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**INCENTIVE SYSTEMS:  
INCENTIVES, MOTIVATION, AND  
DEVELOPMENT PERFORMANCE**

**A UNDP CAPACITY DEVELOPMENT RESOURCE**

**Capacity Development Group  
Bureau for Development Policy  
United Nations Development Programme**

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## CONTENTS

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	<b>Page</b>
<b>ACRONYMS AND ABBREVIATIONS</b>	<b>3</b>
<b>EXECUTIVE SUMMARY</b>	<b>4</b>
<b>I. Introduction</b>	<b>5</b>
<b>II. Incentives Strategy in Application</b>	<b>7</b>
<b>III. Operational Implications</b>	<b>9</b>
<b>ANNEXES</b>	<b>22</b>
<b>1. Annex 1: 3 Case Studies</b>	
<b>2. Annex 2: Bibliography</b>	

## ACRONYMS AND ABBREVIATIONS

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<b>ADB</b>	<b>Asia Development Bank</b>
<b>CAP2015</b>	<b>Capacity 2015</b>
<b>CDG</b>	<b>Capacity Development Group</b>
<b>DFID</b>	<b>Department for International Development (UK)</b>
<b>ECDPM</b>	<b>European Centre for Development Policy Management</b>
<b>FAO</b>	<b>Food and Agriculture Organization</b>
<b>GEF</b>	<b>Global Environment Facility</b>
<b>ILO</b>	<b>International Labour Organization</b>
<b>LENCD</b>	<b>Learning Network on Capacity Development</b>
<b>OECD</b>	<b>Organisation for Economic Cooperation and Development/Development</b>
<b>/DAC</b>	<b>Assistance Committee</b>
<b>UNDG</b>	<b>United Nations Development Group</b>
<b>UNDP</b>	<b>United Nations Development Programme</b>
<b>UNESCO</b>	<b>United Nations Educational, Scientific, and Cultural Organization</b>
<b>UNEVOC</b>	<b>United Nations International Centre for TVET</b>
<b>UNICEF</b>	<b>United Nations Children Fund</b>
<b>USAID</b>	<b>United States Agency for International Development</b>
<b>WBI</b>	<b>World Bank Institute</b>

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## EXECUTIVE SUMMARY

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It is possible to distinguish factors that have motivational effects from other capacity elements. Some are internal, others are external to or “in the environment” of any given system. The question of motivation is inextricably linked with capacity and needs to be analyzed and addressed on all capacity levels: individual, organization and enabling environment.

Incentive measures, such as salaries, secondary benefits, and intangible rewards, recognition or sanctions have traditionally been used to motivate employees to increase performance. Motivators may be positive and/or negative. Reducing dis-incentives or perverse incentives that favour non-conductive behaviour, can often be more important than inventing new incentives. Incentive systems reside within organizations, their structure, rules, human resource management, opportunities, internal benefits, rewards and sanctions, etc. Whether based on perception or reality, organizational incentive systems do have a significant influence on the performance of individuals and thus the organization overall. Perhaps the most pervasive structural motivators and incentives are located at the societal level, such as security, rule of law, investment climate, civil service pay or legislation conducive to civic engagement.

Operational implications are in terms ways in which incentives and other motivators can be used to mobilise capacity and to promote development performance. This is done in relation to the following:

- How to Stimulate Better Performance in the Public Sector
- How to retain and attract talent on the Global Labour Market
- How to encourage local service delivery in remote areas
- How to encourage poor people to claim their rights
- How to align aid for capacity development

The paper suggests throughout potential strategies and tools to pursue. Three of these are highlighted in dedicated boxes.

### **1. Reducing Distortionary Incentives by Aligning Aid Around National Pay Reform**

Countries are encouraged to promote transitional arrangements over the medium term that provide a framework for long term pay reform linked to public service reform and that encourage external partners to harmonise and align their support around a national process. Examples include the Selected Accelerated Salary Enhancement (SASE) scheme in Tanzania (see annexes for case study) and the Cambodian approach of establishing priority mission groups in key ministries.

### **2. Reducing Demotivation And Valuing Non-Material Incentives For Public Service Performance**

Evidence points to a range of demotivating factors besides pay levels and non-material incentives that can have a significant impact on staff motivation and organisational performance. Understanding what makes people and organisations tick should also be part and parcel of any capacity assessment exercise. A sensible starting point is to understand and address first and foremost the de-motivating factors. Drivers of Change and Power analysis are important tools. Non-material incentives need to be recognized, valued and reinforced.

### **3. Conditional Cash Transfers To Strengthen Demand**

Demand Side Financing (DSF) offers a potential innovation and is an example of one of several demand side approaches being explored across various sectors. Conditional cash transfers provide different entry point to the same set of problems, which may have potential for addressing them from a fresh standpoint. Also with larger amounts of development financing available there is a tendency to deliver through vertical arrangements. The potential of using higher volumes of aid for conditional cash transfers to households needs to be seriously considered within conducive socioeconomic frameworks.

