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POLICY IMPLEMENTATION: MEETING THE ORGANIZATIONAL CHALLENGE

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I. INTRODUCTION

Performance-oriented modernization of the state processes must address three over-arching challenges. First, they must keep everyone focused on objectives throughout and beyond the implementation of the modernization process. Second, they must create an enabling environment for performance-oriented management of the targeted public agencies specifically designed to get managers to manage. Third, they must address key transition risks and challenges by orchestrating a realistic implementation strategy, designed to keep everyone focused on the objectives of the reforms, to ensure that the desired enabling environment will be established *and* to ensure that the public agencies and their employees placed within that enabling environment will respond appropriately to the performance challenges. While these three challenges are interdependent, as long as we have general agreement on the key aspects of the required enabling environment, it is possible to provide some sensible advice on how to confront the implementation challenges. This note focuses primarily on the third of these challenges, although we provide a few brief comments on the first two.[1]

II. KEEPING FOCUSED ON REAL OBJECTIVES

Real estate development experts routinely assert that three things matter in any real estate development decision: location, location, location. One could just as reasonably assert that three things matter in policy change implementation: objectives, objectives, objectives. Modern performance-oriented public sector reforms, in fact, are intended fundamentally to reorient the way public sector activities are undertaken from the more conventional "administration" orientation that has been something of a hallmark in most public sectors to the more modern "management" orientation that is more closely associated with the operation of private sector firms. While the former orientation tends to focus more on procedures and ensuring compliance with them, the latter

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orientation focuses more on results and achieving them. In short, the aim is to shift from an "administrative" culture oriented toward compliance with procedural requirements to a "management" culture focused on achieving clear objectives. It should come as no surprise, then, that one of the keys to a successful transition of this sort is to keep squarely focused on clear objectives. Persons who helped lead the path-breaking public sector reform processes in both New Zealand and Australia in the late 1980's and early 1990's have stressed that one of the most fundamental keys to the success of those reforms was getting everyone thinking about and focused squarely on the objectives of each and every program, project or activity being undertaken with public funds.

Functions of objectives

Objectives can serve any number of useful functions. Certainly, the policy analysis literature is replete with admonitions to specify clear objectives as one of the key first steps in any effort to improve the performance of any given program, project or policy. Given the extensive literature on the importance and functions of setting clear objectives, we offer only a few brief comments here. The basic idea is really quite simple. By clearly specifying objectives we provide: (i) the *focus* required to design and select sensible strategy, tactics and activities required to achieve those objectives; (ii) the *touchstone* against which we can constantly assess how well we are progressing toward those objectives – whether it be in improving the performance of any given program, project or agency or in moving forward with the overall reform agenda; and (iii) the *banner* needed to rally support and enthusiasm for the reform effort. As such, clearly enunciated objectives can provide a very powerful and flexible means of keeping a reform effort on track.

Devices for keeping focused on objectives

At least three important devices are available to help keep strategy, tactics and actions focused on objectives: publicity, evaluation and linking rewards and sanctions to performance.

Publicizing objectives

By widely publicizing specific objectives of a reform effort, it is possible to create strong pressures on the responsible parties to meet those objectives. A local health care delivery program in Ceara, Brazil, widely advertised not only the performance standards being sought by the reform of that program, but also specific steps citizens could take if they felt that program had failed to meet its performance standards, as part of its strategy for significantly improving the quality and impacts of that program. This reform met with impressive performance improvements, in no small part because of the ground-level pressure to perform created by this publicity about the program's aims and means of holding its practitioners accountable for achieving those objectives (Tendler, 1997; this example is also cited in World Bank Report, 1997:Box 5.7). The U.K. "Citizens' Charter" represents a similar device, which publicly commits public entities to meeting specific performance standards and identifies means of redress. In the U.S., the National Performance Review (NPR) initiative also placed heavy emphasis on measuring and publicizing results (Clinton and Al Gore, 1997:7).

Using evaluations to keep everyone focused on objectives

Evaluation is widely recognized as a potentially important tool for helping to improve performance. To serve this function, evaluations need to keep staff, management and clients continually focused on the underlying objectives of their actions. Evaluations need to be one element of a self-correcting or iterative-feedback mechanism for continuously improving the capacity and extent to which an organization or its constituent units are achieving their objectives. At the same time, evaluations pose significant and unavoidable risks and non-trivial transactions costs. As such, any strategy for using evaluations to keep everyone focused on performance must take the mitigation of those risks and costs as one of its key challenges.

Evaluations may aim at improving the performance or products of individuals or organizational units. They may aim at facilitating frequent, quick-turnaround adjustments to the behavior or capacities of those individuals or organizational units, or they may aim at adjusting more fundamental and slower-to change aspects of an individual's or organizational unit's behavior and performance. Because evaluations can serve a variety of purposes, subject to distinct time frames and strategic focuses, any strategy for making evaluations useful will need to allow for considerable variation in the ways evaluations are undertaken and the criteria on which they focus.

But this tool is neither risk nor cost-free. Both the preparation and the use of evaluations pose important risks and costs. On the evaluation preparation side, unavoidable difficulties confront any efforts to ensure that evaluations are meaningful – i.e., precise, unbiased and probative. Moreover, non-trivial transactions costs must be incurred to mitigate the risk of such non-meaningful evaluations posed by these difficulties. On the evaluation use side, important risks include the risk that non-meaningful evaluations will undermine the quality of decisions based on those evaluations, as well as the risk that meaningful evaluations will not actually inform the decisions they were intended to inform. Finally, there is the risk that the inevitable missteps made either in the preparation or use of evaluations will not be employed to continuously improve the entire evaluation exercise.

Ensuring meaningful evaluations: No one has yet discovered a fail-safe means of eliminating the risk of biased, inaccurate or non-probative evaluations, especially for many of the objectives aimed at by most public entities. Multi-dimensionality of performance, varying and long lags between actions and results, as well as the existence of numerous important exogenous factors that affect outcomes all augment the difficulties of producing meaningful evaluations. In recognition of these difficulties, a realistic evaluation strategy will incorporate a variety of evaluation-related devices designed to diversify the sources of evaluative information and enhance incentives to provide unbiased and probative evaluations. At least four devices can be built into evaluation practices to address these two needs: (a) permitting a range of types of evaluative criteria; (b) encompassing multiple evaluators; (c) relying heavily on judgment subject to appropriate incentives; and (d) establishing a policy of making evaluations public information, allowing exceptions to this rule only on a case-by-case basis, when a compelling justification for confidentiality can be made.[2]

Ensuring that evaluations lead to performance improvements: When biased, inaccurate or non-probative evaluations inform management decisions, they can create more serious problems than they solve. In recognition of the inherent difficulties in generating meaningful evaluations, a sensible strategy for making evaluations useful will include devices for addressing three fundamental challenges for ensuring productive use of evaluations: limiting the expected damages from non-meaningful evaluations, ensuring that meaningful evaluations actually inform decisions, and making sure that both the producers and the users of evaluations continuously learn from the inevitable missteps in their own evaluation practices (Ibid.).

Devices for addressing the challenge of limiting the damages of non-meaningful evaluations include: (a) use evaluations more for improving performance patterns or averages rather than for punishing individual instances of poor performance; (b) shun the temptation to establish simple, direct, mechanistic links between evaluations and rewards or sanctions; and (c) establish a policy of making evaluations public information, allowing exceptions to this rule only on a case-by-case basis, when a compelling justification for confidentiality can be made.

Devices for addressing the challenge of making sure that evaluations actually inform decision-making include: (a) mandate organizationally widespread but "light" or "simple" evaluation requirements, rather than making evaluation a highly technical task whose "objectivity" is to be ensured primarily through assigning responsibility for undertaking evaluations only to specialized and insulated arms of the organization; and (b) include as one criteria in the evaluation of each performance unit how well it makes use of evaluations of its own or its sub-units' performance.

Devices for addressing the challenge of ensuring that both producers and users of evaluations continuously learn from experience include: (a) establish a policy of making evaluations public information, allowing exceptions to this rule only on a case-by-case basis, when a compelling justification for confidentiality can be made; and (b) include as one criteria in the evaluation of each performance unit how well it makes use of evaluations of its own or its sub-units' performance.

Rewarding good performance and sanctioning poor performance

A number of the devices just noted for using evaluations to keep performance units focused on objectives require the leadership of a reform effort to ensure a clear link between performance and rewards. Given the inherent difficulties of ensuring accurate, unbiased and probative evaluations, any such link will need to be subject to the caveats noted above. But failure to establish such a link will seriously hamper any performance-oriented reform process by compromising its credibility. Examples are hardly necessary.

III. GETTING MANAGERS TO MANAGE

Getting managers to manage requires an enabling environment for performance-oriented management that establishes clear performance accountability. Establishing such an enabling environment requires that at least two key complementary challenges be addressed: modernization of the core administrative support systems, such as the public financial management and personnel management systems, and performance-oriented institutional strengthening or restructuring of public entities. The first of these challenges is to provide the modern financial and personnel controls and monitoring, including automatic generation of audit trails, required to make it possible to devolve management autonomy without creating unacceptably large risks.[3]

The second challenge is to establish a performance-oriented management framework; i.e., a process that clearly links institutional rewards, at least in part, to performance. An approach for accomplishing this, which is now being attempted in a number of Latin America and Caribbean countries, is a process under which individual public entities are offered the opportunity to negotiate a formal performance agreement with central authorities, which would provide specific institutional benefits in exchange for their committing the entity to specific actions designed to ensure performance accountability and improved management and service provision.[4] Key benefits which have been offered in countries that have undertaken such reforms have included:

- Enhanced capacity to compete for key human resources,[5] sometimes including capacity to self-finance enhanced salaries.[6]
- Enhanced managerial autonomy.[7]
- Assurance of reliable cash flow relative to budget.[8]
- Performance-linked institutional rewards.[9]
- Technical assistance for modernizing their management processes.

Key performance accountability requirements have included:

- Meet minimum performance and reporting standards for financial and personnel management systems.
- Negotiate restructuring or institutional strengthening agreement with detailed implementation and financing plan.
- Set performance targets and meet reporting requirements.

