experience is positive. In many countries, non-core programs have remained in the PIP and competed (often successfully) for funds. This suggests that designating a core program may not be as effective as properly sizing and prioritizing PIPs in the first place.
- In several countries, governments have not taken ownership of the PIP process; they have not regularly rolled over the investment program (this tends to get done when a Consultative Group meeting is imminent and donor funds are at stake). Sometimes this is for lack of capacity but sometimes it may stem from a reluctance to make public spending more transparent. Nonetheless, the Bank should continue trying to strengthen project cycle and project programming procedures. But it should frame its technical recommendations in light of the incentive structure facing budget actors.

### Box 1.1 Restoring public expenditures in Ghana

Ghana’s Economic Recovery Program (ERP) was launched in 1983, with Fund and IDA support which continues to this day. In addition to macroeconomic stabilization measures and programs to rehabilitate key sectors of the economy, major initiatives were launched to strengthen public finances and their management.

High on the agenda was reviving domestic revenues, which amounted to less than 7 percent of GDP in 1983. Over the next four years this was raised to 16 percent. This was accomplished by reorganizing the customs and income tax departments into a separate commission exempted from civil service regulations and pay scales; by encouraging greater cost recovery by departments; and by changes in the tax structure that broadened the tax base and made it more responsive to growth in output—which, in turn, was stimulated by macroeconomic reform and larger aid flows.

Next, public investment was reshaped by a task force that prepared Ghana’s first rolling PIP in 1986. Objective screening criteria were established and the PIP was scaled down to a core program of about 100 projects consistent with Ghana’s implementation capacity. The core group emphasized rehabilitation rather than new projects. In 1987 an inner “supercore” program was identified, comprising some 29 projects of special importance. These were to be protected in budget implementation.

Restructuring the recurrent budget was tackled first, by containing the wage bill and implementing a program of civil service reform (see chapter on civil service reform) and, second, by restoring adequate levels of O&M funding for key sectors. To provide benchmarks, a special task force carried out standard cost studies for three sectors: agriculture, education, and health. The results were first applied in the preparation of the 1989 budget.

Much remains to be done, but public finances in Ghana have been greatly improved by these measures. Revenues are now close to the levels that prevailed before the fiscal collapse, the PIP is both more relevant and implementable, and the slow journey back to a better paid civil service and adequate operating expenditures has begun.

under heavy pressure. Concern about the inadequacy of O&M was one of the main reasons the Bank began to look beyond the investment program and to examine public spending programs and government budgets in their entirety. (An additional factor was that OED studies showed a growing gap between estimates of returns before and after project completion.) These are additional reasons the Bank has moved from PIRs to more comprehensive Public Expenditure Reviews. PERs reveal that problems in O&M stem from
several sources. O&M expenditures have been squeezed by stagnant revenues, burdensome government debt service, high consumer subsidies, and growing transfers to loss-making parastatals. Moreover, in many countries excessive growth of public payrolls has caused a disproportionate share of recurrent expenditures to be allocated to the wage bill. Experience varies greatly among regions, but where O&M allocations are seriously deficient, the productivity of the public sector has plummeted. In some Sub-Saharan African countries, effective service delivery has collapsed; parents are reluctant to send their children to schools that lack teaching materials, alternative forms of health care have grown as government clinics have run out of drugs, and agricultural extension services have become marginal. Inadequate spending on O&M has also caused an alarming deterioration of infrastructure assets, imposing high economic costs on road users, for example, and creating a major obstacle to economic recovery.

The Bank has responded in several ways. It has investigated the O&M problem through public expenditure reviews and sector economic studies. These have drawn attention to the heavy economic and social costs of underprovision. More pointedly, the Bank has helped governments in selected countries (for example, Ghana, Kenya, and Tanzania) to undertake standard cost studies. These establish benchmarks that guide departments in restoring provisions for O&M to justified levels.

In several cases — in Bangladesh, Indonesia, and Papua New Guinea, for example — the Bank has encouraged the adoption of O&M strategies for specific sectors such as roads, education, health, and agriculture. Through reform of the parastatal sector, it has sought improvements in utility pricing policies and the commercialization or privatization of public enterprises. It has also encouraged governments to review the pricing policies of the services they provide directly, to improve cost recovery. With the Bank’s encouragement, some governments have begun to contract out such services as road maintenance to the private sector. The scope for expanding this approach is considerable. Finally, the Bank has begun increasingly to suggest that governments prepare some form of medium-term expenditure plan (MTEP), and use it to explore tradeoffs and to examine the financial implications of alternative policies.

There are grounds for cautious optimism. Governments are now more aware of O&M issues. In a number of cases (for example, Tanzania) they have begun to increase recurrent budget provisions for key programs. There has also been encouraging progress on cost recovery. Governments have begun to tackle wage bill issues, checking the growth in payroll numbers through pay and employment reform (see chapter on civil service reform). But some problems remain:

• Governments tackling O&M issues face two problems. First, determining appropriate funding levels can be time-consuming and methodologically complex. Second, it is extremely difficult to find the resources to raise funding levels. Efforts to ascertain standard costs for typical services are worthwhile because they lay bare the true costs of operating services and maintaining public assets. Governments are then in a better position to recognize and evaluate the necessary tradeoffs.

• In a growing number of countries (predominantly in Africa, but also in such low-income Asian countries as Nepal), donors have begun financing recurrent costs in their projects. This enables key social and economic programs to be maintained and is consistent with the fact that many countries experience the highest returns from operating services more efficiently, rather than by adding to capacity. Recurrent cost financing is seen by the Bank and other donors as a temporary expedient, until public finances overall are strengthened. If deemed essential, it needs to take place in a framework of fiscal adjustment that involves revenue strengthening and measures to rationalize spending. The emphasis must be on mobilization of domestic resources.

• Few countries so far have made progress preparing medium-term expenditure plans (MTEPs) and using them to guide annual budget making. IDA countries that have prepared Policy Framework Papers (PFPs) have the rudiments of an MTEP in the form of targets for revenues, expenditures, and the fiscal balance. Governments need to flesh these out with projections and targets for the main components of expenditures. Developing countries that have cast their annual budgets in a medium-term framework for a number of years include Botswana and Kenya.

• Bank reviews of public spending programs have proved costly in staff resources, as they must be repeated at regular intervals to ensure that expenditure programs remain relevant and that programs are effectively implemented. But the Bank has learned that, as with investment pro-
grams, it is necessary to look not just at O&M allocations, but at public spending as a whole: at the balance between such major components as the wage bill, debt, transfers and subsidies, and military expenditures as well as development projects and their O&M. This is particularly true if the Bank is endorsing the public expenditure program on behalf of other donors who are cofinancing adjustment.

**Strengthening the budget process**

Budget processes work poorly in too many developing countries. This reflects weak technical capacity and deficiencies in the determination and application of basic budget systems. In acute cases of administrative collapse, governments are totally unable to produce published budgets. The budget then takes the form of a set of constantly adjusted tables known only to the finance ministry, the IMF, and the Bank. The only part of the budget revealed to the spending ministries is the monthly release of funds. This lack of transparency inhibits accountability, and is clearly linked to poor governance. In a great many countries the budget is published, but late. In most borrower countries, the budget is made as if only a single year mattered — despite the multiyear spending implications of many programs.

Budget implementation also poses problems. Actual expenditures, especially their results, often differ greatly from budgeted intentions. Finance ministries typically see this as a symptom that line departments have weak control of spending and program management. Line departments blame cumbersome procedures for getting funds released and for cutbacks imposed unilaterally during the year; uncertainty about the availability of resources makes it difficult to manage programs and projects effectively. Many countries need to strengthen budget preparation and execution, from finance ministries, down through line ministries to operating departments. Fiscal crises in many countries have drastically centralized budget management. Ways are now being sought to shift the details of financial management back to the line departments, while leaving the oversight function with the budget department and finance ministry.

To strengthen the management of public expenditures, the Bank has emphasized the importance of building a strong macroeconomic analysis and economic forecasting ability. This is particularly important in countries dependent on a few key exports, where unanticipated fluctuations in export earnings would severely disrupt planned revenue flows. Governments can also improve the budget’s macroeconomic framework by improving debt management. A number of special debt units have been created in central banks and finance ministries. The resulting information flows have allowed governments to restructure their debt liabilities favorably. The countries most successful at building debt management capabilities have been in Latin America, Europe, the Middle East, and North Africa (EMENA). African countries greatly need to improve their information systems and debt management capabilities.

It is also essential that developing countries improve revenue projections and collection. To this end, the Bank is focusing increasingly on the administration of tax systems, especially in Latin America. Countries are increasing tax revenues by reforming tax and duty structures and improving the administration of tax and customs offices. They are installing more systematic and transparent assessment and collection procedures, providing better training, offering pay or special incentives to revenue staff (both to motivate output and to reduce the likelihood of corruption), and, in some countries, contracting out specialized revenue collection activities to private agencies. (Indonesia has had dramatic success contracting customs collection out to a private agency.)

Many countries have kept traditional budget structures, with an emphasis on inputs. This facilitates control of costs but fosters “incrementalism”: budget makers tend to concentrate on minor adjustments to last year’s figures instead of improving the efficiency with which resources are used and outputs achieved. In countries which underwent an earlier wave of budget reform, budget structures were changed to a “program” basis, stressing a clearer definition of goals and monitorable measurements of achievement. But the setting of objectives and performance review have mostly lapsed, if they ever operated satisfactorily in the first place. Many budget classification systems — traditional or revised — have become outdated. Published budgets often combine excessive detail and large single line transfers (to public enterprises or the military, for example).

All this makes it difficult to understand the purpose of expenditures. Substantial government spending takes place outside the budget, compli-
cating financial management and undermining stabilization — particularly of aid-financed expenditures especially where payments are made directly to a contractor or supplier or where goods are provided in kind. As a result, budgets often fail to reflect the full value of spending on projects and programs, which hinders its scrutiny by the legislature or reviewing agencies.

Where budget processes are specified by law rather than by Treasury regulations (as in Latin America), legislatures — seeking to bind government — often encumber budget systems with excessive and contradictory legislation, undermining both fiscal stabilization and control of spending. Inflexible budgets cannot respond to intended changes in the role of the state.

Inadequate accounting systems are a common weakness. In many borrower countries government accounts are prepared late and contain many errors and omissions. Departmental managers cannot control spending and the finance ministry cannot monitor implementation of the budget. This frustrates auditing, further undermining financial accountability.

The Bank has no general prescription for budget reform (such as the PIP for investment programming). In countries such as Kenya, the Bank has supported strengthening the existing budget system. In countries where the existing system was judged too weak for renovation, more fundamental reform has been attempted, often based on variants of program budgeting. In Latin America the focus has been to revise budget laws and eliminate the revenue-earmarking mechanisms that have made Latin American budgets so unwieldy. All of these reforms have been complemented by institutional strengthening of budget preparation and analysis units, through training, technical assistance, and the provision of computers and ancillary equipment. These are provided, typically, through Bank-financed public sector management technical assistance projects. In a growing number of countries (Indonesia and Madagascar, for example), the Bank has supported the reform, rehabilitation, and development of government accounting systems and is now turning its attention to audit capabilities. In other countries Bank staff have cooperated closely with their colleagues in the International Monetary Fund to identify weak points in the budget system and to devise remedies for them.