## I. Introduction

Motivation is a critical dimension of capacity, defined as “the ability of people, institutions and societies to perform functions, solve problems and set and achieve objectives”. Incentives and incentive systems are fundamental to developing capacities and to translating developed capacities into better performance. The focus of this paper is on the incentives and incentive systems that influence motivation and behaviour of people or larger system performance for pro-poor action and development outcomes. Incentive systems and motivations are critical for capacity development as they enable individuals and organisations to perform their functions effectively, efficiently and sustainably.

### 1. Motivation, Incentives and Capacity – concepts, notions and analytical linkages

#### 1.1 Motivation and Incentives - definitions

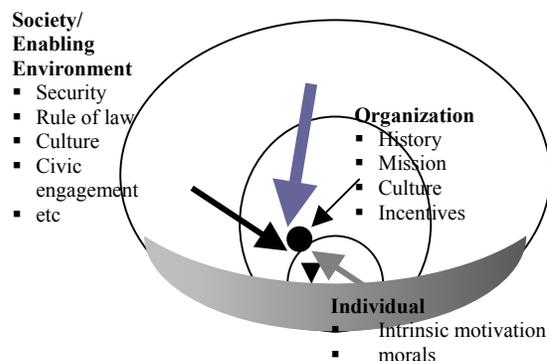
*Motivation* refers to the initiation, direction, intensity and persistence of behaviour. *Incentives* on the other hand are external measures that are designed and established to influence motivation and behaviour of individuals, groups or organizations. *Incentive systems* or structures are combinations of several more or less coherent incentives. *Motivators* include purposive incentives in the above sense but also all other external factors, which impact upon peoples or organizations motivation. The term “*motivational system*” (or structures) can be used to refer to the set of such motivators, more or less persistent in nature, in place at any given time.

Motivation can be at different levels – individual, organizational and societal. Individuals are driven by their own desires and moral beliefs. Individual motivations may be “*internal*” or “*intrinsic*” motivation (activated from the inside) such as hobbies, caring for children, or voluntary work in society; or they may “*external*” or “*extrinsic*” (activated from the outside) motivation, which is nurtured from the outside.

*Organizational motivation*, distinguished from capacity, refers to the internal motivation of an organization.

*Social motivations* derive from the fact that people tend to identify with others and have a sense of belonging to groups. Individuals depend on others and thus have a certain loyalty to the groups they belong to. Social relations are governed by formal and informal rules. There are three dimensions of societal motivations – the first is a sense of fairness: People, groups and organizations want to feel that they are treated fairly compared to peers or competitors. A second dimension is the existence of criteria and authority that stops unfair dealings and that encourages fair behaviour. A third is the phenomenon of “social pressure. It can be appreciation or disapproval from superiors, peers or others that the person feels responsible for, for instance children.

At any of these levels, there are always internal motivational factors (figure 1). But it should be recognized that motivators for improving performance may also come from external sources. For example, for organizations, motivators may reside externally in other organizations and the broader enabling environment. Furthermore, there are interactions of motivations among these three levels – e.g. individual motivations may enhance motivation of an organization, but organizations also impact on people, such as their staff or clients. They influence other organizations such as competing businesses or subordinate offices in the public administration. Organization may in many cases also be the prime entry point for motivating larger societal changes, such as in the case of a tax authority, a Ministry of Education that decides on curricula, or an anti-corruption agency that permeates public and private business.



## **1.2. Performance, motivation and capacity – analytical linkages**

Perceptions and concerns about development performance usually provide the entry point for thinking about capacity issues. Yet, capacity does not automatically translate into improved performance and better development results. To illustrate: a car engine may have all the components to run smoothly, but it would still sit idle without fuel and a driver. By the same token, capacities may be in place, but appropriate incentives need to be present to put them in high gear and in motion toward the desired development destination. ( Boesen,2004)

There are various ways of conceiving of motivation in relation to capacity. On the individual and organizational levels, one can easily conceive of motivation being complementary to capacity. On the individual level, capacity to perform is a combination of personal skills and motivation of people. It can be weakened or fuelled from within (such as changing beliefs or health) or external incentives (measures in the environment that impact on motivation). Learning, which is at the centre of individual capacity development, is fundamentally a function of intrinsic voluntary motivation to acquire knowledge and the means to do so. The capacity of an organization is also a function of the motivational abilities of its leadership as it is of external conditions such as pay scales in public service or investment climate.

In larger systems or the enabling environment, the distinction becomes more blurred. Security, rule of law, and land tenure are part and parcel of societal capacity to manage its affairs. What is capacity on one level may work as incentives on another.

In any case, it is possible to distinguish factors that have motivational effects from other capacity elements. Some are internal, others are external to or “in the environment” of any given system. The question of motivation is inextricably linked with capacity and needs to be analyzed and addressed on all capacity levels: individual, organization and enabling environment.<sup>1</sup>

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<sup>1</sup> See UNDP Practice Notes Capacity Development and Capacity Assessment

## II. Incentives Strategy in Application

### 2.1. Incentives for individual motivation

Incentive measures, such as salaries, secondary benefits, and intangible rewards, recognition or sanctions have traditionally been used to motivate employees to increase performance. Motivators may be positive and/or negative. Reducing dis-incentives or perverse incentives that favour non-conducive behaviour, can often be more important than inventing new incentives. **Box 1** indicates a menu of options from which incentives can be combined into packages.