Designing and establishing such a performance-oriented enabling environment is a challenging and time-consuming task, whose success will depend importantly on the active participation and serious commitment of all key affected central authorities, such as the Presidency, the Ministry of Finance, the Contraloría, the Prime Minister's Office, as well as central personnel authorities. The donor community can help to orchestrate the needed discussions and negotiations. Final responsibility and the initiative required to orchestrate and implement the required agreement, however, will inevitably remain with the Government.

IV. Addressing Transition Risks and Challenges

Experience with performance-oriented modernization of the state programs in a number of Latin American and the Caribbean (LAC) countries[10] suggests a number of relatively practical considerations or lessons to improve the odds of successful execution of such reform programs. At least eight such lessons are probably worth mentioning:

1. Properly sequencing horizontal and vertical interventions.
2. Having the right management teams.
3. Carefully targeting reform interventions within an overall reform framework.
4. Linking real budgetary actions with management strengthening efforts.
5. Serving the interests of stakeholders.
6. Facing unavoidable personnel policy tradeoffs.
7. Sensibly targeting compensation improvements.
8. Approaching reform implementation realistically.

Properly Sequencing Horizontal and Vertical Interventions

Financial and personnel management accountability capacities must be modernized, and minimum performance standards met under these administrative systems as a prerequisite to devolution of the managerial autonomy required for performance-oriented management. Otherwise, the risk of misuse or abuse of the autonomy and other benefits promised under the reform process will be too large. Examples of such misuse and abuse are so widespread in most developing countries that there is little point in citing specific examples here. Suffice it to note that the elaborate constellation of financial and personnel management controls that slowly proliferate over the years in virtually any public sector, and especially in developing countries such as those found in Latin America and the Caribbean (LAC), are testimony to the seriousness of these risks.

Proliferation of controls in the horizontal or administrative support systems (primarily the financial and personnel management systems), at least in LAC countries, has brought with it problems and costs that have grown to be arguably as harmful if not more harmful than the risks they have been designed to control. To illustrate, a careful analysis of the public sector management policies and practices in Ecuador prior to its recent launch of a "Modernization of the State" process found that the highly centralized, input-control oriented administrative support systems that had evolved in that country were failing in their primary aim: to control and limit the use of publicly held financial and human resources. Public employment, for instance, grew inexorably over the decade and one-half prior to the launching of the Government's modernization initiative. More importantly, that proliferation of controls actually sowed the seeds of its own malfunctioning. The highly centralized budget system had generated a proliferation of devices for circumventing the normal budgetary process, including earmarked revenues and off-budget activities. Similarly, the centralized financial control system, including but not limited to both the extremely cumbersome procurement processes and the reliance on pre-control, had led to the proliferation of autonomous entities exempt from many of those controls. The highly centralized personnel management system had also generated a plethora of labor regimes, salary supplements and other devices for circumventing the controls built into that system. Even more importantly, however, that system undermined good management and generated poor management of public resources. For all of those reasons, the Government undertook to create a public management framework that would ensure fiscal control without undermining public management capacity; a framework that would reward public managers for effectively and efficiently providing the public services for which they are responsible; a framework that would withdraw resources from unproductive activities and channel them, instead, into more productive uses.[11]

Ecuador's experience is not at all atypical, especially in developing countries. A set of controls is imposed to prevent misuse or abuse of public resources. Some misuses or abuses occur and come to light. A public outcry leads to additional controls being layered over the initial set. Later some new misuses or abuses come to light. More controls are layered on to prevent these newly discovered means of circumventing the existing controls. The cycle continues. As the set of controls becomes more and more complex, dedicated managers find it more and more difficult to effectively manage their units. Particularly clever managers, be they competent and dedicated or motivated by less laudable aims, search all the harder for ways around the more complicated set of controls. Additional misuses or abuses occur and are detected. The cycle continues.

The end result is precisely what occurred in Ecuador – managerial paralysis. In response, some agencies and their managers convince authorities of the importance of their mission and the debilitating effects of the existing plethora of controls on their ability to satisfy their mission. In response, the legislature or the President or other higher authority grants that agency special status, exempting it from many of the normal set of controls. Over time, the number of such successful means of circumventing the normal set of controls increases, which makes it even harder to resist the temptation to grant additional exemptions. Moreover, these exemptions are often made without adequate attention to well designed mechanisms for holding those agencies accountable, both for their fiduciary responsibilities and for their performance in delivering the goods, services and policy advice within their mandates. Examples of misuse or abuse of such special exempt status eventually come to light. The story goes on.

As in Ecuador, performance-oriented public management reform programs have often been, in no small degree, an attempt to redress this imbalance between imposing controls to prevent abuse or misuse of managerial authority versus granting managerial autonomy subject to performance accountability in order to encourage and facilitate more efficient and effective management of the public's resources.

Given this background, at least four points are probably worth highlighting regarding the task of strengthening the horizontal or administrative support systems prior to granting public managers and their agencies greater autonomy under the banner of improving management performance: (i) eliminating the detritus; (ii) setting modest aspirations during the initial stages; (iii) investing in more elaborate and cutting edge administrative systems only once the more modest systems have begun to work successfully; and (iv) making access to the enhanced managerial autonomy promised by the reform effort contingent on the target agency's having shown that it can meet minimum performance (accountability) standards with the simple versions of the modernized administrative support systems (see also Reid, 1997b; 1997c).

Eliminating the detritus

Because of the tendency for both controls and means of circumventing them to proliferate over time, there is often a solid justification for a thorough review of the full set of financial and personnel management controls, to be followed by a revision of the various laws, regulations and procedures that have been established to effect those controls, so as to sweep away redundant and counterproductive controls, controls that create opportunities for petty graft and corruption, etc. Even though the same vicious cycle of proliferation of controls followed by invention of new means of circumventing those controls, followed by imposition of new controls, etc., can be expected to follow such a revision, such a house cleaning exercise can serve at least three important functions as an initial step in a broader set of public management reforms. First, it can send an important signal demonstrating the Government's commitment to reform. Second, it can eliminate some of the most flagrant, burdensome and counterproductive of the existing controls. Finally, it can disrupt the network of informal beneficiaries of the existing less-than-transparent labyrinth of controls, thereby providing a strategic opportunity to undertake changes that would be resisted more readily if the existing network of rent-seekers were not temporarily disrupted.

Setting modest aspirations for the initial stages

Too many public sector reform efforts in LAC have sought to install a fully integrated, extremely complex, state-of-the-art computerized financial management system only to discover that the time, effort, coordination, and negotiations required to marshal the cooperation required to design, build, implement and ensure operation of that system were beyond the capacities of the Government within a short enough time frame to avoid losing the momentum required to mount such an effort. Many such efforts also begin with the implicit presumption that the existing, often manual, administrative systems are so moribund that nothing short of a completely new, fully integrated financial management system could hope to improve public management. This presumption, however, fails to recognize that existing procedures and practices in many developing countries do actually function, albeit less well than one would like. Public officials normally develop all manner of informal means of ensuring that financial resources do get allocated, human resources are recruited, trained, assigned tasks, etc.

While these informal networks and practices suffer from a variety of well recognized shortcomings, they have typically evolved in response to the most glaring weaknesses in the formal administrative systems. As such, their usefulness should not be ignored nor jettisoned too soon. If appropriate care is exercised, such informal means of coping with problematic formal administrative systems can be relied on to keep those administrative systems functioning during a transition to better designed, more modern administrative support systems. In short, a transition strategy for modernizing administrative support systems would probably be wiser to co-opt than to alienate the troops who make the existing administrative practices function as well as they do. Stated differently, it is probably wise to remain on friendly terms with the existing informal administrative practices and procedures and their executors and to attempt to bring the executors of those practices and procedures on board the modernization process by demonstrating how the newer technologies can ease their task and improve their management capacities, rather than by launching a frontal assault on those existing practices and procedures by completely dismissing them.

Perhaps the Bolivian Government's efforts to implement its Financial Administration and Control System (SAFCO) most clearly illustrate the risks of setting one's aspirations too high and refusing to settle for modest improvements over the shorter term in order to build the capacities and commitment required to later implement those larger and more complicated administrative systems. The SAFCO systems were mandated by law in 1990, but despite considerable investment by both the Government and the international donor community over the next five years, relatively little progress had been made in implementation of those systems by 1995 (see below). Venezuela's Government found its efforts to design and implement such a state-of-the-art integrated financial management system during the late 1980's and early 1990's stymied in the same way as did Bolivia.

Countries or sub-national governments that have undertaken more modest strengthening of their financial management systems have fared somewhat better. Ecuador, under its Modernization of the State reforms (see below) programmed a state-of-the-art integrated financial management system, but only as a follow-on to the creation and implementation of a considerably more modest "bridge system." Initial modules from that "bridge system" were developed in no more than a few months, in close consultation with end-users. They were then demonstrated to the end-users and modified in response to their comments and concerns. Implementation of these modules has been proceeding smartly, benefiting from their simplicity and concrete usefulness to end-users, as well as from the capacity to set them up as stand-alone modules, yet capable of being linked with other modules as those become available. During this transition period, the existing manual elements of the financial management systems continue to function, thereby ensuring that the administrative capacities of the public sector are not seriously disrupted as the more modern capacities are developed and implemented. This strategy has allowed the technical team to slowly build the needed interest and support from among the end-users of those financial management systems – an absolutely essential requirement for any sustained effort to implement such systems. Moreover, development of the bidding documents for the subsequent development of the full state-of-the-art system has benefited greatly from the experience gained through this "bridge system" development and implementation process.

Investing in more elaborate systems later

As just noted, postponing the development of elaborate, state-of-the-art integrated financial and personnel management systems appears to provide a more promising approach for implementation than trying to begin by developing the full-blown system. Such an approach reduces risks of making large and difficult-to-reverse commitments to system design features without adequate knowledge of either their usefulness or their problems. It provides an opportunity to generate immediate, tangible benefits to end-users, thereby building the support that will be necessary to fully develop and implement the more elaborate systems. Finally, it provides an opportunity to develop the human resource skills, habits and mind set needed to operate such systems by training people and setting them to work with the more modest, computerized administrative system modules developed in the earlier phases of such a reform process.