The results of these initiatives are encouraging. Significant improvements have been made in the planning of expenditures. Distressed countries such as Ghana and Uganda have improved their ability to make and implement budgets. Budget laws have been revised and earmarking mechanisms reduced in a number of Latin American countries, Colombia among them. This makes the budget more transparent so it is easier to implement fiscal policy. Budget classification systems have been redesigned as part of accounting reform, consistent with the IMF's Manual of Government Financial Statistics. Partial and modest reforms have succeeded. Sweeping efforts at budget reform have been disappointing. The attempt to introduce performance budgeting in Jamaica was abandoned for a more modest agenda of improving budget procedures. Nepal has adjusted its existing system, tempering hopes for a radical restructuring of the budget system. In Ecuador and other countries, reforms have only recently been initiated so it is too soon to judge results.

Progress has been slow on budget implementation. Weak control of spending and project delays for lack of counterpart funding persist. The Bank’s efforts to strengthen government accounting capabilities and to improve public expenditure planning, through better project programming and a concentration on core programs — both recurrent and capital — have helped. In Latin America, Bank staff have helped governments prepare and implement reform of financial management, notably in Bolivia, but also in Brazil and Mexico.

Corruption — a term that embraces many shades of what economists term “rent-taking” — remains a problem in many countries. Corruption contributes to poor project choices and raises the cost of implementing them. It increases transaction costs for the private sector and harms the investment climate. (Corruption in the government is a “two-way street” in which private firms, foreign and domestic, participate.) It saps morale in the civil service, engenders deep cynicism about government policies in the rest of society, and generally undermines the government. Had governments remained small, as was true when corruption was endemic in the now industrialized countries, the costs of corruption might be viewed as more tolerable. But governments in developing countries undertake almost the same range of activities as those in industrialized countries, so the effects of corruption are seen as profoundly damaging. In the short run, considering only public spending, the Bank can exert some influ-
ence by: promoting procurement reform, encouraging more transparent budgeting, strengthening accounting and auditing capabilities, and supporting civil service reform.

The lessons of this experience are several:

- Introducing totally new budget systems is difficult and disruptive and new systems cost more in staff time to operate than traditional systems do. Despite the conceptual appeal of program, performance, or zero-based budgeting, they are ill-suited for countries in the midst of structural adjustment and facing severe capacity constraints.

- Current concerns about governance and the current emphasis on more “openness” in government business point toward changes in the way budget documents are presented. In recent years OECD governments have greatly simplified budget documents presented to their legislatures, making them more readable and attaching clear explanatory texts and summary tables. There is great scope for extending this approach to developing countries, as Bank staff have already recommended for Kenya.

- Good accounting is vital for effective budgeting and financial management. The Bank’s increasing support in this area, which can involve costly consultancy inputs and computerization, is a logical and necessary extension of the Bank’s work in other areas of public expenditure management. It is also a relatively new area for the Bank, one in which few staff have specialized knowledge. This makes the Bank heavily dependent on consultants for diagnosis and the design and supervision of projects.

- Overlooked by donors for many years, the audit function in governments is now receiving increased attention in Bank adjustment programs. In some cases this involves strengthening the government auditor’s ability to carry out the office’s traditional functions. In others, audit staff are being trained to perform “value-for-money” or performance audits, to improve the efficiency and effectiveness of government spending. In addition, internal auditing capacity is being reinforced in larger ministries and departments.

- Strictly speaking, earmarking is a revenue issue but it has major implications for expenditure management. In Latin America and in countries such as Turkey the Bank’s advice has been to reduce earmarking, but in a number of African countries (for example, Cameroon, Ghana, Guinea, Kenya, and Uganda), Bank staff have found themselves considering earmarking to ensure continuity of funding for key government programs such as agricultural research and road maintenance. Moreover, the issues of earmarking and cost recovery are linked, for legal and administrative reasons. Some legislatures provide for earmarking; others forbid it and require that all revenues be paid into a general fund. The Bank needs to consider more fully the institutional and financial management implications of earmarking.4

- Budget implementation is likely to remain a problem area for many years to come. On the Bank’s side there is a need to increase staff’s knowledge of how the mechanics of the budget operate before recommending procedural improvements. Governments, for their part, need to attach greater importance to the financial management of budgeted programs by line ministries.

Conclusions

The Bank became involved in public expenditure management out of concern, first, about the size and content of the public investment program, then about the adequacy of O&M provisions in recurrent budgets, then out of interest in the budget process itself and its institutional underpinnings. In this progression, the Bank’s approach has deepened in light of perceptions gained and lessons learned. This will continue. Three topics are likely to grow in importance: policy analysis and sector strategies for medium-term expenditure planning; aid planning; and accountability.

Policy analysis and sector strategies linked to medium-term expenditure planning. Traditional approaches to economic planning — centered on target-oriented, needs-based five-year plans — have been discredited. But a strong need remains to build up capabilities for policy analysis, for preparing sector strategies, and for macroeconomic analysis in support of medium-term expenditure planning. (This is particularly true in low-income countries.) MTEPs themselves — if realistically prepared, and if applied with commitment and determination — are a powerful tool for illuminating tradeoffs and testing different allocation strategies. Their proper use would allow budgets to be reshaped in line with changes in the role of governments.

Aid management. Some 23 countries — all but two low income — now receive aid flows of more than 10 percent of GDP. This effectively finances most of the development budget and, increasingly, a
significant portion of the recurrent budget as well. External assistance has had many positive results, but it has also militated against the host government perceiving itself as the owner of reform programs in general, and the public expenditure strategy in particular. To counteract this, more attention will have to be paid to building up aid management capability in low-income countries, specifically to deal with the “soft budget” effects of aid. The Bank might play a more active role in serving as the focal point for the coordination of external donor efforts.

Accountability. In many countries governments operate at very low levels of efficiency, consuming many resources to produce limited output. And how budgets are implemented is often quite different from what was originally intended. There is substantial unauthorized switching of funds between programs and between categories of expenditures. Some resources leak outside the budget; and other funds entirely outside the budget are improperly used to influence government actions. Large-scale corruption has probably been somewhat checked by the reduced availability of commercial lending to the public sector, but “petty” corruption has shown signs of increasing, particularly in countries where civil service pay scales have become unrealistically low. Dependence on illegal rents has become a factor in bureaucratic resistance to economic reforms. Thus, there is a need for reform on several fronts.
Civil service reform

Summary: All aspects of civil service reform should go further in most countries. Reform to date has been insufficiently ambitious and forceful to bring about the degree of change and savings needed. Deeper cuts should be made in numbers of employees and wage bills; but far more effort also has to go into medium-term measures that increase the competence and effectiveness of existing personnel and agencies.

The challenge

Civil services in many developing countries are larger than the countries need, more costly than they can afford, and less effective and productive than they should be. In some acutely distressed low-income countries, the civil service contains many who are superfluous and none who are paid well; and the organizations in which they labor tend to be ill-equipped and poorly structured. Adopting the best macroeconomic and sectoral policies means little unless the public sector can implement, enforce, and regulate them. Instilling or reinforcing this capability starts with civil service reform.

Before 1980, the World Bank claimed no expertise in civil service reform. The issue was perceived as remote from traditional Bank concerns and internal pressures to address the question were muted. In the face of persistent recession and enduring fiscal crisis, however, it became evident that many developing economies could no longer afford to maintain the large bureaucracies built up during the two previous decades, when government had been the main source of non-agricultural employment. The problem was particularly acute in the poorest and least developed countries, many of them in Sub-Saharan Africa. But recognition of the problem's importance has been increasing elsewhere, particularly in Latin America. A growing share of government revenues in many countries was being absorbed by public sector wages and salaries, often at the expense of critical operating funds. At the same time, mounting evidence of government inefficiency was reflected in weak policymaking, pervasive delays in making decisions and implementing projects, the deterioration of public infrastructure, the poor quality of public services, high transaction costs, and widespread corruption. The challenge facing the Bank was nothing less than to assist in the "redimensioning" of the state and to help the affected borrower countries manage less, but manage better.

The Bank has approached civil service reform from two complementary perspectives: short-term cost-containment measures aimed at reforming public pay and employment systems and medium-term programs to build institutional support for cost-containment and to strengthen the government's ability to manage the civil service. Cost-containment measures have been associated mainly with adjustment operations. Medium-term goals have been taken up in "development management" projects. Experience has shown these to be equally important, interrelated reforms: stopping the hemorrhage of resources is
essential, but it is only the first step in a long process of restoring the public service to productive health.

Government pay and employment reform has focused on the following four problems:

- Excessive public sector wage bills, measured both by the ratio of personnel expenditures to government revenues or total expenditures and by the degree to which nonpersonnel recurrent expenditures are crowded out by wages.
- Surplus civil service staff, with "surplus" defined by a range of measures and ratios, including the number of civil servants in relation to the number of participants in the modern sector labor force, and by operating budgets too low to support the current number of employees.
- Salary erosion, that is, declines in wages that reflect not only the high level of inflation in many countries but also the tradeoff between expanded employment and lower average pay, and the proliferation of non-wage benefits to mitigate the fall in real pay.
- Wage compression, meaning low ratios between the highest and lowest civil servant salaries, making it difficult to attract and retain qualified staff.

The medium-term reforms try to deal with larger issues: the breakdown in morale and productivity in the civil service, poor management skills, the absence of career development and merit-based promotion mechanisms, and the lack of modern, routine systems of establishment control.

The World Bank's response

The Bank started lending operations to address these problems in the early 1980s. Activity spread rapidly; to date, civil service reform has been a feature of 76 projects, including 52 adjustment operations and 24 technical assistance loans. Two-thirds of these programs have been undertaken in Sub-Saharan Africa, where the magnitude and intensity of the issue is clearly greatest. But Latin American countries also are reforming civil service practices. Indeed, the largest Bank-supported civil service reform operation was launched in Argentina, where a comprehensive reorganization program, including a planned reduction in central government staff of 130,000 positions, is getting under way.

Employment reform. There are often far more public personnel in Bank borrower countries than are needed to conduct government business. Solving the problem of surplus government employment is key both to restoring order in civil service manpower management and to easing intolerable budgetary burdens. The question is how best to reduce staffs. The Bank has supported a variety of techniques for downsizing. (Table 2.1 and figures 2.1 through 2.3 give an overview of approaches used in Bank civil service reform operations.)

Because many government payroll offices lack information, the first step is often to establish reliable base-line information about who is employed, and where, in government. Bank operations have often cleaned up the personnel information management system, by executing a civil service census and then verifying and computerizing the payroll mechanisms. These measures quantify the often large ranks of temporary staff, provide information leading to enforcement of the statutory retirement age, and most important, regularize civil service employment by eliminating "ghost" workers (salaries being paid to workers who have died, retired, or never existed).

The application of census techniques to remove ghosts significantly reduced employment in a number of countries, including Ghana, Guinea, and Uganda. Experience suggests that civil service censuses are more likely to be successfully implemented when their design is simple, when they are carried out with external technical assistance (which helps to minimize charges of favoritism and corruption), and when they are linked from the outset to an established system of manpower control.

Recruitment freezes have also been used in a number of Bank operations — for example, in the Central African Republic, Costa Rica, Gabon, Senegal, and Sri Lanka. Recruitment freezes aim to put a brake on personnel expansion and to change job expectations of future school and university graduates. Freezes have generally succeeded in slowing or stopping growth in numbers.

Enforcement of retirement age, and early and voluntary retirement programs, have been featured in nearly 20 civil service operations, mainly in Sub-Saharan Africa, as well as in Laos and Sri Lanka. In Guinea and a few other countries, strict enforcement of the stipulated retirement age achieved significant reductions. Early departure programs naturally target civil servants within a few years of normal retirement age. The net present value of the savings stream resulting from these efforts is low; major savings come about
only with the removal of younger workers. Moreover, early retirement may cost governments their most experienced personnel, an especially acute problem in countries where this cohort may be the last one to remember earlier, more productive practices. Voluntary retirement programs risk the departure of the best and the brightest; and attracting enough employees may entail unaffordable costs. In Papua New Guinea, for example, departure compensation packages average about 2.5 years salary, and add up to far more than the government can tolerate. But in countries such as Uganda, where salaries had fallen to very low levels, the fiscal impact of apparently generous severance packages seems bearable.