**Box 1: Incentives that impact on motivation of staff**

- Pay, Salaries, “efficiency wages” etc.
- Direct financial benefits, such as Pension, illness/health/life insurance; allowances (clothing, housing, etc.), subsidies, gain sharing,
- Indirect financial benefits such as subsidized meals/clothing/ accommodation/ transport, scholarships, tax breaks; etc., deferred compensation such as seniority pay,
- Flexible schedules, part-time/ temporary work; sabbatical, study leave, holidays, vacation, etc.
- Work environment/conditions, occupational health, safety, recreational facilities
- Amenities, school access, infrastructure, transport, etc.
- Job security; Career/ professional development/ training opportunities
- Feedback, coaching, valued by organization
- Solidarity, socializing, camaraderie, affection, passion
- Status, prestige, recognition
- Sense of duty, purpose, mission
- Security, opportunities, stability, risk

Thus incentives can be financial, which come in some form of payment or cash transfers. Some of the financial incentives are direct such as salary, pension, insurance, bonuses, etc. Others are indirect such as subsidized meals, clothes or housing. It is important to make a distinction between a proper level of pay and special incentive pay to reward performance. In the private sector financial incentives are generally associated with better performance although perverse impacts can also be observed. Cash awards are shown to have a higher value where remuneration is low. Conditions in the public sector differ significantly from those in the private sector (see below).

Non-financial incentives come in many forms such as gifts, rewards, travel. Some are more tangible than others since they are visible and/or can be compared to financial benefits. Less tangible incentives relate for instance to work flexibility, independence of working, recognition of one’s work, the possibility of advancement. The value of non-financial material incentives seems to be perceived as a function of psychological processes.

There is also a distinction to be made between formal incentives and informal ones. Formal ones are for instance salary scales and staff entitlements. Informal ones may also be legitimate depending on the context but can also represent channels reaping personal benefits through corrupt practices or patronage.

There are also a range of distinctions to be made for non-materialistic incentives. Like generally materialistic incentives, non-materialistic incentives can be “self-interested”, such as psychological benefits related to the status of power. On the other hand they can be of a genuinely “altruistic” nature, based on own desires and moral believes.

For a long time, it was thought that intrinsic and extrinsic motivations were additive and could easily be combined to produce optimal performance. Today it is recognized that there are trade offs. Motivations also have a dynamic nature. As the context and trends change, people also adapt their views and preferences. Different

professional groups respond differently. There is an evolution over time where motivations change with age. While the opportunity for travel, for instance, may be very attractive for young, single professionals, it may become a burden for a family setting. Motivations and responsiveness to incentives also is a function of gender.

## **2.2. Incentives for organizational motivations**

**Incentive systems** are an important part of organizational motivation and are central to helping diagnosticians understand the forces that drive the organization. *Organizational incentives refer to both the reason for staff to join an organization, and the way an organization rewards and punishes its staff.* Incentive systems can encourage or discourage employee and work group behaviour. Organizations must continually seek ways to keep their employees and work groups engaged in their work, motivated, efficient and productive. An organization's success can depend on its ability to create the conditions and systems (formal and informal) that entice the best people to work there. Also, a good incentive system encourages employees to be productive and creative, fosters loyalty among those who are most productive, and stimulates innovation.

Incentive systems reside within organizations, their structure, rules, human resource management, opportunities, internal benefits, rewards and sanctions, etc. Whether based on perception or reality, organizational incentive systems do have a significant influence on the performance of individuals and thus the organization overall. A study of Ghana's public sector concludes that "*The significance of internal factors in creating positive organizational cultures suggests that many of the changes needed to transform public organizations could be initiated by the organizations themselves without substantial external support.*"

## **2.3. Incentives and societal motivation**

Perhaps the most pervasive structural motivators and incentives are located at the societal level, such as security, rule of law, investment climate, civil service pay or legislation conducive to civic engagement. Whether or not an organisation, for instance, is able to achieve its purpose depends not just on only whether it is adequately resourced but on the incentives generated by the way it is resourced under prevailing rules. Many of these cannot easily be influenced from the perspective of individuals and organizations, although these play a critical role as change agents.

The motivational direction and value of many of the above are directly rooted in the prevailing Governance systems. This begins with inclusive democracy and a rights-based approach to development. Neither incentive mechanisms nor external interventions for capacity development will bear results unless there is the rule of law and a proper legal system. A free press and a vibrant civil society serve as watchdogs to deepen inclusive democracy, bolster support for the protection of human rights and further check the misuse of incentive mechanisms. Changing organizational culture takes time. Changing societal values, culture and rules of the game depends on political processes, negotiation, and in many instances is an issue of generations.