Making access to managerial autonomy conditional on satisfactory functioning of administrative support systems

At least two important considerations provide a compelling justification for making access to managerial autonomy conditional on satisfactory functioning of administrative support systems. First, as already noted, reliable and timely functioning of such horizontal support systems is just about the only cost-effective and systematic means of providing the information required to make it possible to keep the risk of misuse or abuse of managerial authority within reasonable limits. That must, of course, be supplemented by vigorous and visible ex post enforcement of the norms governing the use of public resources (both financial and human). This is all the more important in developing countries such as those found in LAC, where circumvention of formal rules and controls tends to be the norm rather than the exception.[12]

Second, such administrative support systems do not represent an unmixed blessing for managers and employees of line agencies, since if they are effective, they will undermine the capacity of those line managers and their staff to circumvent centrally imposed controls. Because of this, it should not be surprising if those line managers and their staff resist or even sabotage the reliable functioning of those systems. Moreover, the actions of those line managers and their staff are pivotal determinants of the quality of the data that enters those systems and the reliability of the controls built into those systems. As such, it is important to create strong incentives for them to ensure that those systems function as intended. Making managerial autonomy and other institutional benefits or rewards conditional on reliable functioning of the administrative support systems and timely reporting through those systems provides a powerful means of enlisting their cooperation in this process. The importance of this linkage cannot be over stressed, and should be a cornerstone of any performance-oriented public management reform process.[13]

Having the Right Management Teams

In any performance-oriented public sector modernization program, one faces a principal-agent problem either in managing the reform program itself or in the management of any given public agency. The person, position or body that is leading the management reform program may be thought of as the "principal" in these principal-agent relationships. The management team that has responsibility for managing the reform program on a day-to-day basis would then be the "agent" in the reform program execution principal-agent relationship; while the management team of each of the public agencies undergoing "modernization" would be the "agent" in an agency-specific modernization principal-agent relationship. The principal-agent problem in each of these relationships is caused by 'information asymmetries' coupled with the non-trivial 'information costs' of obtaining reliable, timely and useful information on which to base management decisions. Because of these constraints, an agent is commissioned to undertake certain actions that will require him/her to exercise a certain amount of judgment and discretion in order to achieve the objectives of the principal

If it were possible to pre-specify all actions the agent must undertake under all possible states-of-the-world, and to costlessly enforce compliance with those directions, the principal-agent relationship would not present any risks or difficulties. This case may be approximated in some manager-worker relationships, in which the worker is required to perform certain repetitive and easily mechanized tasks, such as factory-line work. Not surprisingly, relatively simple contracts which pay fixed wages, complemented by relatively close supervision to ensure compliance with the pre-specified task requirements, serve relatively well for handling principal-agent relationships under such circumstances.

Alternatively, if it were possible to reduce the principal's objective to a simple and readily measured output without omitting any important aspects or dimensions of the principal's objective function, and then to directly and strongly link satisfaction of the agent's own objective function to his or her performance in achieving the principal's simple and measurable objective, the principal-agent problem could be conveniently addressed. This situation is most nearly approximated in the owner-manager relationship of private sector firms in highly competitive markets, in which those competitive pressures ensure that profits provide a relatively complete and easily monitored measure that captures essentially all the important dimensions of the principal's objective function. In such a situation, it is possible to bring the manager's objective function into effective congruence with the principal's objective function simply by tying the magnitude of the manager's rewards to the profits generated under his management.

But neither of these relatively straightforward principal-agent relationships typifies the management of either a public sector modernization program or any particular public agency. The objectives of a public sector modernization program as well as of most public agencies typically encompass multiple dimensions, many of which are difficult or impossible to directly observe or measure. It is generally difficult to agree on weights to be assigned to each of those dimensions. Moreover, the relationships between management actions and end results are often complicated and conditional on innumerable factors which are difficult if not impossible to fully anticipate. Furthermore, due to the absence of competition in the provision of most public services, there is generally no "bottom line" that captures essentially all of the important objectives of the principal; i.e., of the Government or its citizenry. If there were such a potential "bottom line" for any particular public agency, that agency would almost certainly be a prime candidate for privatization.

Because of this situation, it will be either prohibitively costly or prohibitively risky, or both, to attempt to either fully prescribe ex ante all management actions under all possible states-of-the-world or to grant unrestricted managerial autonomy subject only to a simple performance check in the principal-agent relationship between the Government and the managers of either its public sector modernization program or its public agencies. Instead, the Government will need to strike some sensible balance between these two extremes on a case-by-case basis. That balance will require, among other things, that the Government take and implement the following decisions and/or reach the following agreements:

- maintain a sensible set of controls on key aspects of managerial authority that could, if abused or not judiciously exercised, quickly or seriously undermine the Government's objectives (e.g., financial and human resource management controls);
- reach clear agreement with the targeted management team on key but not excessively detailed objectives of either the modernization program or the particular public agency being addressed by that program;
- reach agreement with those management teams on how the team's performance in achieving those key objectives will be monitored, assessed and rewarded or sanctioned;
- reach agreement with each of those management teams on a plan of action for improving or ensuring adequate performance of the agency in achieving its objectives.

Variations across agencies in the complexity and measurability of their key objectives, the reliability with which the optimal set of management actions under any particular state-of-the-world can be known ex ante, the number and percentage of likely states-of -the-world that can be anticipated ex ante, and the ease with which agreement can be reached on the relative weights to be assigned to each of the agency's objectives will each affect the specifics of each of these required Government decisions, actions or agreements with the management teams. While it would be foolhardy to try to spell out the details of each of those sets of decisions, actions and agreements ex ante, a simple point can be made about any such constellation of decisions: some discretion will be lodged with the management team and it will prove difficult to hold the management team fully accountable for the performance of their agency.

The more complex and difficult to measure are the key objectives, the more discretion that will unavoidably rest in the hands of the management team. The less reliably the production technology is understood and routinized, the more discretion will need to be left with the management team. The more the production technology is susceptible to technological improvement, and especially to rapid technological improvement, the more discretion will need to be left in the hands of the management team. The less predictable are the future states-of-the-world upon which good management decisions should be conditioned, the more discretion will need to be left with the management team. The less easily agreement can be reached on the relative weights of the various key objectives, the more discretion will, by default, be left in the hands of the management team. Additional reasons why discretion will or should be lodged in management's hands could undoubtedly be identified as well.

The inevitability of lodging some discretion in the management teams, coupled with the impossibility of readily holding them fully accountable for all dimensions of their agency's performance for the above reasons, brings with it an important corollary; namely that there will be a risk of abuse or misuse of that discretion. The greater the autonomy exercised by a management team, the greater scope will exist for that team to pursue objectives inconsistent with those of the principal; i.e., of the Government, as representative of the citizenry, not to mention the specific citizens who are supposed to be the direct beneficiaries of the services under the stewardship of that agency. Because of this simple and unavoidable truism, it is extraordinarily important to have the right management team.

The right management team may need to meet a wide variety of criteria. It will need to have management skills and experience. It will need to be strongly motivated. It will need to be oriented toward achieving results, rather than simply administering resources and complying with procedures and policies, etc. But more fundamentally, the more nearly the management team shares an objective function fully congruent with that of the principal in this principal-agent relationship, the greater will be the odds of success. To put it in non-technical terms, the more fully the Government can trust the management team, the more likely is the reform to achieve its objectives in that agency. Moreover, the greater the degree of managerial autonomy granted to a management team, the more significantly will success depend on such trust.

Experience with public sector modernization efforts in a number of LAC countries suggests that perhaps nothing is more fundamental in determining the success of a public management reform program than this. Without this almost any reform effort is doomed. The fundamental importance of these management teams highlights two basic challenges that should be accepted at the outset of any public management reform intervention: (a) devote significant resources to the task of finding the right management team and establishing a solid working relationship with that team in any given reform intervention; and (b) be very selective about what reform interventions to undertake, attacking only those where it is possible to construct the right management team. Such a management team will need to: (a) share a 'common vision' of the objectives and underlying strategy of the reform process; (b) be technically 'competent'; (c) have the 'stature' required to spearhead such a reform process, given the backing of the top leadership; and (d) be fully 'committed' to the reform objectives and strategy.

Perhaps a simple example will serve to illustrate the importance of having the right management team in place and establishing a solid working relationship with that management team:

Illustration: Ecuador - Modernization of the State Program

The experience of the Government of Ecuador with its Modernization of the State program provides a useful illustration of the risks created by having a management team that does not fully share the reform leaders' objectives. To fully appreciate the example, some background on the Government's reform program is useful.

The Government of Ecuador developed a Modernization of the State program, which the World Bank is supporting with a Modernization of the State Technical Assistance (MOSTA) loan. That program included two broad and complementary components: modernization of the public financial management systems and institutional strengthening or restructuring of public entities. Within the latter of these components, the Government developed a set of guidelines (*Guía para la Reestructuración Institucional*) which any public entity wishing to receive the benefits of the restructuring process would have to follow. The *Guía* was formally issued in late 1994 by the Consejo Nacional para la Modernización (CONAM), which had been created by the Modernization of the State Law (late-1993) with a mandate to coordinate the modernization process, including both privatization and institutional strengthening of those public entities deemed not appropriate for privatization.

CONAM includes on its Board of Directors the heads of virtually all the key core Ministries and Ministry-level entities, including among others the Minister of Finance and the Secretary of the Secretaría Nacional para el Desarrollo Administrativo (SENDA). This latter Secretariat has legal responsibility for reviewing any institutional strengthening or restructuring efforts of public entities, as well as for reviewing and approving any changes in the authorized employment composition within any public entity. SENDA also has responsibility for recommending the primary public sector salary scale. The Ministry of Finance, on the other hand, is responsible for approving any public sector salary scale, as well as for approving any entity-specific actions that affect the salary mass of the entity.

The *Guía* offered institutional benefits to public entities who signed a "Convenio de Reestructuración Institucional" committing the entity to specific actions designed to ensure performance accountability. *Key benefits* offered included:

- capacity to self-finance enhanced salaries;
- technical assistance for modernizing their management processes.

Key performance accountability requirements included:

- Negotiate restructuring agreement with detailed implementation and financing plan.
- Set performance targets and meet reporting requirements.
- Meet minimum performance and reporting standards for financial and personnel management systems.