These mechanisms have the advantage of being politically palatable, and are useful supplements to direct dismissal, but the money saved and numbers reduced by these measures tend to be small. Only outright retrenchment substantially reduces civil service numbers, but this more direct measure is thought to entail political risks. Still, retrenchment is taking place in various countries through Bank operations (see table 2.1 for preliminary data on results of employment reduction mechanisms). In addition, the Argentine effort mentioned above shows promise; this program involved lengthy and comprehensive preparation using functional review techniques, and the construction of a severance and income maintenance program.

Experience indicates that retrenchment is facilitated by: functional reviews to determine the correct number and type of employees to accomplish defined organizational objectives; and severance packages to mitigate the political ill effects of retrenchment and to give transitional resources to workers adjusting to job markets in the private sector. Such mechanisms have been able to ensure smooth transitions to private sector employment in a good number of cases. A Bank study of retrenchment in public sector transport companies indicates that substantial severance packages are the single most important factor in implementing a staff reduction program. Another encouraging sign is that absorption of dismissed government workers into the agricultural and informal sectors has been less difficult than might have been anticipated, especially in Africa. Indeed, the political repercussions of retrenchment programs have been minimal so far. No regime has been directly destabilized because of retrenchment, and organized protest to staffing cuts has been weaker than expected.

Pay reform. Not all cost-containment measures have focused on reducing employment. Restraining the total wage bill and removing distortions in the structure of remuneration have also been important goals of Bank civil service reform. Before the Bank became involved in government pay issues, the most direct route to wage bill restraint — widely used in International Monetary Fund programs — was through wage freezes. These either held wages constant (in current or real terms), set a ceiling on the wage bill, or required that personnel expenditures not surpass a particular ratio — for example, a percentage of government expenditures. Although wage freezes continue to be applied through adjustment operations, the Bank has also begun to push for reviews and restructuring of government wage policy, aimed at rationalizing the structure of public remuneration within a limited wage bill.

In many countries, rationalizing the structure of remuneration means reducing the proportion of non-wage benefits and allowances in the remuneration package, by monetizing all forms of compensation or by cutting fringe benefits — or both. Fringe benefits had often proliferated to compensate for eroded salaries. Getting rid of them is difficult without increases in base pay. Moreover, systematic information on non-wage benefits is hard to assemble; this constrains monetization. (An outline of the various non-wage payments available to civil servants in Senegal ran to more than ten pages, without going into details about any one mechanism.) Remuneration reforms have sought to reduce pay inequities across the public sector generally — between central, parastatal, and local government entities, for example. Rationalization has also meant simplification of the salary grid, and regrading the salaries of critical staff.

Another important reform has been decompression of the wage structure. Pay erosion and severe wage compression between the top and bottom levels of the civil service are common, especially in the least developed countries. A common result is the flight of professionals from the higher echelons of government service, reaching dramatic proportions in some African countries. In Ghana, for example, civil service wage compression dipped as low as 2.5 to 1 in the initial stages of its economic recovery program, crippling the government's capacity to staff its key policy positions. Compression and erosion also breed moonlighting, absenteeism, low morale, and corruption.
<table>
<thead>
<tr>
<th>Country</th>
<th>Ghost removal</th>
<th>Enforced/early retirement</th>
<th>Voluntary departure</th>
<th>Retrenchment (regular staff)</th>
<th>Retrenchment (temporary staff)</th>
<th>Other mechanisms</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cameroon</td>
<td>5,830 b</td>
<td>5,000</td>
<td></td>
<td>350-400</td>
<td>4,500-4,550</td>
<td></td>
<td>10,830</td>
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<tr>
<td>CAR</td>
<td>2,950 b</td>
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<td>2,871</td>
<td>3,790</td>
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<td>Congo</td>
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<td>2,848</td>
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<td>The Gambia</td>
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<td>Ghana</td>
<td>11,000 d</td>
<td>4,235 e</td>
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<td>15,235</td>
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<tr>
<td>Guinea</td>
<td>1,091 f</td>
<td>10,236</td>
<td>1,744</td>
<td></td>
<td>25,793</td>
<td>38,864</td>
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<tr>
<td>Guinea Bissau</td>
<td>800 d</td>
<td>945</td>
<td>1,960</td>
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<td>3,706</td>
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<tr>
<td>Laos</td>
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<tr>
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<td></td>
<td></td>
<td></td>
<td>600</td>
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<tr>
<td>Papua New Guinea</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2,300</td>
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<td>2,300</td>
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<tr>
<td>Senegal</td>
<td>497</td>
<td>747 i</td>
<td>1,283</td>
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<td></td>
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<td>2,527</td>
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<tr>
<td>Sri Lanka</td>
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<td></td>
<td>12,000</td>
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<td>12,000</td>
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<tr>
<td>Uganda</td>
<td>20,000 k</td>
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<td>20,000</td>
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</tbody>
</table>

a. Gross figures not adjusted for new recruitment and attrition.
b. Elimination of ghosts and double payments.
c. Attrition through hiring freeze.
d. Refers only to ghosts identified. Their removal has not been verified in technical analysis.
e. Includes staff in district assemblies and the education services.
f. Ghosts in Guinea Conakry. A second census in 1989/90 identified a large number of additional ghosts.
g. Of this figure, 10,810 officials were assigned to a personnel bank and placed on administrative leave, and 14,983 were removed from civil service rolls through parastatal liquidations and the transfer of employees of mining joint ventures to company rolls. Whether all of those placed on administrative leave have left the service or not remains unclear.
h. An undetermined but small portion of these may be regular staff.
i. An additional 2,123 officials have applied for voluntary departure or early retirement.
j. Officials who have opted for early retirement and are scheduled to leave the civil service by 1/31/91.
k. Estimate based on savings from ghost removal exercise divided by average civil service wages.

Source: World Bank data.

Where higher level staff salaries have long been severely eroded, Bank and other donor programs often used salary supplements for professional employees — as an ad hoc project-related measure — well before civil service reform was addressed as a separate topic. This was done extensively in programs in Bolivia, Guinea Bissau, Mozambique, Niger, and Uganda, for example. Such "topping up" of civil service salaries allows individual projects to attract the professionals needed. But it defeats deeper, structural pay reform, and it tends to create an artificial alternative labor market in which wage levels can escalate out of control. An extreme example is Mozambique, where salaries on donor-financed projects outstrip standard civil service pay levels by huge multiples. The Bank has officially decided to discontinue its topping-up practices in that country.

**Longer-term reform in civil service management.** Short-term efforts have thus been made to correct glaring and burdensome distortions in government pay and employment practices. In the recent past, such efforts dominated the Bank’s operational agenda in civil service reform. But with the advance or completion of emergency surgery, many governments — with Bank support — have begun to focus on longer-term issues. This shift in emphasis stems from the realization by both borrowers and Bank staff that the short-term, cost-cutting measures were insufficient to bring the services to a satisfactory standard of performance. So, since 1981, 24 operations in 21 countries — most but not all of them in Africa — have begun to address medium-term issues of civil service management. The longer view looks beyond cost containment to concentrate on detailed, slower-paced reforms aimed at making government administrations more efficient and effective.

This type of reform has been launched in a relatively recent series of development management projects in several West African countries, for example, and in Argentina, Bolivia, Sri Lanka, and Yemen. These projects involve a common set of activities. Because reporting and record systems are so weak, data collection has come first, with efforts to determine the number, personal characteristics, skills, years of service, and pay of personnel in the existing civil service. (These data collection efforts differ from the earlier one-time "snapshots" of employees, being instead a more
Figure 2.1 Bank-supported civil service reform operations, by region and lending instrument, 1981–90

<table>
<thead>
<tr>
<th>Region</th>
<th>Number of Operations</th>
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<tbody>
<tr>
<td>Africa</td>
<td>47</td>
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<tr>
<td>Latin America and the Caribbean</td>
<td>15</td>
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<tr>
<td>Asia</td>
<td>8</td>
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<tr>
<td>Europe, Middle, and North Africa</td>
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Competence testing is an appealing idea in principle, but has rarely been tried. Guinea is one country that instituted such testing, with Bank advice and UNDP assistance. Between 1986 and 1989, it examined 23,000 civil servants to ascertain that they had a modicum of knowledge of the occupation to which they were assigned. Of these, 53 percent passed, 21 percent failed and were placed in a “retrenchment pool,” and 26 percent were told they would be retrained and reassigned. The process was expensive. Many placed in the retrenchment pool are still on the payroll years after failing the test; many claimed that the test was ethnically biased; and many groups of civil servants have never been tested — and there are no plans to test them. In Guinea, competence testing produced the information desired but appropriate decisions and actions did not follow and the process was not repeated. The instrument was not flawed, but it was used in a difficult setting. Further experimentation is warranted, but not unless the government is prepared to act on the outcome. Otherwise, the testing could be counterproductive.

Incentive schemes to attract skilled or retain professional civil servants have figured in several Bank projects. In Ghana, a Skills Mobilization

Figure 2.2 Components of Bank-supported civil service reform operations, 1981–90

Building and strengthening personnel mgmt. (28) 14%
Training (28) 14%
Retrenchment and freezes (28) 14%
Studies and diagnostics (21) 11%
Voluntary departure and redeployment (20) 10%
Data collection, MIS, and computerization (18) 9%
Censuses, surveys, and functional reviews (14) 7%
Wage and salary structure reform (41) 21%

Note: Numbers in parentheses refer to the number of operations containing the corresponding reform component. Since most operations contain several civil service reform components, the percentages refer only to the components’s share of the total number (194) of reform components. Source: Public Sector Management and Private Sector Development Division, Country Economics Department.
Figure 2.3 Cumulative Bank-supported civil service reform operations, by region, FY 1981–90

Number of operations

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<tr>
<td>Africa</td>
<td>50</td>
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<td>Latin America and the Caribbean</td>
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<tr>
<td>Europe, Middle East, and North Africa</td>
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Fiscal year

Source: Public Sector Management and Private Sector Development Division, Country Economics Department.

Scheme tried to increase the use of local consultants, attract back to the public sector skilled and experienced people who had left government service, and reward selected civil servants above the normal pay scale. Peru made an effort to build an elite Senior Executive Service. Both efforts ran into problems, mainly because of objections about special treatment of the elite staff and government reluctance to defend the notion that different skills merit different rewards. In Ghana, for example, "Special Duty Allowances" — to be given to certain staff members working on adjustment-related issues — were only partly paid, after long delays. But to dismiss such schemes on the basis of two brief and hastily arranged interventions would be unfair; the lesson to be drawn from this experience is that these initiatives require detailed, lengthy preparation, and that governments must be convinced that the benefits of getting skilled staff outweigh the resentment their higher pay generates.

To be able to strengthen the civil service, governments must be able to formulate and implement personnel policies. Most recent Bank-sponsored programs support studies to help in this process. They focus on salary policy, the creation and maintenance of personnel management information systems, general employment policy, training, and policies for career development, promotion, and performance evaluation. Some studies examine important but poorly understood topics, such as the complex and expensive system of fringe benefits and bonuses in Senegal. The purpose of these studies is to be able to specify feasible, essential steps for reform.

Impact of the reforms

Questions and uncertainties remain about the Bank's success with civil service reform. The Bank and some of its borrowers differ in opinion about the proper role and limits of state intervention in economic affairs; this makes it difficult to determine which services and personnel are superfluous. Moreover, the data base on these reforms comes mainly, but not exclusively, from African experience; as new operations come on line in other regions, many conclusions may require reconsideration. But experience to date suggests the following observations about the degree and impact of civil service reform.