### **III. Operational Implications**

This section explores various ways in which incentives and other motivators can be used to mobilise capacity and to promote development performance. This is done in relation to the following:

- How to stimulate better performance in the public sector
- How to retain and attract talent on the global labour market
- How to encourage local service delivery in remote areas
- How to encourage poor people to claim their rights
- How to align aid for capacity development

#### **3.1. How to stimulate better performance in the public service**

A systemic reality in many developing countries is that public service incentives are weak. There is the monetary side: Wages are too low and pay scales that at best are barely sufficient to live off of, are not competitive with the private sector or do not compensate for postings to remote locations. Wages are too compressed, not reflecting the skills, training, and seniority of management positions as compared with low paid jobs. Further, non-monetary compensation and allowances play a major role in total compensation – benefits such as housing allowances, official cars, pensions, and other retirement benefits often form a large part of total compensation. These factors can contribute to a culture of absenteeism, alternative employment, rent-seeking and low productivity often compounded by a system of non-transparent benefits and allowances that discourage rather than encourage performance. Donor practices on salary supplements can further distort incentives if not coordinated.<sup>2</sup>

##### **3.1.1. Public service pay reform**

Pay reform poses many challenges. UNDP's practice note on public administration reform argues that an iterative process, applied with considerable flexibility and pragmatism, with particular attention to sequencing, is more likely to bear positive results. Pay is a politically sensitive issue and a technically appropriate strategy may not be feasible in an unstable environment with high political contestation.

The degree of stability (institutionalization) and of political contestation (competitiveness) in the political system is a key factor in determining how public sector pay will be established. Technical, rational decisions are based on criteria such as productivity, retention, fairness, transparency and affordability. Politically rational implies a similar set of criteria moderated by political considerations, negotiation and wider political goals. In politically reactive decision-making, patronage, little transparency, and political exigencies to diffuse threats to the regime prevail.

As tackling pay regimes presents numerous challenges for political and institutional reasons, the trend in LDCs has been to introduce various forms of performance based incentives, including targeted salary reforms (**Box 2**). To improve implementation and monitoring of government pay policy, a number of countries have also created independent pay and compensation bodies. Malawi established an independent public service remuneration board to oversee the implementation of the medium term pay policy. The board is composed of 7 eminent independent citizens. Bangladesh also set up periodic national pay commissions, composed of members from different organizations, including the private sector. But the latter have not proven very effective: "whenever pay increases are announced with great fanfare, there is a simultaneous jump in the prices of essential commodities, leaving almost everyone in society in dire straits". (Kahn) But experience shows that pay and compensation reforms cannot be done in isolation from other policies, in particular those related to macro-economic controls, reduction of military expenditures, and measures to reduce corruption and irresponsible management. Other strategies included introducing special pay scales for the senior civil service, core functions, special purpose agencies and selective enhanced compensation for technical and professional staff. Despite these various efforts, most LDCs are still grasping with the many difficulties related to these reforms.

## Box 2 : Performance pay and compensation reforms in Cambodia and Afghanistan

In an attempt to correct the distortionary problems of donor driven salary top ups and project implementation units, Cambodia has now embarked on some far reaching reforms. The government's Rectangular Strategy now calls for a 10-15% per annum increase in civil service pay. Also, the government's "priority Mission group" scheme is a flexible tool at the disposal of ministries to rapidly increase their capacity to implement priority missions focused on service delivery bottlenecks or other strategic tasks. Under this scheme, selected teams of qualified civil servants will receive an adequate remuneration (special monthly allowance ranging from 48 US\$ to 130 US\$) in return for good performance and adherence to a strict code of ethics as set out in personal service contracts.

However, these reforms are not free of problems. There is a risk that the Primary Mission Group initiative triggers a series of pressures for additional top-ups in other sectors (e.g. police and military). But the greatest risk probably comes from parallel donor funded incentive schemes. For example, the Public Finance Management Program (PFM) that is supported by several donors also features a merit-based pay initiative for officials responsible for the PFM reform agenda. Levels of incentives are up to three times higher than the national scheme, but only 15% of the centrally located staff will be entitled to participate in the scheme. There is thus a risk that income inequality within the civil service will exacerbate, even between various incentive systems.

Competition for qualified human resources is more harsh than usual in post-conflict settings, e.g. in Afghanistan, where demand largely exceeds supply. The excess of demand over supply drives up salary and remuneration levels and causes inconsistencies between wages paid within government and donor funded government programs. In Afghanistan, different solutions were applied to solve these problems. The Afghanistan Reconstruction Trust Fund (ARTF), the EC funded Capacity Building Groups as well as USAID have paid higher salaries for staff who function as advisors under contract. A component of the ARTF also supports the recruitment and payment of expatriate Afghans. One of the key drivers for structural and functional reforms is the Priority Reform and Restructuring Initiative (PRR). The PRR links enhanced payment to ministries' initiatives for public sector reform. Amounts can range from US\$ 40 to US\$ 500 per month. The successes for these reforms are still too early to tell.

Sources: Keuleers, Patrick. "Cambodia Mission report", December 2004, Flaman, R. "Afghanistan, Merit based recruitment and the public service.