The capacity to self-finance enhanced salaries proved to be by far the strongest incentive for public entities to subject themselves to this restructuring process. The mechanics of this self-financing capacity were as follows. The entity could produce operating budget savings by reducing its personnel or by improving its operating efficiency. In addition, entities were encouraged to divest non-productive assets, which would produce a one-time infusion of cash. At the same time, employment reductions would incur one-time costs due to severance payments mandated by the *Modernization Law*. The Convenio included, as noted above, a Financing Plan, which identified all of these projected cost savings and revenues from the sale of non-productive assets, as well as the severance payment costs.

The rules governing these Financing Plans mandated that each public entity undertaking a sanctioned restructuring must self-finance a fixed percentage of the severance payment liabilities incurred by its employment reductions, which percentage would be negotiated between that entity and the Ministry of Finance as part of the Convenio required by that process. These public entities would accomplish this self-financing through the divestment of assets and through cost-savings achieved through the employment reductions they attained. In addition, each public entity undertaking a sanctioned restructuring would self-finance the salary enhancements for its post-restructuring employees from the personnel cost-savings achieved through its employment reductions. The magnitude of the salary enhancement costs plus the portion of self-financing of severance payment liabilities from personnel cost-savings was restricted to no more than 80% of the personnel cost-savings achieved through the entity's employment reductions. The remaining 20% or more in operating budget cost savings would accrue to the Treasury, thus ensuring that the restructuring process yielded a fiscal dividend to the Government.

SENDA and the Ministry of Finance are apparently key members of the team leading this modernization program. Moreover, the *Guía* was developed by SENDA personnel with the assistance of World Bank staff. Importantly, however, the top leadership of SENDA changed shortly before finalizing that *Guía*, and the new leadership had scant confidence in the process mandated by that *Guía*. In fact, the SENDA representative on CONAM's Board of Directors was the lone dissenting vote when the *Guía* was endorsed. In addition, the leaders of the reform process failed to devote enough time and effort to ensuring that the management team within the Ministry of Finance fully appreciated the benefits to them of undertaking the restructuring process within the framework mandated by the *Guía*.

The consequence of having the wrong management team in SENDA and of failing to enlist the commitment of the Ministry of Finance to the *Guía*-mandated restructuring process was predictable. Within less than two months of CONAM's mandating the *Guía* to govern all public entity restructurings, SENDA responded to strong political pressures and declared virtually all Central Administration entities restructured and reclassified their remaining employees into higher-paying job classifications. The Ministry of Finance, who had not yet fully committed itself to the *Guía* process, bowed to those same political pressures and authorized the salary mass implications of the job reclassifications within each of those "restructurings." In short, in a matter of months every Central Administration entity was declared "restructured" and received the primary benefit of the restructuring process – salary enhancement for the remaining employees – despite the fact that not one of those "restructurings" complied with any of the requirements established by the *Guía*. This was, in no small part, the consequence of having the wrong management team within SENDA and of failing to get the Ministry of Finance to fully commit to the management strengthening process mandated by the *Guía*.

We return to how Ecuador's modernization effort has been brought back on track below, when we discuss the sixth key implementation lesson: approaching reform implementation with patience and adaptability.

Carefully Targeting Interventions Within Overall Reform Framework

Serious fiscal and human resource constraints militate against an "all-at-once" approach to performance-oriented public sector modernization. Quite apart from these constraints, there are also positive advantages of a reform process that serially targets its interventions. At the same time, sustainable targeted modernization processes require a consistent legal and regulatory framework to ensure that inter-agency jealousies do not undermine the process before all public entities are able to be incorporated under the reform program's umbrella (see also Reid, 1997b).

Constraints that necessitate serial targeting

Performance-oriented public sector modernization is costly and requires substantial infusions of scarce managerial and professional talent in order to be effective. Because of this, most developing countries simply cannot reform the entire public sector at once.

Fiscal considerations: Because it is fundamentally important for the public sector in most developing countries to maintain a sound and usually fairly tight fiscal policy in order to enhance the economy's growth prospects, it would be counterproductive for the Government to undertake a public sector modernization program that would jeopardize its overall macroeconomic fiscal policy. Moreover, performance-oriented management reforms require more expensive human resources than are typically encountered in a poorly functioning public bureaucracy. While it is usually possible to partially finance the higher costs of better human resources from salary savings achieved by employment reductions, as was intended in the Ecuador Modernization of the State program, such salary savings rarely are sufficient to cover the full costs of the less numerous but more highly skilled labor required by a performance-oriented agency. Accordingly, it will be important to target management strengthening interventions in a way that phases in the cost increases over a long enough period of time that the Government can meet the increased fiscal costs from a well-designed strategy for enhancing its own-source revenues; a program which is consistent with its overall fiscal program to ensure macroeconomic stability. This will almost certainly require that public agencies be incorporated into the modernization program serially over a sustained period of time, so as to ensure that the interventions in any given agency are significant enough to permit noticeable performance improvements while simultaneously ensuring fiscal sustainability.[14]

Human resource considerations: Fiscal constraints are not the only important reason for targeting modernization interventions and phasing them in over a sustained period of time. The highly qualified managerial and professional human resources required for such reforms to achieve their objectives are normally in scarce supply, especially in developing countries. This scarcity of these key human resources occasions two key reasons why it would probably be unwise to target a large number of public entities at once. First, it will be difficult to find enough such persons to reform a large number of public agencies at once. Second, even if the Government mounted a major effort to recruit a large number of such personnel at once, the short supply could easily drive up the market-clearing levels of remuneration for such personnel, thereby driving up the costs of the reform process. Accordingly, these human resource constraints provide a second major reason for phasing in such performance-oriented reforms over a sustained period of time (Ibid.).

Positive advantages of serial targeting

While these fiscal and human resource constraints militate against an "all-at-once" approach to modernization of the public sector, there are also positive reasons for undertaking a results-oriented management reform program through serially targeted interventions. The most obvious such advantage is that serial interventions permit the leaders of the reform program to learn from the inevitable mistakes that will be committed. Such learning from experience can inform two distinct aspects of a reform program: (i) how to cope with the inevitable day-to-day challenges of undertaking such reforms within any given public agency; and (ii) how to better design the enabling environment for the reform process.

The second obvious advantage of serial targeting is that the reform leaders can begin with the most promising agencies, thereby enhancing the chances of demonstrating visible results, which will be needed to convince the doubters, and there will be many, of the gains to be reaped from such performance-oriented management reforms.

Ensuring a consistent legal and regulatory framework

While the above considerations make clear the desirability of serially targeting agency modernization interventions, it is important to recognize that to be sustainable, serially targeted modernization processes require a consistent legal and regulatory framework to ensure that inter-agency jealousies do not undermine the process before all public entities are able to be incorporated under the reform program's umbrella. Failure to ensure the existence and credibility of such a framework can pose two serious risks for any serially targeted reform program. First, in the absence of clear and uniform rules to govern the phasing in, the process can readily fall prey to insider pressures and favoritism, as occurred in Ecuador (see above) even when such clear rules existed.[15] Second, precisely because of this first risk, an absence of clear rules and evidence that eligibility for the benefits of a modernization process will be ensured for all public entities encompassed by the reform program once they meet the entrance criteria is almost certain to generate fears, jealousies and opposition from agencies not yet benefiting from those promised changes. Such fears, jealousies and opposition can readily derail such a reform effort. Accordingly, a key challenge of any strategy for building performance-oriented public sector management capacities is to first establish and enforce such a legal and regulatory framework.

Perú's impressive reforms of its Tax Subsecretariat (SUNAT) illustrates that carefully targeted modernization interventions can yield substantial and observable improvements in the quality of the agency's performance. At the same time, the very success of the SUNAT reforms has apparently generated some disaffection and distrust outside that agency. This is precisely why it is so important to embed such interventions within a legal and regulatory framework that establishes a "level playing field"; which is to say, makes clear to all agencies that these interventions will be made available to all agencies on the basis of a consistently applied and justifiable set of rules, and not simply restricted to the favored few. While it is possible to attain impressive performance improvements from a few hand-picked agencies without embedding those interventions in a consistent and even-handed process for making such interventions, it is difficult to sustain such reforms and to spread them to other agencies without establishing such an umbrella framework.

Illustration – Bolivia

Bolivia's efforts to improve the management and performance of its public agencies provides a helpful illustration of the reasons for and keys to successfully serially targeting such reform efforts. In 1988 the Government of Bolivia realized that a lack of managerial talent within its public entities was seriously hampering efforts to get those agencies to efficiently meet their legal mandates. In response, the Government developed a program which recruited and aimed to provide a limited number of middle level managers to its public entities in the belief that if it could staff a few "key posts" in each of its agencies, significant performance improvements would follow. A total of 653 key posts were originally envisioned, although the initial target group included only 233 such posts. By June 1993 only 69 key posts had been filled.

By mid-1992 the strategy of sprinkling small amounts of managerial talent across a large number of public entities had failed to deliver the hoped for results, and the Government decided to rethink its strategy. This failure of the "key posts" strategy led the Government and the donor community to support a much broader civil service reform approach, in which as many as 14,000 to 16,000 posts would be incorporated into the newly forming Programa del Servicio Civil (PSC), which imposed transparent and competitive recruitment and selection procedures and provided market-level salaries to all posts incorporated into the PSC. But as this approach was more fully examined, first the Government and later the donor community realized the fiscal folly of undertaking such a large commitment, which would bring with it a huge and enduring future stream of salary commitments.

Out of this realization, the Government proposed once again a much more narrowly targeted civil service program, yet broader than the original "key posts" approach. The donor community initially responded to this apparent reversal of strategy as a sign of lack of commitment on the part of the Government, since the number of targeted positions was cut from around 15,000 to 2,814 and finally to 2,566. In consultation with the World Bank, however, the Government's strategy eventually crystallized into one which sought to achieve a 'critical mass' of managerial and professional talent within selected public entities, and to serially increase the number of targeted entities. The explicit justification for this strategy rested on two key premises: (i) that in order to achieve observable improvements in the performance of any given entity, it would be necessary to provide a critical mass of managerial and professional talent; while (ii) for such interventions to be fiscally sustainable, it would not be possible to incorporate every public entity at once. In line with this reasoning, the Government chose to restrict the focus of the initial stages of their reform program to the Central Administration alone, which omits a very large fraction of all public employment.[16] The idea is to demonstrate that such a strategy works, and then expand it to other parts of the public sector.