In most countries assisted, efforts to reduce the wage bill and to decrease the number of civil service employees have yielded modest, but positive results. In a few countries the total number of civil servants has declined substantially (see box 2.1, "Results of civil service reform in West Africa"). Cuts in the public sector wage bill — either absolute or relative — have been much harder to achieve. Attempts to correct distortions in the structure of pay and employment by decompressing wages and rationalizing the remuneration system have had limited success. On the other hand, growth rates for wage bills and civil service numbers — extremely high in the 1960s and 1970s — have remained constant, and in a few cases have declined.

Of 15 countries undergoing Bank or IMF-sponsored civil service reform, eight registered absolute increases in their wage bill even after the reforms had been implemented. Those eight included countries such as Guinea and Jamaica, in which reform had seemingly progressed furthest. In five countries the wage bill declined in absolute terms. But all these data are sketchy and difficult to interpret. For one thing, wage bills may increase even when numbers remain steady or fall. In Senegal, efforts to freeze numbers in the civil service succeeded for a time, but salary costs continued to rise, although more slowly than in the past, because of step and seniority increases based solely on years of service. Guinea's reform program reduced civil service numbers by almost a quarter, but the annual average increase in the wage bill was more than 16 percent, as a new regime
Box 2.1 Results of civil service reform in West Africa

The experiences of Ghana, Guinea, and the Gambia show that civil service pay and employment reform can produce substantial results. Ghana in particular has achieved significant reductions in staff. Roughly 12,000 workers were removed from the civil service payroll in 1987, including 4,000 who were past retirement age. Another 12,000 were eliminated in 1988, and 14,000 were retrenched in 1989. The result was a 3 percent annual average reduction in total civil service employment from 1986 to 1990. Guinea achieved a reduction of more than 5 percent a year from 1985 to 1989, starting from a position of pervasive state control. This was made possible by a sharp redefinition of the role of government, after a change of regime. In the Gambia, the percentage reductions in civil service staffing were smaller — about 1 percent a year — but overstaffing was less acute to begin with (12 civil servants for every thousand people compared with 23 per thousand in Ghana).

Aided by rising tax revenues, Ghana and Guinea have succeeded in substantially raising the average levels of real remuneration since the mid-1980s. However, in neither country has there yet been any significant decompression of wages and salaries. In the Gambia, where the primary objective of pay reform was to reduce budgetary burdens, real wages actually declined; but the average wage is still very much higher as a multiple of the country’s per capita income than in Ghana or Guinea. All three countries have made some progress in simplifying grading structures and in improving procedures for performance appraisal. Ghana plans to introduce performance-based pay in 1992. All three countries used bold initiating steps to set the scene for longer-term pay and employment reform.

Conclusions

These Bank-supported efforts were the first attempts ever to carry out a large, managed reduction in the size of government and at the same time restructure its fundamental activities. Given the magnitude and uncertainties of the problem, the results have been promising. But fiscal pressures have not relaxed, and in some cases have become even more severe, so many governments will have to consider deeper cuts. The Bank has learned a great deal in the past decade. It is now in a better position to assist the next essential steps in the process.

The less confrontational employment reduction mechanisms, such as voluntary departure schemes and early retirement programs, are useful and politically astute. They do not reduce employee numbers significantly, however, so they should be used in conjunction with explicit dismissals. Functional reviews and competence test-
ing are also useful (or at least promising) in providing a transparent and objective basis for cost-containment measures. They provide some assurance that the reform process has been undertaken fairly and equitably, and they have generally been well received by governments eager to convince the citizenry that retrenchment is being applied rationally, transparently, and equitably.

Retraining, redeployment, credit, and public works programs for redundant employees are expensive and administratively cumbersome, but they provide financial assistance to the staff affected by downsizing, and valuable political assistance to the governments that must bear the responsibility for implementing the retrenchment policies. The Bank generally avoids direct financing of severance payments for redundant workers, preferring to rely on less direct mechanisms, such as retraining programs or credit schemes to help laid-off staff buy land or start small businesses. But direct severance payments to dismissed employees is simpler and lower in cost, and bypasses the rent-extracting bureaucracies sometimes encountered in more elaborate retraining or directed credit schemes.

Topping up salaries for key government posts or, more broadly, widely supplementing civil service salaries through donor-financed activities, has long been recognized as a costly and destructive alternative to across-the-board pay and incentive reform. The problem is that in the short run neither hard-pressed governments nor Bank operational staff have feasible alternatives at their disposal. The short-run survival of a project or activity often depends on salary supplements; and the wider solution is either too long in coming or too expensive to contemplate. But the Bank is increasingly recognizing (as in Mozambique) that existing and proposed methods of supplementing salaries do not provide enduring answers to the fundamental problems of civil service incentives—indeed, they ultimately weaken the likelihood of devising a durable solution. The Bank should not support or use such mechanisms without a strategy for long-term structural reform in government pay and employment policies.
Public enterprises

Summary: The performance of public enterprises is generally inadequate. Experience shows that it is possible to make improvements without changing ownership. But the measures needed have proved difficult to conceive, painful to implement, and very hard to sustain. So privatization may be necessary not only to foster efficiency in poorly performing public enterprises, but also to lock in the advances achieved under reforming public ownership.

The challenge

Public enterprises (PEs) are government-owned production units designed to function in a manner similar to a commercial corporation. By the early 1980s they were major economic, financial, and sociopolitical actors in most of countries borrowing from the World Bank. They now dominate the “natural monopoly,” social-service-providing sectors in those countries and they are also important in industrial and commercial operations. Although there is great regional variation in their role, they account on average for 10 to 20 percent of GDP, for 15 to 20 percent of modern sector employment, and for one-quarter to one-third of gross fixed capital formation in developing countries. They are also major borrowers in developing countries’ domestic and international credit systems.

In just about every developing country some public enterprises (PEs) perform well, but good performers are few in number. Too many PEs have failed to live up to the expectations of their creators and funders. Many lose rather than make money. Some that make money do so not because they are efficient and productive competitors in the market, but rather because their powerful owner — the state — rigs the market and shelters them from competition. Many that do operate profitably yield a rate of return lower than that generated by private operators in the same field of production. Many PEs in the industrial and commercial sectors, created to generate revenues for the state to invest, instead pose heavy burdens on heavily strained government budgets.

The World Bank’s response

Poor public enterprise performance has long been recognized as a serious problem, and the World Bank has long been involved in efforts to improve their economic and financial outcomes. From the 1950s through the late 1970s, the Bank focused mainly on strengthening and restructuring — and in some cases creating — individual public enterprises in the context of sector and project lending. The Bank’s emphasis was basically technical and financial. But many of these efforts to improve performance proved disappointing. Many performance problems were caused by factors outside the managers’ control — for example, political interference in the day-to-day management of the company, improper pricing, credit and labor policies, and failure to impose a hard budget constraint. Dealing with these problems required a broadening of efforts — adding a policy and administrative perspective to the engineering and
financial focus. Recognizing this, the Bank enlarged its scope of action and adopted a sectorwide approach to enterprise reform. Public enterprise reform became a public sector management concern.

The Bank's broader approach to the reform of public enterprises is based on the following reasoning:

- Many of the assets presently being underused or wasted in public enterprises — particularly in public industrial and commercial firms producing tradables — could be more productively placed in the hands of private owners. Private investor/managers possess the incentive to use the assets more efficiently.

- The Bank recommends privatization of public enterprises for which a change in ownership would produce efficiency gains and tolerable non-economic losses.

- Where a divested enterprise would operate in a competitive market, the efficiency gains are thought to be obvious, and the analysis need not be extensive. But the generally poor performance record of PEs also means that when new activities are contemplated the burden of proof should shift to those favoring the public enterprise option: unless it can be shown that there is a market failure or that the market is not contestable, the option of private ownership should be preferred.

- Still, even massive divestiture programs will leave sizable public enterprise sectors, including the natural monopoly social-service providers, or certain enterprises that governments insist have "strategic" significance to the state, or those firms undergoing the sometimes lengthy process of being prepared for sale or closure. These PEs need attention, often urgently, because of their inadequate production and high costs, the intolerable burden they place on public budgets, and the obstacles their subsidies and distortions pose for the development of the private sector.

- The reform advocated by the Bank is to "commercialize" or "corporatize" the remaining state enterprises. This means: subjecting PEs wherever and whenever possible to operation in a competitive environment; imposing on them a "hard budget constraint" which reduces or eliminates direct or indirect budget transfers; giving their managers the autonomy to run the firm in a businesslike manner; and seeing that those enterprises that cannot survive in this environment are bankrupted and closed. The general aim is to subject enterprises to as close as possible an approximation of the conditions and signals of a profit-maximizing firm, operating in a competitive market.

These reforms strike at the root causes of poor public enterprise performance: an overextended state, an inappropriate policy environment that sends the wrong signals to enterprise managers, and the state's failure to properly exercise the functions of ownership. To deal with these problems, the Bank has supported four specific kinds of reform.

- Rationalizing the size and scope of the enterprise sector.

- Improving the market and competitive environment in which public enterprises operate.

- Creating and reinforcing appropriate institutions through which governments can exercise effective ownership of enterprises.

- Rehabilitating and restructuring viable enterprises.

This issue of "restructuring" individual public enterprises raises many important questions. When is it appropriate, who should undertake the task, how should it be financed, and how does a country prevent unproductive bailouts? These firm-level questions deserve answers but are not part of public sector management as defined in the introduction so they are not addressed in this paper. (For the full range of Bank interventions in public enterprise reform, see figures 3.1 through 3.3.) Public enterprise reform is the most active area of World Bank involvement in the realm of

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Figure 3.1 Public enterprise reform operations approved as of December 1990, by region and lending instrument

<table>
<thead>
<tr>
<th>Number of operations</th>
<th>Technical Assistance Loans</th>
<th>Sector Adjustment Loans</th>
<th>Structural Adjustment Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>92</td>
<td>42</td>
<td>28</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>15</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Europe, Middle East, and North Africa</td>
<td>15</td>
<td>15</td>
<td>15</td>
</tr>
</tbody>
</table>

Source: Public Sector Management and Private Sector Development Division, Country Economics Department.
public sector management, comprising more than 150 interventions in 50 countries, half of them in Sub-Saharan Africa. Moreover, enterprise reform is emerging as a major component of Bank operations in Latin America, in North Africa, and particularly in Eastern Europe and other reforming socialist economies.13

Reforms attempted and lessons learned

Rationalizing the size of the public enterprise sector. A major objective of enterprise reform has been to reduce the size of the sector by liquidating companies that are not viable and privatizing those that are likely to be better run under private ownership. The largest number of Bank-supported attempts to reduce the size of the public enterprise sector have been made in Africa, where downsizing programs—through sale, liquidation, and merger—are under way in more than 20 countries. But programs exist in every other region—for example, in Argentina, Hungary, the Philippines, and Tunisia. At present, the Bank group, including the International Finance Corporation, is assisting divestiture operations in over 50 countries worldwide. Experience reveals that countries prefer sale to closure, although liquidation has been extensively applied in the Mexican rationalization program, and in Hungary, where literally hundreds of liquidation procedures are in progress.

The accomplishment and problems of divestiture are the subject of a separate Bank paper.14
Suffice it to say that privatization invariably takes far more time to plan and especially to implement than originally anticipated. Even those governments most committed to divestiture find that the process normally takes years to effect. So it seems inevitable that public enterprise sectors will remain large and costly and will require continuing efforts to improve performance — the theme of the rest of this section. The resurgence of faith in the market and the resulting quest for divestiture has placed the burden of proof on those who champion public ownership of productive assets. The Bank has been a leading advocate of this reassessment process. The reduction in the total number of public enterprises in developing countries has been modest, but these enterprises are only rarely being created. In Madagascar and several other countries, an official moratorium has been declared on the creation of public enterprises. This in itself is a significant development.