The mode of decision-making also varies over time and the approaches to supporting improved public sector efficiency through better pay policy will be more effective if they take account of these wider political rhythms and the prevailing political background. Public service pay needs to be distinguished from incentive pay. *"The impact of performance pay on motivation is ambivalent: while it appears to motivate a minority of staff, it seems that a large majority often do not see performance-related pay as an incentive... Job content and career development have been found to be the strongest incentives for public employees. Performance-related pay is unlikely to motivate a substantial majority of staff, irrespective of the design."*<sup>3</sup>

### 3.1.2. Harmonized approaches

While there are no quick solutions for reforming the public service, there is a general need for harmonized approaches, preferably led by national agents, and optimally integrated in the national budget. Tanzania now for several years has gained experience with a scheme of 'Selected Accelerated Salary Enhancement' (SASE) (see box 3). The scheme has faced a number of challenges, including a strong egalitarian culture, implementation problems on government side and reluctance by donors to support the scheme. Yet the scheme combines characteristics of a solid and workable transition arrangement that offers valuable lessons to other countries.

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<sup>2</sup> UNDP Practice Note on Public Service Reform (2004), and UNDP Conference Paper on CD in Transitions (draft, Nov 2006).

<sup>3</sup> OECD, 2005, p. 176-77, quoted from Paul 2006

### **Box 3: Reducing distortionary incentives by aligning aid around national pay reform**

#### **The Issue**

Pay reform in the public sector is technically complex and politically challenging. There are no easy answers and solutions need to be part of a wider package of reform measures to promote capacity and performance improvement. These should be locally determined and must balance political and technical considerations. Where public sector pay is low in absolute and relative terms, where pay scales are compressed and where recruitment and promotion lacks objectivity and transparency pay reform is a critical issue to address. In practice, issues of pay have been addressed piecemeal and in an arbitrary manner, often lacking sustainability and fairness, and usually breeding resentment and disaffection. External partners have contributed to this problem through a variety of practices such as establishing enclave PIUs, by providing salary top-ups to project staff and by providing various material and non-material incentives.

#### **Proposed Strategy**

Countries are encouraged to promote transitional arrangements over the medium term that provide a framework for long term pay reform linked to public service reform and that encourage external partners to harmonise and align their support around a national process. In so doing, it helps avoid ad-hoc reward arrangements that distort incentives and motivation in the public service that can also undermine capacity, while assuring that incentives are in place to encourage performance in areas of priority. Examples include the Selected Accelerated Salary Enhancement (SASE) scheme in Tanzania (see annexes for case study) and the Cambodian approach of establishing priority mission groups in key ministries. Characteristics of such schemes include:

- The process is country driven and is an integral part of a wider public service reform process
- External partners align their support around the country initiative and pool their resources with those of the government
- It is part of a medium to long term strategy linked into the budgetary process which can be continuously monitored and adjusted
- It offers a point of reference for dialogue among partners on pay, capacity and performance
- Transparent and objective criteria are established to determine the basis for salary enhancement
- Objective procedures are applied by an independent review board with representation from relevant stakeholders
- Scheme beneficiaries are regularly monitored and sanctions are invoked in case of non-performance to avoid perception of entitlement
- An exit strategy for external partner support is built in to assure financial sustainability

The design of such schemes needs to take particular account of the extent of objectivity (political independence) in the recruitment process, to avoid being captured by special interests. It is important to consider socio-cultural factors related to equity and fairness, and to understand the factors that influence public service behaviour and attitudes with regard to performance, accountability, equity and pay. A high degree of management and coordination is required to ensure that all parties play their part and that there is strict adherence to time lines and to the overall budgetary framework. In countries that lack a clear policy commitment to reform or that are unable to sustain the financial implications of higher salaries in the longer term devising bridging solutions is even more challenging. The characteristics above should in principle apply and remain compatible with country ownership even so implementation may take different forms.

### **3.1.3. Non-materialistic Incentives**

Non-materialistic motivation, especially moral motivation, to serve in the interest of the community is particularly strong. A specific term has been coined by analysts. "Public service motivation" (PSM) reflects that the public service attracts a certain kind of person that more readily identifies with the mission of the organization.<sup>4</sup> Modest pay and the absence of strong material incentives in the non-profit sector seems to have a screening role and public organizations attracting members with high levels of public service motivation who identify very closely with the goals of the organization.

Caution is also in place because of the crowding out risk. "Why should one make a voluntary effort if others are paid for it." Higher materialistic incentives can reduce non-materialistic motivation, in particular in environments where the latter is high or where such measures are perceived as controlling. The result may ultimately be a negative one, i.e. overall reduced motivation. This also is a function of values and culture that vary in different societies.

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<sup>4</sup> Paul (2006) p27: "There is considerable evidence that PSM exists within the public sector (e.g. Perry 1996, 1997; Brewer et al., 2000; Wright, 2001), and that public service organizations tend to attract such people (Houston, 2000). There is also empirical evidence that the same type of moral motivation exists, to varying degrees, in the non-profit sector and even, in certain cases, the private sector (Wittmer, 1991)."