An important aspect of the Bolivian Civil Service and Administrative Reform (CSAR) process is that the targeted interventions are not stand-alone or ad hoc interventions, but are instead being undertaken within a uniform set of rules governing: (i) which entities are eligible to receive the transparently recruited, highly qualified, strongly motivated and well remunerated PSC positions; (ii) what those entities have to do in order to receive those PSC personnel; and (iii) what is expected of both those entities and the PSC personnel provided to them in return for having received those positions. These reforms are being embedded in both a thorough-going legal framework established by a major Financial Administration and Control Act (Ley 1168 of 1990), the "normas básicas" for each of the administrative support systems mandated by that Law, and more detailed regulations for each of those administrative support systems. In fact, the development of the "normas básicas" and the supporting regulations is not yet complete; and the pace of incorporation of positions into the PSC has been delayed in part by a concern to make sure that such positions would be provided within an enabling environment sufficient to provide reasonable assurance that observable impacts would follow.[17]

The experience of the Bolivian Government illustrates: (i) the importance of recognizing the fiscal and human resource constraints that make serially targeted interventions more sensible for a developing country such as Bolivia or Perú than an all-at-once approach; (ii) how serially targeting such reform efforts can allow the Government to adjust its tactics and strategy as it learns from is mistakes; and (iii) the importance of embedding such serially targeted reforms within a consistent enabling environment, so as to limit the risk of generating substantial opposition to the modernization program among those agencies and personnel that haven't yet been incorporated.

Illustration – Chile

Chile's experience with a public sector reform effort, which, during the Pinochet regime, focused primarily on reducing public employment, rather than on the broader objective of improving the performance of public entities, is nevertheless also instructive regarding the importance of serially targeting reform interventions.[18] Chile's employment reduction effort during the Pinochet regime's grip on power advanced via a three-pronged approach: (i) meaningful initial actions to establish credibility; (ii) diversification of employment reduction efforts to hedge against risks and facilitate maintenance of progress, and (iii) sustained employment reduction efforts.

While the military regime's solid hold on power during this period made at least the last of these three aspects of its strategy easier to adhere to than will be the case in a democratic society, the advantages of pursuing such a three-pronged, serially targeted approach are nonetheless clear and applicable under other circumstances, with the caveat that maintaining the sustained political commitment to such a strategy will be a more important challenge within a democratic society. This challenge underscores the importance within a democratic society of the reform effort's providing a continuous stream of successful interventions in order to maintain the political support necessary to sustain the overall reform effort.

Meaningful initial actions: Much as Perú demonstrated credible commitment to a public management reform agenda by undertaking successful interventions in a few key agencies, such as SUNAT, Chile's retrenchment program demonstrated credible commitment early on by cutting employment within its Ministry of Housing and Urban Development by over 27 500 workers, or more than three-quarters of its 1973 level, within a period of less than 15 months.

Diversified approach: Moreover, the Government undertook a diversified portfolio of employment reduction efforts, in at least two senses. First, it serially targeted specific public agencies, focusing on the Ministry of Housing and Urban Development during the initial stages of its efforts, later shifting attention to other Ministries, including Education. Second, it employed three distinct devices for reducing central government employment – releasing employees within maintained central government functions, off-loading or decentralizing central government functions to local governments or the private sector, and privatizing or re-privatizing public enterprises.

Sustained effort: Finally, the Government mounted a sustained program for achieving public employment reductions, concentrating most of its employment reductions during the first 8 years of its reign, but continuing to achieve significant reductions throughout its entire 17-year hold on power.

Linking Real Budgetary Actions With Management Strengthening

At least three good reasons exist for ensuring that real budgetary actions are linked with the management strengthening process: (i) the importance of cash flow reliability for managing an organization; (ii) the fact that making adjustments in the day-to-day exercise of specific budgetary controls provides one of the most fundamental and flexible avenues for enhancing managerial autonomy; and (iii) perhaps the clearest and most adaptable signals that can be sent to management as to whether performance of their agency matters are those sent by budget decisions. The first two of these reasons reflect key ways in which budget actions can establish an enabling environment for effective management, while the last identifies a key means by which budget decisions can be used to provide the proper incentives to management to deliver the goods.

Cash-flow reliability

This is not, however, easy. A typical cash-management pattern in LAC countries is the following. The Ministry of Finance typically has responsibility both for providing budgeted resources to the Government's line agencies as well as for ensuring that the Government's overall macroeconomic program meets its fiscal balance targets. The latter of these two functions is normally given higher priority than the former by the Ministry of Finance. When revenue shortfalls relative to projections occur, the Ministry of Finance, quite understandably and for sound fiscal reasons, normally places top priority on ensuring that cash-outflows do not violate its macroeconomic fiscal targets. Unfortunately for the mangers of line agencies, this too often translates into interruptions in cash-flow to their agencies. As just noted, such a pattern, especially if it is the norm rather than the exception, seriously compromises the capacity of those managers to effectively manage their organizations. If this pattern cannot be changed, it will be extraordinarily difficult to improve the management of line agencies; and consequently, it would be patently unreasonable to try to hold the managers of those line agencies accountable for the performance of their agencies.

This illustrates the importance for any performance-oriented management reform program of incorporating improvements in budget practices into that reform program. To fail to do so is to doom the management reforms. In the case of cash-flow reliability, it would be a mistake to ignore the importance of maintaining the capacity to ensure execution of a sound fiscal program. What is required is: (i) the capacity and willpower to make realistic budgets; and (ii) the capacity and willpower to employ a well-designed array of fiscal instruments for coping with the inevitable transitory revenue fluctuations without resorting to cutting off or temporarily curtailing budgeted cash-flows to line agencies.

The task of *making realistic budgets* requires: (a) building the technical capacity to make reasonably reliable projections of revenues; (b) making those projections independently of the expenditure wish-lists of each of the budget units within the public sector; and (c) ensuring that the aggregate budget does not exceed those revenue projections. In other words, the capacity and willpower to make realistic budgets is the fundamental challenge of subjecting the budget formulation process to a hard budget constraint.

Coping with transitory revenue fluctuations requires that the Government develop such instruments as (a) a contingency or "rainy day" fund, and (b) short-term borrowing instruments. These instruments should provide the capacity to cushion the within-year, individually unpredictable but statistically likely fluctuations in revenues relative to budgeted cash-flow requirements; while imposing a realistic budget constraint during the budget formulation process should provide the basis for enforcing a hard budget constraint over the full budget period. While both of these challenges are more difficult in developing than in developed countries, both must be met if line agencies are to have any hope of being able to manage for results.

The importance of ensuring reliable cash flow will be patently obvious to anyone who has ever managed a budgetary unit. For those who may have some doubts, a couple of examples may serve to illustrate the point.

Illustration: Bolivia -- SNIC Acuerdo Interinstitucional

The Secretaría Nacional de Industria y Comercio (SNIC) recently underwent a thorough functional analysis to help it to better identify a strategy for improving its performance. The findings of that analysis were used to inform the negotiation of SNIC's Acuerdo Interinstitucional, an agreement with central authorities that identifies both benefits to be provided to SNIC (e.g., numbers of professional and middle level management personnel under the Programa del Servicio Civil) as well as the performance commitments of SNIC and its management. Once that functional analysis was completed, the head of SNIC sent a letter to the Minister of Finance expressing his satisfaction with the analysis and its recommendations and pledging SNIC to meeting the various and quite detailed performance targets identified in that report. Significantly, however, that letter stated quite unequivocally that SNIC's willingness to commit itself to those targets was conditional on the Ministry of Finance's ensuring a reliable flow of budgeted resources to the agency.

Illustration: Ecuador – Revised Guía para la Suscripción de Convenios de Fortalecimiento Institucional:

When the restructuring process mandated by the Government of Ecuador's *Guía para la Reestructuración Institucional* collapsed for the reasons cited above, the Government's efforts to resurrect that process required that it find some benefit for candidate public entities that could prove as attractive as the prospect of better salaries had been under the original *Guía*. The new *Guía* promises reliable cash flow relative to budget to meet this need. Getting the Ministry of Finance to commit to this, at least on a pilot basis, proved to be one of the most important achievements of the negotiations required to reinvigorate that institutional strengthening/restructuring process.

Budgetary controls and managerial autonomy

The legal and regulatory framework for performance-oriented management must establish the broad parameters for ensuring adequate budgetary controls and granting appropriate managerial autonomy conditional on the management of a given agency providing adequate accountability for the resources, both financial and human, under its stewardship. But myriad day-to-day actions and decisions of officials within core agencies such as the Ministry of Finance, the Contraloría or the Central Bank will prove at least as important both in shaping those controls and in giving form to that managerial autonomy. Moreover, the flexibility to adapt the nature of the autonomy granted to management on the basis of the quality of its accountability and performance will unavoidably rest in those day-to-day decisions and actions of officials within those core agencies. Accordingly, it is important to ensure that those core agencies and their key personnel understand and share the aims of the modernization process, since their actions will shape the day-to-day aspects of that process (see "Serving the interests of both central authorities and the targeted agencies" below).

Linking performance to budget allocations

This is fundamental. If there is a complete disconnect between budget decisions and line agency performance, nothing will change. Line agencies are not stupid. If they see that they do not fare better in the budgetary process when they provide reliable and timely accountability for their stewardship of financial and human resources, they will quickly figure out that it is not in their interest to provide such reliable and timely accountability. If they see that the budgetary process does not reward them when they improve the cost-effectiveness with which they meet their mandates (e.g., provide health or education services, etc.), they will quickly learn to not bother to incur the headaches and costs required to make those improvements in cost-effectiveness. If the reverse is the case – i.e., if budget decisions do reward good-performing line agencies – those line agencies will learn just as quickly that it is in their interest to deliver the goods; i.e., to provide reliable and timely accountability for their stewardship of financial and human resources and to more cost-effectively provide the services and policy advice within their mandates. In short, linking line agency performance to budget decisions is fundamental to an effective public management reform effort.