Improving the market environment. A primary lesson of experience is that for enterprise reform to be effective, the macroeconomic and sectoral policy frameworks must be in order. It has been shown that no amount of internal restructuring or modification of institutional arrangements can substitute for liberalization of trade policy and the lifting of controls on exchange rates, interest levels, and other basic prices. Thus, the public enterprise reforms supported in the framework of adjustment operations (the vast majority of them) have been in conjunction with programs correcting overvalued exchange rates, excessively low and often negative interest rates, excessive protection, price controls, subsidies, and other distortions.

The efficiency of public enterprises suffers when competition is restricted — by monopoly rights, barriers to the entry of new firms, import restrictions, price controls, rigid labor and wage policies, privileged access to bank credit and government funds, and protection against bankruptcy. (Of course, they often benefit financially from such restrictions.) The Bank has accordingly supported a range of measures designed to expose public enterprises to greater competition. These include the reduction of trade barriers, price liberalization, and the end of monopoly rights. Experience shows that these corrections are essential for enterprise reform, but are sometimes slow to take effect: competition-enhancing changes in Mexico’s macroeconomic framework undertaken in the early 1980s, for example, only began to pay off — in terms of improved industrial public enterprise performance — at the end of the decade. Where competition can be introduced rapidly, the results...
are usually impressive (see box 3.1, "Exposing public enterprises to competition").

Another reason for exposing enterprises to market forces is to allow them to raise their prices and tariffs to levels that allow cost recovery. This has been a central element of reform in Bank enterprise operations in all regions. Changes in tariffs and increased managerial autonomy on output pricing have featured prominently in most Bank-supported enterprise reforms and — where governments have lived up to their commitment to allow higher prices — have resulted in substantial decreases in the budgetary burden posed by public enterprises (for example, in Turkey). But allowing monopoly public enterprises to raise prices does not necessarily result in efficiency gains; indeed, it is quite possible to improve financial performance yet decrease efficiency. Thus, introducing a hard budget constraint on enterprises and installing rational pricing regimes are important, but the prerequisite for improving performance is to expose the enterprise to competition while removing barriers to entry and exit. The practice of liquidating commercial or industrial public enterprises that demonstrably cannot compete is spreading in Sub-Saharan Africa (Burundi, Central African Republic, Malawi, Togo) and has also been a condition of loans to Hungary and Panama. All of these are significant steps toward improving the market environment, cutting costs, and improving the competitive position of public enterprises. They merit continuation and strengthening.

**Government-public enterprise relations.** Increased competition and the removal of price distortions can result in increased efficiency. But not if managers are forced by the government to pursue multiple and conflicting objectives, not if their performance is not adequately monitored and rewarded, and not if limits are imposed on their freedom to make the operating decisions normally left to managers in private firms. These include decisions about the pricing of products in competitive markets, the hiring and firing of workers, plant location, product run, and the procurement of inputs.

Many PE managers do not have freedom of action where they should. And some have freedom of action where they should not — for example, on contracting foreign debt with an explicit or implicit government guarantee. The Bank has therefore widely and consistently advocated reforms designed to clarify enterprise objectives, to decentralize management authority to the firm level, and to enhance the role of the government as owner and regulator. The Bank supports the substitution of ex-post for ex-ante controls, and it promotes efforts to make managers more accountable and to reward them on the basis of their performance. In sum, the aims of Bank efforts in this area are to:

- Increase the autonomy of enterprise managers so as to allow them to seize opportunities (rather than obey orders).
- Increase enterprises’ accountability to their owners, by clarifying the legal and financial frameworks for enterprise activities, improving financial reporting and management systems, and creating or reinforcing oversight agencies.

A few of the Bank’s earliest interventions to reform public enterprises as a sector — particularly in Africa — had the perverse effect of both strengthening and increasing the number of instruments of bureaucratic control, while doing little to promote enterprise autonomy. This came about — in Senegal, for example — as the result of efforts to create strong “focal points” to guide and monitor enterprise performance. Such oversight agencies are often justified. But experience reveals that they must be combined with increased fiscal discipline as well as efforts to strengthen management decision-making authority at the firm level. Increasingly, therefore, the emphasis in Bank-supported programs has shifted toward loos-

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**Box 3.1 Exposing public enterprises to competition**

The agricultural sector provides productive ground for the rapid introduction of competition-enhancing measures. State agricultural marketing agencies in Ghana, Madagascar, Malawi, and a number of other African countries have been opened to competition from private traders, with generally good and quick results. In some cases the results have been spectacular: in Niger, exposing a state food distribution agency to private sector competition resulted rapidly in a wider range of food products being made available to consumers, at generally lower prices. This included many consumers previously not served by the public agency, even though one justification for its existence had been to serve remote and disadvantaged regions. Most impressively, the state agency responded to this competition by cutting costs and improving services, and began to recapture customers — and earn profits — for the first time in its history. Here competition was the key, not ownership.
ening day-to-day sectoral ministerial control over production decisions, while reserving to government the few guidance functions exercised by the head office of a multidivisional private firm. These are:

- Setting enterprise objectives.
- Appointing the managing director.
- Evaluating performance and rewarding or penalizing managers accordingly.
- Approving major investment decisions when they require external funds.
- Planning and coordinating activities involving more than one unit.
- Doing nothing else.

The Bank advocates that commercial public enterprises maximize profits and that (under most circumstances) monopolies minimize costs. Non-commercial objectives should be minimized, if not eliminated. The assignment of noncommercial objectives to public enterprises has generally had an insidious effect on the achievement of all the firm's objectives — commercial and noncommercial alike. Where the public enterprise is the last-resort instrument for achieving an important or "strategic" noncommercial objective, then the state as owner should quantify the costs and compensate the enterprise accordingly. These principles are enshrined in a large number of Bank projects and operations, in every region.

An urgent and fundamental task in most African, and now Eastern European, public firms has been to improve basic enterprise accounting, institute a proper system of financial auditing, and provide government oversight agencies with a reduced flow of higher quality information about enterprise operations and finances. This was the main thrust of the second public enterprise operation in Senegal, and it has been a prominent feature of the Bank's initial interventions in a number of other low-income countries, including Burundi, Congo, Côte d'Ivoire, and Ghana. At best, these institutions conceive and carry out needed reform; at least, they provide decisionmakers with information on the performance and impact of the public enterprise sector. In countries better endowed with human and administrative resources, enterprise reform has introduced more sophisticated performance evaluation techniques. Korea, Mexico, and Pakistan offer successful or highly promising examples of such techniques (see below).

Equipping government agencies to supervise enterprises more effectively has been the main purpose of technical assistance extended to, among others, the ministries of finance in Ghana, Jamaica, and Morocco; ministries of state enterprises in Mali and Togo; the ministry of planning in Mauritius; the ministry of production in Pakistan; and a government holding company in Peru. Conscious of the need to avoid expanding the plethora of government organizations, the Bank has tried to assist existing agencies, but in some cases it has been persuaded to support the establishment of new supervisory institutions. Again, the distinction falls along lines of income. In least developed countries (Niger, Senegal, and Togo) new oversight organizations were needed to provide decisionmakers with information on a sector that has escaped financial controls; in middle-income countries (Mexico, Morocco, or Thailand, for example) the recommendation is usually to reduce the interference of existing agencies, and if possible to reduce their number.

The Bank has helped devise and introduce new legislation to regulate the enterprise sector in several countries, such as Jamaica and Mexico. The most far-reaching case (before the sweeping legal reform now being enacted in Eastern and Central Europe) was that of Turkey. A law enacted in 1983 laid down rules about the composition, appointment, and power of public enterprise boards of directors, the tenure of board members, and the appointment of top managers, and allowed state enterprises wider discretion in determining prices and making investment decisions.

As a mechanism aimed at establishing an appropriate balance between autonomy and accountability, the Bank has widely advocated performance agreements, or "contract plans." They seek to clarify government-enterprise responsibilities and obligations, specify enterprise objectives and performance criteria, and provide a sound basis for planning investments. They are negotiated between the government (as owner) and the enterprise. With and through Bank help, they are in use throughout francophone Africa, as well as in Ghana, Kenya, Morocco, Tunisia, the Gambia, and — in a modified form, without Bank involvement — in India. Their use is generally endorsed by both public enterprise managers and government supervisors; all involved agree that establishing the process of enterprise-owner dialogue is beneficial. Contract plans clarify goals and have reduced the number and weight of control mechanisms and procedures (particularly in Morocco). Thus, they can contribute to managerial autonomy. They are associated with improved ability to estimate investment needs, and, in natu-
Box 3.2 Public enterprise reform in Korea

In 1983 the Government of South Korea changed the way an important group of its public enterprises was managed. This group, known as Government Invested Enterprises or GIEs, consists of 26 companies which account for 60 percent of the value added in the entire public enterprise sector; the two largest are the Telecommunications Authority and the Electric Power Corporation, which together control around $32 billion in assets and employ 75,000 people. Government controls over these enterprises were relaxed, and enterprise managers were given much greater autonomy to make decisions on budgets, staff appointments, and procurement. Whereas previously almost half the senior staff were appointed from outside the enterprise, priority was now given to internal appointments. Performance review techniques were then developed as a basis for promotion on merit.

These changes were accompanied by the introduction of a system for evaluating overall enterprise performance. Performance indicators and annual targets for each enterprise are established by outside experts and agreed upon with the enterprise management. These are then weighted and combined to produce a score which is assessed each year and used to determine the ranking of the enterprise and the annual bonus the staff will receive. These indicators are designed to reflect the performance of the management and to discount factors that are outside the management’s control. All financial indicators are put into constant prices, and profits are counted before deduction of interest, depreciation, and taxes (but minus non-operating income). This provides a measure of “public profitability.”

This approach was first tried out in Korea (see box 3.2, “Public enterprise reform in Korea”) and then adopted, with Bank support, for manufacturing enterprises in Pakistan. It has positively affected the motivation of enterprise managers, and has increased efficiency in both countries. It is now being installed in Mexico and the Philippines, with Bank support. The system shows great promise; however, it depends on a regular flow of reliable and up-to-date information and on relatively sophisticated accounting methods, making its application in countries with weaker administrations questionable.

Public enterprises in developing countries are key elements in patronage systems, so overstaffing is often rife, and appointments to senior management positions are often made on the basis of family and political connections rather than merit. Membership on public enterprise boards of directors in many countries is often an over lucrative position. In a few countries, ministers themselves chair enterprise boards, diluting the board’s functions (no one contradicts the minister) and leading to conflicts of interest. The problem of overstaff-
ing is being addressed in many of the Bank's operations; there have already been massive layoffs of cocoa workers in Ghana and tin miners in Bolivia. Governments have been reluctant to directly face the overstaffing issue, but in country after country straitened financial conditions are obliging regimes to cut back on wage bills and personnel numbers. As with civil service reform, the Bank has been helping to develop social safety mechanisms, to provide resources and training for those laid off. These efforts are now included in every large-scale public enterprise adjustment operation; they range from retraining and credit schemes for affected workers in Senegal, to assistance in creating an unemployment benefits system in Poland.

A key method for decentralizing authority to its most appropriate level is to change the composition and powers of enterprise boards of directors. The Bank has had only limited success dealing with problems of patronage and political appointees, but where the issue has been directly attacked—for example, in Korea—the resulting improvements in performance have been dramatic. In Korea, board members of public enterprises are now drawn from the private sector, bankers, lawyers, and academics. Only two board members, out of at least seven, come from the civil service: they represent the sectoral ministry and the ministry of finance. Giving the boards this kind of composition—and assigning them the clear prime task of promoting the enterprise's profitability—has much improved performance.