A sensible starting point is to understand and address first and foremost the demotivating factors, which may undermine employee motivation. Kohn (1998) sensibly states: “Pay people well. Pay people fairly. And then do everything in your power to take people’s minds off of money.”<sup>5</sup> This also implies clear, fair and enforced rules to deal with corruption. Even if a sound public service pay is highly desirable, many developing countries will not be in a position to ensure adequate levels of salary and should for very practical reasons appeal and avoid undercutting non-materialistic motivation of civil servants. This also implies that aid budgets will continue to be of importance in many countries and that ways need to be pursued to align incentive schemes with the objective of long-term pay reform and sustainability in the public service.

#### **Box 4: Reducing demotivation and valuing non-material incentives for public service performance**

##### **The Issue**

Pay is fundamental to raising public service performance but it should be viewed as a necessary but not sufficient factor. Evidence points to a range of demotivating factors and non-material incentives that can have a significant impact on staff motivation and organisational performance. Often outstanding performance has arisen in contexts where it might be least expected and where pay has not been the critical determinant. Job content and career development have been found to be the strongest incentives for public employees. In many developing countries the prospects of ensuring adequate levels of pay remain remote, so for very practical reasons, attention should be given to understanding the non-material incentives that can drive performance. It is equally important to remove those incentives that can undermine performance.

##### **Proposed Strategy**

Efforts to promote performance improvement beyond pay should begin by analysing the spectrum of non-material incentives that can help or hinder individual and organisational performance. In the context of performance management, appropriate ways to inculcate administrative behaviour that embraces a culture of openness, result-orientation and accountability to the public need to be identified. The following may guide:

- 1. Understanding what makes people and organisations tick should also be part and parcel of any capacity assessment exercise.** The identification of capacity gaps can be a comparatively straight forward exercise as the needs can be more precisely defined. However, understanding the significance of individual and organisational incentives, particularly those that are non-material, is much more complicated. Self-assessment can be a useful entry point for engaging in dialogue on the subject, and in identifying the critical factors.
- 2. A sensible starting point is to understand and address first and foremost the de-motivating factors** Unfair treatment, opaqueness and lack of sanctioning authority can undermine performance. Political ambitions can be at cross purposes with formal mandates. Patronage, employment creation, constituency-building, or symbolic purpose may drive organisational existence. Power struggles between political factions or between management and board can also have a determining influence on organisational performance. Equally, bureaucratic rules and management styles can stifle innovation and risk taking, and discourage a focus on results.
- 3. Analysing the drivers of change<sup>6</sup>** that can help to better understand where support and resistance might be encountered. The identification of appropriate incentives moreover lies at the heart of any change process and is fundamental to the concept of ownership. Unless key stakeholders are motivated to embrace change, and unless appropriate incentives can be brought to bear on the rank and file, efforts to reform or change organisations are unlikely to succeed.
- 4. Non-material incentives need to be recognized, valued and reinforced.** For instance: a belief in public duty and civic responsibility, having one’s efforts recognised and appreciated, a sense of fairness and equity, a commitment to personal improvement, or a sense of respect and status related to one’s position. But it can also be linked to power, authority and influence. Non-material incentives that drive organisational performance include leadership and vision, internal values and organisational identity, and the legitimacy and mandate bestowed upon it by stakeholders and society at large. An enabling policy and institutional environment is equally important.

There are no standard solutions for addressing the challenge of non-material incentives. Whilst certain incentive issues such as policy framework or organisational mandate and mission may best be addressed through cross-the-board interventions, others that have a strong personal or organisational specific dimension are best addressed at departmental level, and count on the active engagement of senior management as well as junior staff. Investing in effective human resources management capability to tackle these issues and to steer the process is an important starting point. Political leaders have a critical role to play in appealing to public servants to serve the nation and uphold values of public duty, integrity and selflessness, but must begin by setting an example themselves, and by ensuring the accountability and transparency of public institutions.

<sup>5</sup> Kohn 1998, quoted from Paul (2006) p5

<sup>6</sup> DFID provides a set of tools on Drivers of Change and Power Analysis that could be useful in this regard.

### **3.2. How to retain and attract talent in a global labour market**

Brain drain is facilitated by an increasingly transparent though highly filtered global market for high skilled labour and caused by several interlocking factors. Some are pushing people to leave their country, such as insecurity, lack of opportunity, low salaries, and so on. Others, such as higher salaries, quality schools, but also the imagination of a better life constitute pull factors for attracting skilled work from low income country. Easing obstacles to migration, for instance by easy access to visas raises the opportunity cost of staying at home. Until the time when the international community can agree on mechanisms that can effectively compensate for the migration of the highly skilled, brain drain remains a major concern.

#### **3.2.1. Reducing push factors**

For people still residing in a given country push factors are basically motivators that drive people to consider leaving. They are related to dissatisfaction with living conditions, work opportunities and overall social environment. Materialistic motivations surely matter but so do quality of life, family bonds, language and being culturally at home. Generally speaking there are many non-materialistic, intrinsic and social motivations that make people want to stay home.