Illustration: Ecuador – Failure to link budget actions to budget submission requirements:

An example of the consequences of a failure to link performance to budget allocations may serve to illustrate this point. During the early stages of the Government of Ecuador's implementation of its *Modernization of the State Law*, the Government developed through its MOSTA project a modest computerized budget preparation system (Sistema Puente or "Bridge System") and provided the required training to ensure that all Ministries could use that "Bridge System." Once this software was developed and available, the Minister of Finance agreed with the World Bank to issue a formal letter to all Ministries informing them that for the next year's budget preparation exercise they would have to submit their budget proposals by a specified date, using this software and in compliance with the accompanying guidelines. That letter stated that for any Ministry failing to meet these requirements, the Ministry of Finance would refuse to recommend a budget allocation for the upcoming Fiscal Year in excess of the subject Ministry's nominal budget during the previous Fiscal Year. Given annual inflation of roughly 27%, such a threat represented a serious sanction for failure to comply with the budget submission requirements. Unfortunately, when virtually no Ministries complied with the budget submission directive, the Minister of Finance failed to follow through on the promised sanctions. This failure to enforce promised sanctions further undermined the credibility of the Ministry of Finance's commitment to the budget reform process, thereby making it all the more difficult to implement the reform program. While substantial progress has been made since then, this failure to link budget decisions to line agency performance posed a serious setback for that reform program at that time.

Serving The Interests of Stakeholders

There is perhaps no surer way of ensuring that a reform program will not be implemented as envisioned than to fail to make sure that the reforms serve the concrete interests of both central authorities and the targeted line agencies. At the same time, it must be recognized that some individuals will inevitably find their sources of power, prestige or other perks of their positions put at risk by a reform process. These risks must be recognized, and the implementation strategy must be carefully orchestrated to ensure that even though not all key actors can be brought on board, a winning coalition is constructed and held together throughout the reform process. In short, a management reform process cannot be treated as simply a technical challenge. It is fundamentally a political or human relations challenge in the sense that its success hinges on the ability of the leaders of that reform process to construct and hold together a winning coalition of key actors throughout the reform process.

Serving the interests of central authorities

If the Budget Office or Secretariat cannot readily see that the reform process will improve its control over the budgetary process, that Office will be unlikely to be a strong ally of the reform process. Related to this, if that Budget Office or Secretariat does not find line agency performance measures promised or provided by the reform process to be helpful to its budget formulation process, those performance measures are unlikely to inform or influence that budget formulation process. If the economic management team cannot see that the reform process will strengthen its capacity to formulate and execute a sensible macroeconomic program, that team will be unlikely to actively champion the reform process. If the Contraloría cannot see tangible improvements in the reliability and timeliness of financial controls, it is unlikely to lend its weight to the leadership of the reform process.

The importance of this was recognized in the design of the original *Guía* to govern the modernization of individual public entities under Ecuador's Modernization of the State process. That *Guía* required that an agreement be reached between the Ministry of Finance and each entity passing through the restructuring/institutional strengthening process that would commit both parties to a Financing Plan for the reform intervention. The policies governing those Financing Plans required that the severance payment and salary enhancement costs of each reform intervention be financed from salary savings achieved by employment reductions, divestment of unproductive assets and increased cost-recovery, and that those sources provide, in addition, a fiscal dividend to the Treasury of no less than 20% of the salary savings achieved through employment reductions. This provision ensured that each reform intervention would generate net fiscal benefits to the Treasury, rather than imposing net fiscal costs – a design feature intended to enlist the Ministry of Finance's support for the reform process.

Serving the interests of line agencies

It is equally important to ensure that the reform process serves the interests of line agencies and their management. If the modern financial management systems being created as part of a reform process are not adapted to provide agency-specific management tools desired by the management of the line agencies targeted by the reform process, those systems are unlikely to yield their desired impacts. Line agencies will comply in form but not in substance with requirements imposed on them by a reform process that fails to provide concrete advantages to the management or staff of those agencies. Perhaps nothing more succinctly illustrates the importance of serving the interests of line agencies in order to enlist their support in implementation of a reform process than the above noted agreement of the management of Bolivia's Secretaría Nacional de Industria y Comercio (SNIC), in which SNIC management enthusiastically committed itself to a detailed plan of action and performance targets, but only on the condition that the Ministry of Finance guarantee a reliable flow of budgeted resources.

To illustrate the importance of constructing a winning coalition in order to implement a reform process, consider the following example. The Government of Bolivia enacted a widely praised, model public financial management law in 1990, the SAFCO Law (Ley 1178, which mandated the Sistema de Administración Financiera y Control - SAFCO). That law mandated modern financial management systems, a devolution of responsibility and accountability for management of public financial resources coupled with performance accountability. But despite substantial investments and considerable time, little progress was made in implementing that model Law as originally envisioned until late in 1995, when the Government finally pulled together an effective coalition of key actors and set about in earnest to establish the normative framework required for actual implementation of that Law.

Serving the interests of workers

There are both sound reasons and a variety of means of serving the interests of workers in a performance-oriented modernization effort.

Reasons for enlisting worker support: At least two important reasons exist for taking steps to serve the interests of affected workers: (i) the workers possess the detailed, first-hand knowledge that will often be required to materially improve the performance of any given organization; and (ii) workers are in a pivotal position, often enabling them to either make or break any given reform effort.

Reaping the benefits of workers' knowledge: Robert Stone, Director, U.S. National Performance Review (NPR), has stressed an obvious but fundamental insight: nobody knows better how an organization really works and what are its most difficult challenges than its workers (Stone, 1997). Any reform effort would be well advised to tap that wealth of on-the-ground knowledge. NPR publications highlight this insight:

- "People who face the customers every day already know how to improve service" (Blair House Papers, 1997:7).
- "Front line workers know more about the work and how to improve efficiency than managers in Washington" (Ibid.:8).
- "When labor and management form partnerships to cooperatively solve problems, implement changes, and jointly resolve worksite issues, agencies better serve their customers and save money"(Ibid.:21)

Reaping the benefits of worker support

As noted, workers can make or break any reform program. The NPR effort in the U.S. quite explicitly exhorted the leadership of targeted agencies to pro-actively enlist worker support in the reform efforts:

> "People want to make a difference. If you give them the chance and let them know you trust them, you'll unleash their untapped human potential, and they'll solve problems and serve customers better than you dreamed possible. your job is to raise their spirits with a vision of what they can be and what they can do, and to keep the job from grinding them down with red tape and distrust. Symbols of distrust are everywhere: time sheets, multiple approvals of travel requests, systems to track people's activities, checks and limits on people getting the tools they need -- like Internet access. Just as the system won't willingly cede power to the front line, it won't stop grinding people down. You need to personally see the fixes through.
>
> "But it'll be worth it. Empowering and energizing the front lines has paid off fabulously in both government and business" (Ibid.:27).

Means of enlisting worker support

There are, of course, no simple, fail-safe recipes for reaping the benefits of workers' knowledge and enlisting their support in a reform process. At root, the success of any such effort will depend on whether serving workers' interests is a serious aspect of the reform process. Moreover, when, as is often the case, it is necessary to change some personnel as part of a modernization program, it will be important to provide job transition assistance on an equitable basis, as part of a consistent effort to enlist worker support for the reform effort. A number of studies shed light on the costs, benefits, risks and alternative means of designing and targeting such job transition assistance.[19]

Devices that can prove useful in such efforts to enlist worker support for a reform process include:

- empowering workers by involving them in design and implementation of the reform process;[20]
- providing performance-linked institutional rewards that are valued by an agency's workforce – e.g., public recognition for clear and impressive improvement in the performance of the agency, means of improving post-reform remuneration levels, etc.;
- job transition assistance – whose design could offer a menu of options (subject to a fiscally feasible fixed budget envelope) to workers subject to retrenchment, so as to allow each worker to select the option that best matches his or her job transition needs; options could include cash settlements (either up front or spread out over a fixed period of time), pension benefits, retraining, job-search assistance, etc.;[21]
- retraining of selected workers who will remain within the agency (Reid, 1997d);
- providing workers with an equity stake in the reformed agency if privatization is involved.

Serving the interests of clients

By making clients stakeholders in the reformed or modernized institution, it is possible to create strong performance pressures that can help to keep the reform focused on achieving its intended objectives. Such client stakeholder interest can serve as an important antidote to a reform process becoming captive to bureaucratic interests. Examples of devices for accomplishing this include:

Empower clients by widely publicizing performance standards they should expect from particular public agencies and their employees and spelling out specific steps they can take to force those agencies and their employees to meet those performance standards. Examples include the health reform program in Ceara cited above (see Tendler, 1997), the U.K. "Citizens' Charter", as well as the U.S. government's National Performance Review (NPR) program, which set customer-driven organizational culture as one of the key challenges to improving the performance of public entities.[22] NPR's *Blair House Papers*, for example, urged public entities to:

- "Identify your customers – start with the reason your organization was set up in the first place.
- "Continuously ask your customers what they want – skip this step and you'll get it wrong.
- "Set standards so people know what to expect.
- "Measure and publicize results"(Ibid.:7).

Change the rules of the game so that clients/citizens make investments whose value depends on how well the modernized institutions function.

Land titling mechanisms, such as that provided through the Commission for the Formalization of Informal Properties (COFOPRI) mechanism recently created in Perú, provide an example of such a stakeholder-creating change in the rules of the game. Barbara Geddes (1994), in *Politician's Dilemma: Building State Capacity in Latin America* (University of California Press)) provides a careful analysis of such changes and their role in ensuring sustainability of reforms.

Facing Unavoidable Personnel Policy Tradeoffs

No one has yet succeeded in identifying a public sector human resource management framework that guarantees that public employees (a) face strong performance incentives, while simultaneously (b) are protected from undue political pressures or influence. Mechanisms designed to enhance the performance incentives faced by public employees more often than not are at odds with mechanisms designed to insulate personnel actions (such as hiring, firing, promoting and providing job enrichment and career growth opportunities) from undue political influence. The most obvious example of such a conflict are tenure guarantees, which serve the latter function, while undermining the former function. More generally, mechanisms that enhance the discretion of managers in taking personnel actions while holding those managers accountable for the performance of their units in meeting identifiable performance standards aim at strengthening the performance incentives facing both those managers and the personnel subject to their actions. But the more tenuous is the capacity of central authorities to hold such managers accountable for their units' meeting specific performance standards, the greater will be the risk of abuse of any discretionary authority over personnel actions granted to those managers. Conversely, mechanisms that 'technify' and subject personnel actions to elaborate formal controls aim to protect public employees from being subjected to personnel actions driven by political or other non-performance related considerations. But such mechanisms almost unavoidably make it more difficult to face those employees with strong performance incentives. They are simply too cumbersome and, due to their explicit rules, too readily "gamed" by both managers and their staff.