**Impact of the reforms**

The overall impact of these reforms has been positive. There is now a worldwide awareness of the high costs and insufficient benefits of past performance patterns of public enterprises. A few public enterprises are still being brought into existence, but this has become a rarity, not a matter of course. Today, public enterprises play a less significant economic role than they did in the past. This is partly because of the success and spread of divestiture programs and partly because of cost reductions and performance improvements in enterprises that remain in state hands. Among other examples of divestiture: the Philippines has sold a quarter of its 1985 portfolio; between 1982 and 1990 Mexico reduced by more than 40 percent the number of its public enterprises; Jamaica has divested US$100 million of state-owned assets, and Guinea and Togo have sold or leased significant portions of their industrial public enterprise holdings. The Bank can take credit for these important reductions in overextended state sectors.

Assessing improvements in performance is somewhat more difficult. It takes time to determine whether an organizational and behavioral reform has had the desired effect; it is inherently a gradual process. It is not easy to separate the effects of Bank interventions from all the other factors that influence public enterprise performance, or to establish the counterfactual. But one can state that reform programs supported by the Bank are paying dividends in improved profitability for many public enterprises. What is the evidence for this conclusion?

A study carried out by Bank staff in 1989 showed that, out of a sample of 18 countries with Bank-supported public enterprise reform programs, eight registered an improvement in the financial performance of the sector, eight at least arrested further declines, and only two continued on a downward trend (Côte d'Ivoire and Senegal). In Thailand, where the Bank has not lent directly for enterprise reform, but where the policies enacted followed recommendations made in Bank country and economic sector work, the aggregate profits of nonfinancial public enterprises increased 75 percent (at current prices) between 1983 and 1988. The group of Pakistani industrial public enterprises using the Bank-supported "signalling system" reported a doubling of post-tax profits after three years of use; the dramatically improved performance in Korean GIEs has already been noted. The introduction of performance evaluation systems, cost-cutting measures, and improved managerial structures and incentives in the framework of overall policy reform, have raised productivity in many PEs. Price liberalization measures have been effected in several dozen reform programs. Improvements in investment and credit policies have been noted in Congo, Ghana, Jamaica, Mexico, and the Philippines. Substantial staff reductions have been implemented in Côte d'Ivoire, Ghana, Jamaica, Niger, Panama, and Togo. All this adds up to positive results.

Evidence on the budgetary impact of Bank-supported enterprise reforms is less conclusive. Some countries have registered substantial declines in transfers from the government to the enterprises: Kenya, Mauritius, Mexico, Thailand, and Turkey, for example. But the year-to-year flow of funds from the Treasury to public enterprises and vice versa is affected by several variables unrelated to enterprise efficiency, such as
investment needs, tax exemptions, and subsidies. Moreover, enterprises often have other sources of finance such as borrowing from the banking system. In Senegal, for example, while direct operational subsidies from the budget declined between 1985-86 and 1988-89, there was a large rise in public enterprise overdrafts. This is a common and costly occurrence: often when efforts are made to impose a hard budget constraint, the financing shortfall is made up—sometimes briefly, sometimes for an extended period of time—from the banking system. Therefore, a major and widely applicable lesson of the Bank's reform experience is that fiscal discipline cannot be imposed simply by cutting direct budget allocations; there must be a corresponding discipline on credit flows.

Conclusions

Countries that have increased the efficiency of their state enterprise sectors have done so by increasing the responsibilities—and competence, and incentives—of enterprise managers and boards, while shifting government supervision from control of financial transactions to the stimulation and evaluation of results. (Sectoral ministries have been the clearest "losers" in this process.) A proven way to hold public enterprise managers accountable is to isolate the factors that are within their control and then let them know they will be judged according to changes in these variables. The Bank has pushed for and helped implement these sorts of changes.

The reform of the public enterprise sector is daunting because it simultaneously touches so many facets of the economy and society. Yet not all public enterprises need be dealt with at once, and some not at all. Some can be left to fend for themselves without subsidy or support. Those that cannot survive should be liquidated quickly—a painful outcome, but one that is increasingly tolerated.

Clearly, a strong political will is needed to carry on and carry through public enterprise reform. This has been very much in evidence recently in such countries as Bolivia, Ghana, Jamaica, Mexico, Morocco, Nigeria, and Poland. Moreover, persistent and intense fiscal crisis is pushing a number of governments once resistant to public enterprise reform—among them Algeria, Argentina, and Egypt—to undertake or contemplate far-reaching changes. A number of other countries, many of them previously socialist, are rethinking their public enterprise policies and are contacting the Bank, seeking guidance and assistance. This is an area of high demand.

The public sector management approach has had its greatest impact and clearest successes in the field of public enterprise reform. But there is room for improvement in the Bank's programs.

- The Bank is presently studying the economic and financial effects of privatization on a select sample of divested public enterprises. The information produced will help both borrowers and Bank staff in deciding whether, when, and how to privatize.

- The Bank will shortly launch a program to determine how to make performance agreements or contracts more effective. The underlying idea in these contracts—agree on what the enterprise is to do and on what it needs to do it—is simple, appealing, and essential. But the positive impact of these devices has been less than anticipated. Research will try to ascertain precisely why this has been so and what can be done to correct it.

- Regionally based studies to examine the impact of Bank-assisted PE reforms are required, and are under way in Africa and parts of Latin America and the Caribbean region.

- The handling of redundant workers and the effect this has on overall economic efficiency will also receive further attention. Retrenchment is a sensitive, indeed, a potentially explosive issue. Most governments that have succeeded in downsizing enterprise labor forces have paved the way by giving special attention to a social safety net woven of severance packages, training, credit schemes, and resettlement programs. But these have been expensive and management-intensive in their own right.

- Overall, the "commercialization" of public enterprises by subjecting them to market proxies yields benefits of improved performance and lower costs. But the strategy has its limits. It is highly dependent not simply on government's giving autonomy to PEs, but on its keeping that commitment over time, in a variety of conditions and circumstances. This enduring commitment has proved difficult to maintain. That is why many governments in industrialized countries moved from the reform of PEs to their sale. Privatization is increasingly being viewed as necessary, not only to improve performance but also to lock in the gains achieved under reforming public ownership. This important thesis will be tested in upcoming Bank work.
Methods of Bank support

Summary: Neither the recipients nor the providers of technical assistance—a principal instrument of public sector management reform—have been satisfied with its results. To improve its impact, the Bank should develop explicit technical assistance strategies that complement its policy reform agenda and should adapt the mix of Bank instruments to the degree of government commitment for PSM reform.

Types of lending

The Bank’s support of public sector management reform over the past decade has been linked with the evolution of three types of lending:

• Structural adjustment and sectoral adjustment loans and credits.
• Public enterprise reconstruction loans and credits.
• Freestanding technical assistance loans and credits for PSM.

Adjustment operations. Public sector management actions have been conditions in almost every adjustment operation. Adjustment operations tend to intensify the dialogue on proposed PSM actions in quarters such as the presidency, the prime minister’s office, and the ministry of finance. Without this association, some governments might not have been prepared to commit themselves to such unpopular measures as dropping pet projects, staff retrenchment, and enterprise divestiture. However, the quick-disbursing nature of adjustment loans makes them questionable as instruments for promoting institutional PSM reform. PSM reforms evolve over a relatively lengthy period, unlike policy changes, which tend to be more clear-cut and can often be enacted rapidly. It can be argued that this lack of a fit between rapid disbursement and institutional reform is minimal, since adjustment operations are normally disbursed in more than two tranches, and are usually repeated. Indeed, a number of countries have received between three and five consecutive adjustment loans. In principle, this allows ample opportunity for the government and the Bank to follow up in areas of perceived need. But the adjustment process tends to emphasize the quantifiable and the monitorable. This may have led the Bank to stress unduly those factors that can be measured, which sometimes differs from what is most needed.

The dissonance between adjustment operation schedules and the longer time required for PSM reform led Bank management, in 1984, to separate technical assistance (TA) from adjustment lending. The Bank then began to provide specific institutional support for adjustment operations through freestanding TA projects. Bankwide, the institutional components of 59 structural adjustment loans have been supported by 42 “companion” TA projects, sometimes referred to as public sector management projects.

Technical assistance. Technical assistance is the Bank’s principal method of delivery for PSM reform efforts. The TA projects referred to above are
of recent origin. Their purpose is to strengthen institutional capabilities in a range of core ministries or agencies, selected public enterprises, and enterprise policy-setting and supervision bodies, and to improve policy formulation and public administration in general. Examples include the public financial management operation (Bolivia), economic management technical assistance project (the Philippines), public administration support project (Morocco), public sector management technical assistance project (Argentina), economic and public enterprise management project (Burundi), and development management projects (Mauritania and Senegal). Their magnitude varies from as little as US$1 million to over US$75 million. As a percentage of all freestanding TA projects, the number of PSM projects increased from about 20 percent to almost 70 percent in the period 1982-88; 60 PSM projects were approved. In the Africa region, this has become the fastest growing category of TA. It has been used to a somewhat lesser extent in Latin America and the Caribbean, and sparingly in Asia, Europe, the Middle East, and North Africa (for example, in Bangladesh, China, and most recently in Algeria and Morocco).

The scope of public sector management projects has broadened since the earliest projects, away from institutional support in a few key agencies, aimed at facilitating Bank-borrower policy dialogue, and toward broader reforms aimed at overcoming the more fundamental deficiencies perceived in public sector management. The idea now is to help the borrower create the analytical capability needed for diagnosing and preparing new and better policies.

Use of technical assistance. Many of the accomplishments detailed in the earlier sections are directly attributable to well-designed and executed programs. But internal Bank reviews carried out in recent years have pointed to weaknesses in the way TA for PSM is managed. They are as follows.

At the design stage there has been: insufficient involvement of recipients and, as a result, insufficient commitment to the proper use of TA; a tendency to build too many complex components into the project, making it difficult to staff and supervise; insufficient preparation time; inadequate assessment of the borrower's needs and the sociopolitical climate in which TA is to work; loosely drawn terms of reference or, in extreme cases, no terms of reference at all; targeting that is overambitious in scope and especially in timing; unmeasurable outputs; and inadequate or inappropriate instruments (excessive reliance on long-term expatriate TA, and insufficient provision for training).

Design deficiencies are compounded by defects in implementation. These include: recruitment delays and problems finding suitable consultants, a variety of problems associated with the employment conditions and utility of long-term expatriate advisors, lack of adequate counterparts, inadequate supervision by the Bank, poor coordination with other donors, and, again, inadequate commitment and administration on the part of the borrowers.

The phenomenon of "supply-driven" TA is most commonly encountered in Africa and some least developed countries in other regions. That is, when project officers encounter institutional and technical gaps in their designs, they deal with the deficiencies by means of technical assistance. TA is said to be supply-driven when project recipients view the TA as imposed from the outside — as a "price" they must pay to receive the financial assistance, rather than a response to a locally felt need or demand. As a result, the involved government often makes little or no effort to use the TA, even though it may be paying for it.

As for technical assistance management issues, experience and the analyses cited suggest the following remedial measures:

• More effort should be devoted to the design stage of technical assistance actions. In particular, monitorable achievements should be set out.
• At the same time, an element of flexibility should be built into the design to allow for changing realities during implementation.
• The borrower must participate fully in project design.
• The borrower must be committed and an assessment must be made of the borrower's ability and determination to put TA to proper use.
• Creative delivery arrangements should be tried and tested — for example, by integrating short- and long-term consultants.
• Whenever possible, more use should be made of local consultants.
• Supervision of technical assistance components and projects must be intensified.
• Both the selection and performance of consultants must be more rigorously assessed.