It is thus wise to look first at whether de-motivating factors that actually drive people away can be reduced, such as insecurity, lack of liberties and opportunities, red-tape, corruption, mismanagement, injustice, etc. Such motivational factors in the enabling environment are ultimately the most important factors to be concerned about. No motivational measure will keep people in their country if there is no environment where people feel safe, where they can flourish and prosper.

Part of such an environment is a conducive investment climate for private sector development, upgrading the quality and status of public services, allowing a vibrant civil society to develop, voice in public decision making and fairness in treating citizens. The relative success of the South Korea and Ireland in fostering return migration has been attributed to the opening of their economies and policies to foster domestic investments in innovation and R&D. Developing countries with some infrastructure in R&D, like India, are more likely to attract the return of migrants, as well as money and business contacts. India is also an interesting case in the IT industry, where it attracts work because of a large English speaking work force, with IT skills and internet connectivity. Instead of workers leaving the country, foreign companies now ship their work to India at very competitive costs, attracting many to remain home and not seek jobs abroad in this field anymore.

#### **3.2.2. Migration and education**

There is little magic in all this that would apply only to managing migration. However there are some lessons that demonstrate motivational mechanisms. Because of its importance migration, education and professional learning is an interesting nexus to explore. Some lessons on promising approaches can be summarized as follows:

*Raising the standards of tertiary education:*<sup>7</sup> One reason why many bright students leave their countries to study abroad is that the universities in their countries are ill-equipped, poorly staffed and do not uphold certifiable academic standards. Degrees even from national universities may not be recognized unless supported by patronage or bribes. Governments must recognize this problem as a crucial obstacle to sustainable capacity development and reform tertiary education to introduce more effective teaching methods and up-to-date curricula, as well as acceptable and impartial standards for certification. International and regional cooperation with other universities may help establish standards that will make it unnecessary for students to seek their basic academic education abroad. China, for instance, has recently launched a project to develop 100 universities into world-class institutions that not only provide higher education training, but also academic employment and research opportunities. (Cervantes 2002)

*Bonding of university graduates to national service.* Several countries have in the past imposed a bond on students who graduate from government-funded programmes, obliging them to hold a government job for a

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<sup>7</sup> Also see UNDP Conference Paper on Knowledge Services and Learning, Nov 2006, that addresses this issue in more depth.

certain number of years after graduation. In view of the vast pay differences between domestic government jobs and the alternatives offered by industrialized countries, bonding is not an effective method to restrain international migration. However, if like a loan, the bond can be redeemed, for instance by a private employer who wants to recruit the graduate before the end of the bonded period, it becomes more attractive and has a compensatory effect.

*Reducing the portability of professional qualifications.* A precondition for immigration in many countries are qualifications that are internationally or nationally recognized. Reducing the portability of qualifications can be done by developing particular training programmes and professional degrees that are less marketable internationally. This does not need to be at the detriment of relevant skills. In effect internationally recognized qualifications for instance may only be partially suited to the needs of essential health services in poor countries. Training can focus on the most relevant and important skills by training new types of health workers, taking into account evidence that use of such health workers can be safe when properly trained.

*In-country and in service learning:* Action learning, online coaching and similar methods of promoting on-the-job-learning within the work context and in country have shown to be promising. In Central and Eastern Europe and the former Soviet Union, for instance, the IPF programme of the Open Society Institute provides leaders from all sectors with a year of opportunities to work with mentors on policy projects, while remaining in their home countries. As a result, fellows not only conduct original field research to benefit their communities, but also establish and maintain ties with local policy-making organizations.<sup>8</sup>

*Making better use of existing national capacity:* While institutional capacity may be low in the public sector, underutilized individual capacities often exist in civil society and the private sector. These can be better tapped if monopolies for professional work are eased – for instance, in health, education and law – and small enterprise is allowed to compete on equal terms with government and large international firms in the domestic consultancy market.

*Restricting the use of technical cooperation to where it is needed:* The prevailing incentive structure favours using expatriate technical cooperation personnel even in situations where local expertise is available. There are cases where over-reliance on technical cooperation appears to have crowded out domestic expertise, thereby encouraging brain drain.

### **3.2.3. Reverse brain drain**

Once people have left, their skills and experience may not be lost altogether. But enticing them or their contributions (knowledge, business, technology and remittances) to the development in their country back requires even more appropriate incentives. Returning migrants from the Diaspora bring back foreign education, valuable management experience, increased ties to foreign research institutions and access to global networks. UNDP and IOM for instance have initiated formal programmes, such as TOKTEN and others, seeking return - permanent, temporary or even virtual. While permanent return might be hard to achieve, since developing countries cannot offer comparable salaries and infrastructures, temporary and virtual repatriation can go far in employing expatriate knowledge and skills. Programmes of this kind seem to be most successful when they are supported by an active Diaspora organization.

The concept of the Diaspora as a “brain bank” from which knowledge can be borrowed by people in the country of origin is not new, but the development of the Internet has inspired fresh and very promising applications during the last ten years. Knowledge networks, built to connect expatriate professionals with their country of origin and to promote the exchange of skills and knowledge, have emerged all over the world, particularly in countries with large immigrant populations such as the United States. The motivation for joining the networks is usually a combination of national solidarity and interest in keeping informed. Diaspora networks can be important channels for knowledge transfers through what the International Organization for Migration (IOM) calls “virtual return migration” as opposed to physical travel. They may also have the effect of enhancing self-confidence and credibility within the home country, which has been the case with a number of networks set up by expatriate Indians (Kapur, 2001).