Tailoring the tradeoffs

In short, there does not appear to be any single best public personnel management framework. Tradeoffs between enhancing pressures to perform versus reducing the risk of abuse of authority in personnel actions are unavoidable. Because of this, the quality of any public personnel management regime will depend heavily on how appropriately authorities tailor this tradeoff to the circumstances of each targeted public entity. Public entities with readily observed outputs, subject to clear performance accountability, subject to reliable and timely financial accountability, whose management can be trusted and is responsive to the performance objectives of their clients and their principals (i.e., the central authorities who established those objectives and fund the entity), can, at an acceptably low risk, be subjected to a human resource management framework that leans more toward the performance incentives coupled with managerial autonomy and performance accountability end of the spectrum.

Public entities with difficult-to-observe outputs, subject to weak performance accountability, evidencing weak capacity to provide timely and reliable financial accountability, whose management can not be fully trusted nor is responsive to the performance objectives of their clients or principals, would probably be more wisely subjected to a personnel management framework more heavily weighted with controls over personnel actions designed to protect against undue influence by political or other non-performance related considerations.

Examples of aspects of personnel management policies and practices that pose such tradeoffs between enhancing performance pressures versus holding risks of abuse or misuse of personnel management authority within acceptable limits are summarized in Table 1.

Given that any given personnel management regime will aim at both encouraging performance and preventing misuse or abuse of personnel management authority, the challenge in designing such a regime rests in making each of the above tradeoffs so as to reflect: (i) the relative priorities of those two objectives, and (ii) the constraints and risks posed by the environment within which personnel actions within the particular managerial unit will occur.

Table 1- PERSONNEL MANAGEMENT TRADEOFFS

Objective: **Create Pressures for Performance**	**Objective:** **Reduce Risks of Abuse or Misuse of Authority**
Absence of tenure guarantees	Tenure guarantees
Line manager authority to take all types of personnel actions[23]	Central authorities responsible for taking personnel actions
Open competition for all positions	Prohibition or restrictions on eligibility of external candidates to compete for positions[24]
Promotions criteria based on performance.	Promotions criteria based on seniority.
Annual salary adjustment and bonus pool based on management unit's performance[25]	Annual salary adjustment pool independent of management unit's performance[26]
Line manager's performance evaluation based on quantity and quality of key products, services and/or policy advice provided by his unit	Line manager's performance evaluation based on compliance with fiduciary and administrative systems responsibilities and requirements
Employee performance evaluation systems that leave considerable scope for subjective judgment	Employee performance evaluation systems that rely on detailed objective criteria
Policies that give line managers authority to choose the most cost-effective institutional arrangement for undertaking specific activities[27]	Policies or central authority decisions that pre-specify the institutional arrangements for undertaking specific activities[28]
Personnel budget allocations based in part on the management unit's performance in meeting quantity and quality targets for key products, services and/or policy advice provided by the unit	Personnel budget allocations that include no element based on the management unit's performance.
Allocations of training resources that are sufficient to yield impacts[29]	Allocations of training resources that are too meager to yield impacts.
Compensation levels competitive with those encountered in the local private sector[30]	Compensation levels that are not competitive with those encountered in the local private sector

Establishing key personnel policies and practices not posing tradeoffs

Certain aspects of personnel management policies and practices, on the other hand, do not pose such tradeoffs. In particular, policies and practices designed to enhance the transparency of all personnel actions are important regardless of whether the dominant aim of the personnel management regime is performance or keeping risks of poor management in check. Examples of such transparency-enhancing policies and practices include:

- Recruitment and selection procedures that require the participation of third parties.

- Promotions procedures that require the participation of third parties.[31]
- Employee performance evaluation policies and practices that require inputs from a variety of persons impacted by the employee being evaluated.
- Systems that provide timely and reliable information on personnel decisions, usage, and performance and enable appropriate parties both inside and outside the subject entities to review and evaluate those decisions and their consequences.
- Systems that provide information on program-specific costs, thus making it possible to evaluate the cost-effectiveness of programs and personnel uses.

A public management reform process in a developing country interested in focusing its public sector managers on performance will certainly want to incorporate all of these personnel management policies that do not pose tradeoffs between performance pressures and insulation from undue political influence. At the same time, among those personnel policies that do pose such tradeoffs, they will probably aim to move the personnel management regimes of the targeted entities more toward the performance-oriented end of the tradeoff between performance orientation versus protection from undue political or other non-performance considerations. But the widely varying suitability of different entities to a performance-oriented personnel management framework will probably make it wise to establish at least two distinct personnel management regimes, and allow entities to operate within the more performance-oriented regime only once they meet certain tests designed to ensure an acceptable level of risk of abuse or misuse of the personnel management autonomy available under that performance-oriented personnel management framework. Such an approach is consistent with the advice offered above regarding both targeting of interventions within an overall reform framework and linking of real budgetary actions with management strengthening efforts; namely, that enhanced managerial autonomy should only be granted conditional on evidence of adequate fiduciary accountability. An important challenge for such an approach will be specification of the tests that must be met before a given entity becomes eligible for the more performance-oriented personnel management framework.

Sensibly Targeting Compensation Improvements

The case for sensible targeting of compensation improvements is a special case of the more general case for serial targeting of management strengthening interventions discussed above (see "Properly Sequencing Horizontal and Vertical Interventions" above); but personnel remuneration is a significant enough issue to deserve special consideration. Uncompetitive public sector remuneration is a common cause of the considerable difficulty that the public sector in most developing countries has attracting highly qualified and highly motivated human resources. While it is unquestionably crucial to offer remuneration competitive with that available in the local private sector[32] if such public sectors hope to recruit talented and motivated personnel, a sensible strategy for implanting such compensation improvements is neither so obvious nor so simple as one might suppose on first thought. At least five important considerations need to be addressed by any such remuneration improvement strategy: (a) ensuring fiscal sustainability of any program for improving the competitiveness of public sector remuneration; (b) establishing a uniform legal and regulatory framework that permits compensation improvements only once well-specified criteria have been satisfied; (c) carefully targeting agencies to benefit from such compensation enhancement by making remuneration improvement within any given agency conditional on satisfaction of minimum performance standards for (horizontal) administrative support systems; (d) being selective about the types of positions targeted for compensation improvement; (e) resisting pressures to compromise or violate any of these four recommendations for sensibly targeting compensation improvements.

Ensuring fiscal sustainability

The costs of making public sector compensation competitive are often the largest expense associated with modernization of public sector management to give it a stronger performance orientation. As explained above, given the importance of ensuring fiscal sustainability of such reforms, it is wise in most developing countries to 'phase in' any salary improvements over a period of time sufficient to allow the Government to develop the fiscal capacity to sustainably finance the increases in the public sector wage bill. This consideration alone militates against across-the-board salary improvements. But additional considerations, as well, argue against an across-the-board approach to salaries improvement.

Ensuring a uniform legal and regulatory framework

As explained above, when an implementation strategy rests on phasing in some particular improvement, such as enhancing the competitiveness of public sector remuneration, it is crucially important to first establish and enforce a legal and regulatory framework that ensures that clear and uniform rules and practices will govern that phasing process. Otherwise, two important risks could easily destroy the strategy. First, in the absence of clear and uniform rules to govern the phasing in, the process can readily fall prey to insider pressures and favoritism, as occurred in Ecuador (see above) even when such clear rules existed.[33] Second, precisely because of this first risk, an absence of clear rules and evidence that eligibility for salary improvements will be ensured for all public entities encompassed by the reform program once they meet the entrance criteria is almost certain to generate fears, jealousies and opposition from agencies not yet benefiting from those promised salary improvements. Such fears, jealousies and opposition can readily derail such a reform effort. Accordingly, a key challenge of any strategy for improving public sector remuneration is to first establish and enforce a legal and regulatory framework that ensures that clear and uniform rules and practices will govern the phasing-in and eligibility for salary improvements across public agencies.

Carefully targeting agencies conditional on personnel management accountability

Given the risk of misuse or abuse of financial and personnel management authority in most developing countries, it will be wise to ensure that agencies demonstrate adequate financial and personnel management accountability prior to being made eligible for such compensation improvements. One means of accomplishing this is to create a Senior Executive Service (SES) or equivalent program and make personnel who have been centrally recruited through competitive and transparent procedures under that SES available to line agencies within the institutional strengthening/restructuring agreements approach described above. This approach is being implemented by the Government of Bolivia at this time through its Programa del Servicio Civil, and the Bolivian Government has managed so far to avoid the problems that were encountered by Ecuador when it made salary enhancement possible through a less centrally controlled mechanism (see above).

Being selective about the types of positions targeted

At least two sound reasons exist for being selective about the types of positions targeted in an salary improvement effort. First, it is often true that the competitiveness of public sector salaries varies across skill levels. A not atypical pattern is for the more highly skilled positions to offer less competitive remuneration than the less highly skilled positions. As such, it is often more important to improve the salaries of the more highly skilled positions more than, or even rather than, the salaries of the lower skilled positions. Second, there are more compelling reasons for ensuring some insulation from the winds of political change among the middle level management and professional ranks than among the ranks of either top level executives (which will generally be political appointees) or the semi-skilled or relatively unskilled personnel. Those middle level management and professional ranks are arguably the most pivotal for the following two reasons: (i) these cadres are in a position to most significantly impact the overall performance of a targeted agency, while (ii) the competitiveness of recruitment and selection conditions can more dramatically improve the quality of the cadres contracted within these ranks than would be the case in the lower skilled ranks. Third, just as fiscal and human resource limits make it wise to limit the number of entities targeted (see above), those same limits make it wise to limit the number of positions targeted. In short, limiting salary improvements to these middle management and professional ranks will often be more cost-effective than extending such salary improvements to include all types of positions.