These suggestions derived from past experience are being taken into account and progress is being made. For example, in the more recent
technical assistance projects, clearer overall goals and tighter terms of reference and work programs have been defined. More use is being made of local consultants. In some instances, a larger role in project design and consultant supervision has been assigned to staff in the Bank’s resident missions — who, being on the spot, can provide the close supervision necessary. More creative modes of delivery are being experimented with: “twinning” (see box 4.1); programs to use repatriated, specially skilled nationals in place of foreign consultants; and schemes that supplement the resources of long-term resident advisors with periodic short visits by specialists to deal with technical bottlenecks and to offer training to host country staff.

But even with improved design and delivery, Bank-supported TA programs for PSM are still not effective enough. Why is this so?

One reason is that projects with significant institutional or PSM components evolve in ways difficult to foresee, and require considerable adaptation as they develop. This conflicts with Bank staff’s tendency to try to specify a complete and minutely planned solution to problems they encounter. This overrational perspective often leads staff to develop an elaborate “blueprint” for the design and implementation of technical assistance projects, and to try to hold rigidly to the blueprint when implementing the project.

Recent analysis recommends a different course. It supports the contention that the successful technical assistance programs are those that are flexible (that is, based on a close reading of the specific country’s — or agency’s — needs and skills), subject to frequent review and modification both to alter or eliminate poorly functioning elements and to seize unexpected opportunities. Where this flexibility has been adopted by the Bank and borrowers, the results have been positive, as in the Kenya Agriculture Technical Assistance Project.

This advice has proved hard to follow. This is partly because of the urgency attached to meeting operational deadlines. But it is also because of a Bank tendency not to expend many resources in either the design or supervision of TA, perhaps because technical assistance, albeit substantial, still represents a relatively small part of Bank lending. Frequent turnover of Bank staff working on a particular country or project is an additional problem in dealing with long-term institutional-managerial issues. Moreover, the Bank is not used to giving systematic, explicit attention to the issue of government commitment, a persistent problem that is much discussed but little analyzed.

Thus, some unanswered questions remain about the ways the Bank uses technical assistance for PSM reform and about the appropriate division of labor between the Bank and other suppliers of assistance. Experience shows that TA is not effective in cases of acute institutional weakness, so it is logical to conclude that the Bank ought to be more discriminating in its use of PSM reform, limiting it to cases where the government’s commitment is clearly demonstrated, and where there is a minimal pre-existing institutional base on which to build. But this would curtail activities with some most deserving borrowers; thus, the Bank would have to compensate by stepping up efforts on non-TA routes to PSM reform. These measures — training, finding ways to elicit desired behavior from existing staff by providing material or nonmaterial incentives — are less precise than TA.

To resolve the dilemma arising from the close correlation between an extreme need for PSM and a relative inability to use traditional

**Box 4.1 Twinning**

Twinning is proving to be an effective method of delivering technical assistance to strengthen public sector institutions. It has been used in several programs of financial management and public enterprise reform. It is also well adapted to the strengthening of training institutions. The Paris Chamber of Commerce and Industry, supported by one of the Grands Écoles, is twinned under IDA financing with the National Institute of Accounting and Management in Madagascar. A Canadian consortium comprising the Ontario Human Resources Secretariat, the Niagara Institute, and the Ontario International Corporation has entered into a twinning arrangement to provide support to the Malawi Institute of Management and to supply eight management trainers.

Broadly defined, twinning arrangements can take the form of consulting services, management contracts, or even joint ventures. The main advantage of twinning is that it provides an operational relationship between institutions engaged in similar types of activity in different countries. It is a more cohesive and continuous approach to technical assistance than relying on normal consultancy arrangements, and it is generally a good deal cheaper. It lends itself readily to cooperation between agencies in different developing countries (for example, between Ghana’s Irrigation Development Authority and Korea’s Agricultural Development Corporation) and is a good way to integrate training with technical assistance — much preferable as a rule to on-the-job training provided by individual consultants.
technical assistance effectively, capacity building and motivational work must precede significant TA efforts.

In countries where the preconditions for the successful application of TA exist, several low-cost steps can be taken to improve performance.

- The Bank could be more selective about TA projects, advancing only those projects for which there is demonstrated commitment and a high chance for success. A decision not to proceed with a project, or a decision to cancel undisbursed amounts on the ground of inadequate borrower commitment, should not necessarily be interpreted as a failure on the part of the Bank. Withdrawing support from a borrower institution may be a means of securing reform, as well as freeing Bank resources (including staff time) for more productive use elsewhere.

- The Bank could be more realistic and specific in setting objectives and goals to be achieved.

- The Bank could allow more lead time for these projects. Good PSM work normally requires in-depth knowledge of a country and careful negotiation with many officials and agencies, all of which takes time.

- Operational staff should systematically compile information on consultants, including frank evaluations of their performance.

- Practical guidelines and project implementation manuals should be prepared for Bank staff working on these areas.

- More use should be made of the Bank's field offices—for example, to identify the sociopolitical contacts and information so essential to PSM project success, to identify and review the work of local consultants, to monitor the performance and progress of ongoing projects, and to coordinate TA financed by the Bank with that provided by bilateral donors.

- More effort should be expended on cross-fertilization of ideas and dissemination of best practices to staff working in these areas.

The suggested actions are not new. The issue is much more one of applying the lessons of experience and—following the advice the Bank gives to borrowers—doing less, but doing it better.

Consultants

Consultants account for most expenditures on PSM-related technical assistance financed by the Bank Group. International accounting firms—management consultants in particular—have been extensively used to advise on such matters as civil service compensation, financial management, and public enterprise reform. The Bank’s experience with these consultants has been distinctly mixed (indeed, often the consultants supply the TA criticized above), and costs are high—now typically in the range of $15,000 per person-month.

The choice of consultants is formally the responsibility of the borrower. Bank staff often advise on the list of firms invited to submit proposals and may comment on the proposals received. But they do not have the time and they are not particularly well placed to screen the final selection of individuals who will carry out a given assignment. All too often, the host governments also lack the expertise to choose wisely and the inclination or resources to supervise well. The result has been a small but steady stream of less-enthusiastic assessments of the quality of consultants’ work in PSM. The Bank maintains a register of consulting firms, and files on individual consultants are kept, but information on the qualifications and performance of consultants is not systematically recorded. This should be done as a matter of priority.

Bank Group projects have been used in a number of countries to build up domestic consulting expertise in both the public and private sectors. A positive byproduct of public enterprise reform in Senegal, for example, was the development of local accounting firms to carry out enterprise audits; these were generally set up as joint ventures with foreign partners. Local universities have been contracted to train financial analysts in Jamaica and to help strengthen the government’s economic services in Nigeria. Among many examples that could be cited, a domestic private consultancy firm in Ghana has helped the National Revenue Secretariat evaluate the organization and staffing of the tax administration. In Kenya, studies of the evolution of government policy on the parastatal sector were carried out by local consultants. The projects for strengthening the civil service training center in Bangladesh and establishing the Malawi Institute of Management see these institutes as providing both consultancy and training. A high proportion of the technical assistance extended by the Bank for PSM reform in Latin America and Asia is being spent on consultants from within those regions.

But these laudable examples do not resolve a prime question: what are the benefits and costs of using local, as opposed to international, consult-
nants? The high costs of international consultants, and the presumably greater local knowledge of domestic consultants, should make local firms competitive. To date, no extensive data base exists on the use, costs, or quality of work of domestic firms, nor has their work been formally compared with that of international companies, but in Africa, at least, domestic consultants command a very small share of the market. Building capacity for local consultancies is therefore a candidate for technical assistance, especially for PSM actions, where local knowledge is critical to good advice.

Technical assistance from the IMF: a contrasting approach

The International Monetary Fund handles technical assistance somewhat differently from the Bank. In three IMF departments — Fiscal Affairs, Central Banking, and the Bureau of Statistics — technical assistance is a major activity, and the departments are staffed with relevant experts. Long-term consultants — drawn from panels of experienced government officials and professional economists — are employed and paid by the Fund and serve in an advisory capacity under the Fund's close supervision. The Fund bears all the costs; the host country pays nothing. The number of fields served is limited, and the Fund extends technical assistance only at the request of an appropriate government authority. The operational control of technical assistance activities is a continuous process, with advisors required to submit monthly progress reports and to consult headquarters on issues of substance. Short-term assignments are often carried out by Fund staff members.

The Bank does not exercise as much control over the appointment or performance of the consultants it finances; it depends largely on private consultants, for whose services the borrower has to pay. The Bank's International Economics Department and its predecessors have occasionally dispensed short-term technical assistance similar to that provided by the Fund, in debt reporting and statistics. The Bank has also seconded staff members to serve in advisory positions in member countries, notably under the special programs initiated in the early 1980s for low-income countries. But these efforts were limited and temporary and were not always judged successful. Indeed, it is difficult to see how the Bank could adopt wholesale the Fund's approach, even if it were established that this approach is more effective in transmitting skills. The main problem is that the wide range of issues and areas in which the Bank works makes it impossible to duplicate the expensive and intensive supervision that seems to be the essence of the Fund's method. Nevertheless, a pilot experiment using the IMF approach might be considered for some priority PSM activities.

Technical assistance "embedded" in country economic and sector work

The Bank continues to make extensive use of its country and economic sector work (CESW) as a vehicle for technical assistance in promoting PSM reform. Public expenditure surveys, public investment reviews, and diagnostic studies of public enterprises often provide a basis for adjustment operation conditionality and serve as a point of departure for technical assistance operations. Offering advice on institutional matters has been one of the main functions of recent Bank economic missions in Eastern Europe. In some African countries (for example, Zambia in the early 1980s) Bank staff became heavily involved, in collaboration with the IMF, in helping to reorganize planning and especially budgeting systems. These efforts were assessed as beneficial but quite costly and difficult to sustain. As the Bank has become more deeply involved with problems of development administration, it has become increasingly difficult to draw a dividing line between CESW and work on the preparation and appraisal of projects for strengthening financial and economic management and enterprise reform. Limited staff availability and the high opportunity costs of CESW impose limits on its use as a substitute for lending operations. Still, through its analytical, policy-dialogue, and financial work, the Bank provides a form of TA that is "embedded" in its normal dealings with borrower governments. The objectives of these exercises are seldom written up in a formal sense, nor are they costed out; but the informal assessment of both borrower government personnel and Bank staff is that this form of assistance yields positive results.

The Economic Development Institute

The Economic Development Institute (EDI) supports improved management in the public sector of borrower countries through its training courses. Most of the training sessions relevant to public
sector management are offered on a regional basis. Topics covered include macro- and microeconomic management, public financial management, fiscal reform, aid coordination, public enterprise management, civil service reform, and decentralization. Over the past decade, about 200 courses of both short and medium duration, in and outside Washington, have been held. The efforts have taken place in all regions, though African concerns and needs have received the most significant share (roughly 40 percent) of attention.

In the 1980s the EDI established long-term partnership relations with public training and management development institutes in all four regions. For example, in 1987 the Institute — in conjunction with the International Labour Organisation and the United Nations Development Programme — launched UNEDIL, a scheme to strengthen 17 African management training centers and regional organizations, the latter operating in the fields of policy analysis, financial management and administration, and business development and marketing. The program builds faculty skills; reinforces local staff capabilities for consulting, research, and performance evaluations; and aims at increasing the financial and administrative autonomy of each participating organization. Three other programs of a similar nature are in operation or preparation.