At the same time, it should be noted that it will be important not to ignore the remaining public servants in the targeted agencies. The Government of Bolivia, for instance, while it is phasing in the equivalent of a Senior Executive Service through its Programa del Servicio Civil, also issued a Supreme Decree in 1995 establishing that Central Government budgetary units may use personnel expenditure savings achieved through reductions in force to finance higher salaries for their remaining staff, thereby providing an incentive for agencies to reduce the size and improve the quality of their staff, which should prove particularly useful for improving remuneration for personnel outside the PSC.

Resisting pressures

Finally, perhaps the most constant and difficult challenge in any salary improvement strategy is the task of resisting pressures to compromise or violate the key elements of that strategy, such as ensuring fiscal sustainability, establishing and enforcing a uniform legal and regulatory framework, carefully targeting agencies conditional on adequate personnel management accountability, and being selective about the types of positions targeted. Ecuador's fiasco under the *Guía de Reestructuración Institucional* provides a clear illustration of how easily a well defined framework can be abandoned in the face of such pressures. Resisting such pressures is a key to success under such a reform strategy.

Approaching Reform Implementation Realistically

Public sector modernization is a process that requires a sustained capacity to adapt to changing actors and conditions, or more colloquially, to roll with the blows. It is not like building a piece of infrastructure, such as a bridge or a dam or a school, in which blueprints can be meticulously spelled out in advance and followed to the letter because virtually all important variables can be known and anticipated in advance, while modest alterations can be added without much risk. Rather, public sector modernization is a process of refocusing the attention and priorities of key players – central authorities, line agencies as well as clients and the public – more on results, rather than on procedures and compliance, while modernizing those procedures and controls so that they provide the fiduciary accountability required to keep the risks posed by such a refocused management regime within acceptable bounds.

At the same time, it is essential to recognize that a public sector modernization process requires a consistent legal and regulatory framework to guide that process and ensure coherence and focus. Nevertheless, judgment calls will have to be made constantly – by central authorities, by line agencies – throughout this process in order to appropriately tailor decisions to unique and constantly changing circumstances. Because of this, mistakes will be made. Setbacks will occur. The sustained capacity to correct such mistakes and overcome such setbacks will require patience and adaptability coupled with a willingness and capacity to take advantage of windows of opportunity when they arise. These traits will likely prove instrumental to the ultimate success of any such modernization process. Moreover, given the length of time required by such reform processes, it will be important to set *realistic expectations*, so as to avoid losing credibility by failing to meet announced but unreasonable targets, especially in the early stages of such a reform process.

Illustration – Ecuador Modernization of the State Program

The reader will recall from the earlier discussion of the Ecuador Modernization of the State Technical Assistance (MOSTA) project, that the Government of Ecuador made a major miscalculation when it launched a public entity restructuring process as part of its modernization initiative. Within less than two months of the Government's mandating a carefully defined framework to govern all public entity restructurings, every Central Administration entity was declared "restructured" and received the primary benefit of the restructuring process – salary enhancement for the remaining employees – despite the fact that not one of those "restructurings" complied with any of the requirements established by the Government's stated policies (see above).

This setback was quickly recognized by the Bank and the Government in May of 1995, and a strategy was agreed upon at that time between the Bank's MOSTA team, the MOSTA project's policy level counterpart (the Executive Director of CONAM) and the MOSTA project unit, for revising and resuscitating the restructuring process. Using resources from a Program for Human Resource Development (PHRD) Grant for preparation of the MOSTA project, the Government hired a consultant who had worked closely in the preparation of the restructuring component of the MOSTA project and who had the stature and expertise necessary to help shepherd through a revision of the *Guía*, to ensure that it would still address the management reform and strengthening needs of the Government, yet be tailored to the changed circumstances. By May of 1996 a new *Guía para la Suscripción de Convenios de Fortalecimiento Institucional* (CFI) was drafted, endorsed and published by CONAM and the restructuring process began anew, this time with the full commitment of not only the CONAM leadership, but also the leadership of both SENDA and the Ministry of Finance.

The revised process was not only renamed "institutional strengthening," but also adjusted to reflect the fact that salary enhancements could no longer constitute the primary benefit to be offered to agencies for subjecting themselves to that process. Instead, the Ministry of Finance agreed, at least on a pilot basis, to ensure cash flow reliability to participating entities. In addition, the Government undertook to redraft its Civil Service Statute in a way that would enable it to create a "Cuerpo Gerencial y Técnico," i.e., a senior executive service, which could be provided to participating entities as an additional benefit of passing through the "institutional strengthening" process prescribed by the new *Guía*.

This experience highlights the importance of being able to respond to such setbacks with flexibility, patience and a determination to get the reform process back on track.

Notes

1 A collection of other materials that we have drafted over the last 4-5 years, which focus primarily on how the first of these two public management challenges have been confronted in a number of other LAC countries, such as Venezuela, Ecuador, Chile, Jamaica, Trinidad & Tobago, Bolivia and Nicaragua is available from the author. In that sense, this note is complementary to much of that previous work.

2 For a more detailed analysis of these recommendations see Reid (1997a).

3 This point is addressed in more detail in the following section on the requirements for a realistic implementation strategy (see "Properly sequencing horizontal and vertical interventions").

4 Ecuador, Nicaragua, Bolivia, and Jamaica are undertaking such programs, each with its own particular bundling of institutional benefits and performance accountability requirements.

5 E.g., access to a body of transparently recruited, highly qualified, competitively remunerated personnel within key ranks, such as the professional and middle management ranks (e.g., a senior executive service), under terms and conditions designed to ensure that: (i) those positions are strategically targeted, (ii) those positions are provided to any given entity in sufficient numbers to achieve the critical mass required to produce observable impacts on the entity's performance, and (iii) the personnel provided face strong incentives to improve the beneficiary entity's performance.

6 Subject to centrally established norms governing how such self-financing targets will be set, monitored and compliance with them enforced.

7 E.g., through broader budget heads, delegation of responsibility for exercising financial controls (i.e., replacing ex ante external financial controls with ex ante internal controls subject to ex post external controls); delegation of authority over certain personnel actions (but still within an appropriate set of norms governing such actions, and subject to reliable monitoring of compliance with those norms).

8 See "Linking real budgetary actions with management strengthening efforts" heading below.

9 See "Linking real budgetary actions with management strengthening efforts" heading below.

10 Ecuador, Bolivia, Nicaragua, Jamaica, Trinidad and Tobago, El Salvador and Perú.

11 World Bank (1994). See "Background" section of *Technical Annex: Ecuador Modernization of the State Technical Assistance Project*, Report..

12 The reasons for this tendency need not be dismissed as simply "cultural." Rather, as illustrated above, proliferation of controls can actually breed pressures to circumvent those controls, which, of course, will accentuate any tendency to do so. Moreover, such circumvention reinforces itself, since behavioral expectations are based in no small part on one's perceptions of one's neighbor's patterns of behavior.

13 See also "Linking real budgetary decisions to management strengthening efforts" below.

14 See "Sensibly Targeting Compensation Improvements" below for a more thorough treatment of these issues.

15 Ecuador's unfortunate experience with its salary enhancement strategy demonstrates the fifth important challenge for any strategy for improving public sector remuneration;

namely, resisting pressures to bypass or circumvent the targeting and phase-in rules (see below).

16 The Central Administration excludes both regional governments (Prefecturas) and local governments (Municipalities), as well as the major public sector service-providing employees, such as teachers, health workers, police and the armed forces.

17 The Bolivian Government's reform program has been designed in close consultation with the World Bank, and will be supported by an IDA Credit, which is expected to include co-financing from several other donors.

18 For a detailed analysis of the Chilean public sector employment reduction experience under Pinochet regime, see Reid (1992).

19 Mills and Sahn (1993a, 1993b); Fiszbein (1992); Svejnar and Terrell (1990, 1991); Alderman, Canagarajah and Younger (1993).

20 A reform process currently underway, which will corporatize the Postal Service of Trinidad and Tobago and then bring in a private operator to manage the restructured entity, has benefited greatly by regularly consulting with and including representatives of the Postal Workers Union in the design of the reform process itself. In the United States, a labor-management partnership in the Department of Education "transformed an adversarial labor-management relationship into a collaboration, where both the agency and the union committed to becoming a high performing, customer-focused organization. Through partnership, Education's Debt Collection Service ... increased collections from $174 million in fiscal year 1993 to more than $862 million in fiscal year 1996. The Debt Collection Service also reduced busy signals on its toll-free lines from more than 400,000 in January 1994 to the point where 25 unanswered calls is now considered a 'bad day', The Blair House Papers (1997: 21-22.).

21 See above citation on job transition assistance.

22 Blair House Papers (1997:5-7). See also USGPO (1993, 1995). For online access to the U.S. Government's National Performance Review's extensive 2 500-document library. World Wide Web: http://www.npr.gov.

23 Key personnel actions would include: recruitment, selection, personnel evaluations, promotions, setting of compensation levels (both base salary and collateral benefits), annual salary reviews and adjustments.

24 E.g., external candidates permitted to compete for entry level positions only.

25 These encourage managers to reward high performing employees, since rewarding such employees both rewards and encourages them to continue to enhance the budgetary unit's performance, thereby increasing its share of such performance-linked resources.

26 These encourage managers to avoid discriminating between the performance of their employees, since such discrimination can pose risks (of disgruntled employees who receive low performance reviews), yet cannot enhance rewards for the manager and his/her overall budgetary unit.

27 E.g., relying on staff to undertake particular activities, contracting out particular sets of activities, direct purchasing of particular intermediate or final products. Examples of such activities might include training, clerical support, building maintenance, certain professional services (e.g., legal or other specialized advice), etc.

28 E.g., requiring that all activities be undertaken by staff or by staff and consultants.

29 Sizable training allocations pose a greater risk of misuse of those resources than modest training budgets, while small training budgets effectively prevent those training resources from having any impacts.

30 Adjusted to reflect any non-financial benefits of public employment, such as tenure protections.

31 E.g., their supervisor or manager, colleagues within the same organizational sub-unit, colleagues within the same organization but outside the employee's organizational sub-unit, persons managed by the employee, clients.

32 Appropriately adjusted to reflect any unique benefits or job security provided to private sector employees.

33 Ecuador's unfortunate experience with its salary enhancement strategy demonstrates the fifth important challenge for any strategy for improving public sector remuneration; namely, resisting pressures to bypass or circumvent the targeting and phase-in rules (see below).

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