Conclusions

The main delivery mechanism for PSM reform has been technical assistance through lending. Too much of the TA provided by the Bank in the public sector management field has been the supply-driven type — insisted upon by the Bank — which has not been effective. On the one hand, part of the fault lies with the Bank. Management-related TA components of adjustment operations have too often been inadequately designed and insufficiently supervised. These defects can be corrected, at some expense: a slower pace of project and program preparation, higher coefficients of staff time on supervision, and — if it were decided to emulate the IMF approach — a narrower range of activities that could be supported by “in-house” experts. On the other hand, PSM-related technical assistance has sometimes been called on to compensate for organizational and institutional deficiencies in least developed countries, a task that may simply be too large and complex for the resources devoted to it. In other words, in some instances it is not that TA was poorly done; it is that the task was beyond TA’s capacity.

But the Bank can and should do more — some of it at low cost — to improve the quality of TA. Specifically, the Bank should experiment with:

- More creative delivery mechanisms (perhaps including more formal use of “embedded” TA).
- More intensive and frequent supervision of TA components and projects.
- More rigorous and objective assessments of the performance of consultants (by both Bank and borrower country personnel) to establish a list of preferred consultants.
- The posting of PSM specialists to resident or regional missions to work with governments and TA.
- Perhaps most important, more rigorous assessment of the borrower’s commitment to put the TA to effective use.
Conclusions

The benefits of improved public sector management are significant: lower costs, more effective delivery of the goods and services produced by public agencies, heightened project impact, enhanced capability for policy formulation and implementation, more "sustainable" projects and programs. A key lesson of the adjustment experience is that poor performance is a function of weak institutional capacity in the public sector; the best policies cannot be put into effect with a poor public administration. The conclusion: management matters, often crucially so.

It was the rise of adjustment lending that led the Bank more deeply into complex institutional issues and resulted in public sector management being treated as a subject in its own right. The Bank has undergone an extraordinary learning exercise and has now accumulated a wealth of practical experience that allows it to operate in previously uncharted multisectoral areas — such as civil service pay and employment reform, efforts to increase program sustainability, and reform of public enterprises as a sector. Agencies essential to the development process have been created or reinforced; effective administrative procedures have been established; people have been trained; services have been provided; money has been made or saved — all with Bank help. The gains have been considerable.

But this stocktaking review also shows that PSM successes have been limited. They have been difficult to conceive, to sell to concerned governments, to implement, and to sustain. Successes have come about more gradually than anticipated and have concentrated on relatively few themes. Geographically, roughly half of the entire PSM effort has gone to assist borrowers in Africa; and while the PSM activities centered on that region have been worthwhile, they have yet to produce dramatic breakthroughs. These problems and shortcomings are important. They frustrate borrower governments and involved Bank staff and managers. What are the causes of these shortcomings? And what can be done to improve the record?

Obstacles to public sector management reform

Why have there been problems? There are several reasons. First and foremost, PSM actions reveal, and highlight, the tensions between economic benefits and political costs. The rationalist reforms proposed in PSM often require decision-makers and implementers to act against their own short-term political or even material interests. Governments tend to be in extreme crisis (or, conversely, well advanced on the road to prosperity) before they find the resolve to tackle such painful, opposition-provoking steps as the liquidation of persistently loss-making public enterprises, the removal of political appointees from enterprise boards, the elimination of well-publicized, well-championed projects, the dismissal of superfluous civil servants, the matching of pay to productivity, and the changing of procurement practices to eliminate fraud.

Second, PSM reform normally takes a great deal of time to conceptualize, to set in motion, and
to come to fruition. But governments and external assistance agencies alike are impatient; they insist on immediately discernible effects that justify the expenditure of scarce resources. So PSM efforts have been concentrated in areas where the short-term economic and especially budgetary impact is most apparent; in measures to improve public enterprise performance and to contain civil service costs, for example. As a result of this tendency to downplay the importance of the longer run, more attention is paid to containing the public sector wage bill than to rejuvenating dilapidated and demoralized line agencies; to persuading governments to drop poor projects than to installing procedures that would prevent such projects from coming on stream in the first place. This is understandable, but it tends to treat the symptoms rather than the cause of the disease.

Despite these difficulties, technically sound prescriptions can be and have been assembled from the Bank's analyses and experiences. A well-defined reform "package" exists for PEs remaining in the hands of the state. Experience has generated a good set of goals at which public expenditure management reform should aim. Knowledge of how to approach civil service reform, including the longer run issues of improving organizational effectiveness—is growing rapidly. Measures to overcome the deficiencies of past technical assistance efforts have been devised. The problem is not that one does not know what to recommend; on the contrary, the goals and instruments are clear. But governments continue to have difficulties implementing PSM reform. The quandary is that sociopolitical and bureaucratic obstacles in each country impede or block the implementation of good practices. Overcoming these obstacles requires detailed knowledge of the contexts—social, political, and organizational—in which a reform is being proposed. Obtaining this knowledge, and applying it in a specific reform, takes time (which is normally not available) and skills and resources (which are in short supply). Perhaps more than in other areas of Bank activity, the implementation of public sector management reforms is a matter of constant adaptation of ideal mechanisms to the prevailing conditions of the country in question.

Corrective mechanisms

At various points this paper presented tactical suggestions for how to improve the impact of different PSM activities. But what can be done in a larger, strategic sense to enhance the quality and impact of the Bank's PSM efforts? One general recommendation is that the Bank should devote more resources to PSM issues. The sociopolitical context in which a reform is to be implemented must be better understood, by extending sector work to include PSM issues, and by requiring staff to acquire and apply such knowledge. There is a need for more thorough design and preparation of actions. And most important, there must be more and better supervision of reform implementation. This would entail costs, mainly in time and effort of Bank staff. But enlarging or diverting staff resources is not easy to justify, given the difficulty of showing that a particular PSM action results in a particular payoff.

The Bank could take two incremental measures to sharpen the focus, quality, and relevance of PSM work:

- First and foremost, it could expand efforts in the design and preparation stages of operations to assess the feasibility of needed PSM reforms, including the degree of government commitment to the reform.
- It could strengthen efforts to spread the lessons of experience, within both the Bank and the borrower countries (through CESW and particularly through EDI activities), by means of seminars, workshops, and formal and especially informal training programs. They can be as simple as senior staff informing junior staff as to "how things work" or as complex as requiring missions to devote a portion of their time to mini-training courses for their counterparts in government.

To free up the resources needed for more intensive staff support for each PSM operation, the total number of such operations, and the range of issues or institutions addressed in each, could be reduced. Not every public agency deserves to be restructured or perpetuated. In some cases, large amounts of technical assistance and the most advanced set of procedures will have little or no impact. The Bank needs to be more selective, focusing on countries and activities where the chance for reform is high because the government is committed and ready to change. The Bank should use its modest resources to build the foundation for constructive change through the country dialogue and selective capacity-building initiatives.
Endnotes


2. For example, see Jerry M. Silverman, “Public Sector Decentralization: Economic Policy Reform and Sector Investment Programs,” the World Bank, Public Sector Management Division, Africa Technical Department, Division Study Paper No. 1, November 1990; and Mamadou Dia, “Cultural Dimensions of Institutional Development and Management in Sub-Saharan Africa,” the World Bank, Africa Public Sector Management Division, October 1990. Moreover, PSM reform at the local level has been addressed in Bank lending for urban and rural development; a paper assessing this experience is being prepared by the Urban Development Division of PRE.

3. In this regard, the African Capacity Building Initiative — supported by the Bank, the African Development Bank, and the United Nations Development Programme, in partnership with Sub-Saharan African countries — is a promising innovation for the region, aimed at improving policy analysis and development administration. It focuses on six components: rebuilding national institutions, strengthening regional institutions, reinforcing policymaking or analysis units within governments, training Africans for entry into these professions, expanding in-service training, and strengthening local consulting firms. Because the initiative is new and has not yet produced results to assess, and because its design is the subject of a recent study, the matter is not pursued in this paper. See the World Bank, The African Capacity Building Initiative (Washington, D.C.: January 1991).


7. The notion of “surplus” contains an element of subjectivity; rigorous measures of the concept have proved difficult to devise and apply. Criteria used include comparative (cross-national) ratios of the number of civil servants to the overall population, or as a percentage of the country’s modern sector labor force. Another measure often used is the extent to which personnel costs “crowd
"out" operating budgets for supplies and maintenance. In trying to determine when staff are in surplus, functional reviews and staff inspections may be undertaken to identify sector- or function-specific excess through the use of ratio analysis — which applies standardized norms of, say, proportion of agricultural extension workers to farmers. In some instances a surplus is a consequence of the streamlining or elimination of government functions; then it is a case not of too many people per task but too many tasks, period.


9. Some counterarguments could be advanced against this conclusion: (1) Except in a few countries, outright cuts have tended to be small, so protests may have been muted because the threat is viewed as minimal. (2) Most of the experience on which this conclusion is based is African. In other regions it might be harder to shift from industrial to agricultural employment. (3) In many countries pay adjustment had already taken place through wage erosion: many jobs may have been viewed as not worth fighting for. This reasoning is plausible, but the fact remains that, despite dire predictions about the political peril of retrenchment, what has been accomplished so far has not been politically costly for reforming governments.

10. In 1986-90, annual average real growth of the wage bill was 0.0 percent in Ghana and -0.6 in the Gambia. In Guinea in the same period the wage bill rose 16.3 percent a year — starting from one of the most compressed bases in Africa. For details see Louis de Merode, "Civil Service Pay and Employment Reform in Africa: Selected Implementation Experiences," AFTIM, Africa Technical Department, the World Bank, March 1991.


12. To demonstrate the complexity of the issue: the superficially simple question — should one refurbish an enterprise before sale in hopes of increasing the sales price? — turns out to be extremely difficult to answer. The vendor must, of course, provide the purchaser with a clear title, which invariably entails some cost to produce. Where it can be shown that the addition to the sales price is greater than the cost of the refurbishing investment, it would seem rational to proceed. The problem is that governments consistently tend to underestimate costs and overestimate benefits. The emerging consensus is that government owners should bear the bulk of the costs of financial restructuring and staff reduction before the sale, but that new investment should be left to the private purchaser.

13. Enterprise reform and privatization in socialist economies poses special problems that are relatively new to the Bank, and about which much still has to be learned, so this issue is not analyzed in this paper. For preliminary discussions see Barbara Lee and John Nellis, Enterprise Reform and Privatization in Socialist Economies, World Bank Discussion Paper 104, 1990, and "A Note on Enterprise Reform in Socialist Countries," in Chapter 8 of Mary Shirley and John Nellis, The Reform of Public Enterprises: Lessons of Experience, the World Bank, EDI, 1991. One apparent difference between developing and reforming socialist countries is that in developing countries divestiture is regarded as one tool among many for the policymaker seeking to raise levels of efficiency; in reforming socialist countries, privatization is increasingly seen as essential to the transition to a market economy and thus an end in itself.


15. And accountability: in the Gambia, failure to achieve the goals stipulated in contract plans led to the dismissal of three PE managers.

16. Technical assistance is defined here as including project-related training. In terms of dollars lent by the Bank for technical assistance, that for PSM reform accounts for less than 10 percent of total TA lending. It is provided mainly through freestanding TA projects.

17. For a complete discussion of Bank actions in technical assistance for institutional development

18. Technical assistance constituted 9 percent of total lending in FY82; it declined to 6 percent by FY88, and increased again to 9 percent in FY90.


20. At the time of writing, a high-level Bank Task Force is reviewing all aspects of technical assistance, including that devoted to PSM reform. The Task Force is expected to draw together the various past studies and critiques, and produce a comprehensive set of recommendations on how the Bank should approach this issue in the 1990s. The review is scheduled to appear early in FY92.
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