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<sup>8</sup> Lopes/Theisoehn and UNDP 2004

In many countries, reverse brain drain is also taking place. In the 1960s, just 16% of Korean scientists and engineers with doctorates from the United States returned to Korea. In the 1980s, that share jumped about two-thirds. A large part of the difference was due to Korea's improved economic prospects. In Africa, the Return of Qualified African Nationals Programme, run by the IOM, has tried to encourage qualified nations to return and helped them reintegrate. It reintegrated 1,857 nationals in 1983-99, slightly more than 100 a year. Korea and Taiwan have adopted a number of measures to ensure reverse brain-drain (**box 5**).

**Box 5: Measures for reverse brain drain in Korea and Taiwan**

Korea and Taiwan have focused more on encouraging their diasporas to return than on encouraging them to invest at home. Taiwan set up a government agency – the National Youth Commission – to coordinate efforts to encourage return. The commission acts as an information clearing house for returning scholars seeking employment and for potential employers. Korea has focused on upgrading its research institutions, such as the Korea Institute for Science and Technology (KIST), as a way to attract returnees. Those who join KIST are given a great deal of research and managed authority.

Both Korea and Taiwan have tried hard to attract scholars and researchers. Intensive recruiting programmes search out older professionals and scholars and offer them salaries competitive with overseas incomes, better working conditions and help with housing and children's schooling. Visiting professor programmes allow the countries to tap the expertise of those uncertain about returning home for good

Source ; Human Development Report 2001

**3.3. How to encourage local service delivery in remote areas**

The challenge of local service delivery is particularly acute in remote areas. However, the particular hardship conditions in many rural settings de-motivate teachers, doctors, nurses and others skilled personnel to accept remote postings. The challenge of motivating people to work in remote areas with limited infrastructure, services and choices is in many ways akin to the challenge of retaining people in-country, and so are responses.

**3.3.1 Performance-linked funding**

There are a range of practiced approaches. One of them is the linking of funding allocations to certain conditions. In its practitioner guide, "Delivering the Goods", UNCDF codifies a wide range of lessons related to basic local infrastructure development and service delivery. Amongst other dimensions of financing strategy the report discusses linking funding to local performance. The genesis and results of performance based funding in Uganda offers valuable insights. (**Box 6**)

**Box 6: Uganda: the genesis of performance-linked funding**

In 1996 the Ugandan government was preparing radical local government legislation that would transfer very substantial powers, responsibilities and fiscal resources to districts and sub-counties. Policymakers were very concerned to ensure good local performance, so as not to discredit the decentralization experiment and undermine a major plank in the programme for the restoration of good governance in Uganda.

UNCDF worked closely with the Ministry of Local Government in Uganda on the design of a grant modality with inbuilt performance incentives. Local authorities were awarded grants if they fulfilled certain minimum conditions; furthermore, the grant was adjusted according to detailed, nationally established performance guidelines for local government planning, procurement, accounting, etc.

The Ministry of Local Government invested considerable effort in broadcasting to the general public the conditions to be fulfilled by local authorities, the amounts of money they received, and the justification for increasing or decreasing grants following performance assessment.

As a result, the public became much more concerned about local government performance, as it now had a visible and direct link to service provision (the amount of development funds the council was allocated). Councillors also became much more interested in how their staff performed. While they had not been particularly concerned about the timeliness of accounts in the past, for instance, they now pushed staff to have them prepared punctually. In several cases account staff, planners, etc. who were underperforming were disciplined in various ways, and some were even sacked.

Performance-based funding has proven to be a very valuable motivator for improved local service delivery.<sup>9</sup> UNCDF summarizes as follows:

*Overall, the introduction of the performance link to LG [local government] funding has had extremely positive results. It has proved to be an effective instrument in encouraging stronger LG performance, compliance with the legal and regulatory framework and broader national policy goals, and has attracted considerable interest from policymakers in several countries. Nevertheless, several cautions and qualifications need to be borne in mind. (UNCDF 2005)*

Making information on financial allocations for local service provision transparent has an explosive potential as it mobilizes poor people to claim their rights and quality service. It is not surprising that local governments may be reluctant or lack capacity to make information publicly available. UNCDF proposes a number of incentive options for dealing with this:

- Providing LG officials with training in communication;
- Covering information provision costs (e.g. signboards for projects) through a small allocation within the annual block grant;
- Making the provision of information to upper tiers of government on a timely and regular basis a minimum condition for access to annual block grants;
- Including compliance with statutory requirements for public information as a minimum condition for access to block grants;
- Making the degree to which information is made public by LGs a performance criterion, such that good communications performance is rewarded by increases in block grant allocations.

### 3.3.2. Material incentives

In many countries material incentives for specific groups of workers have proven useful in particular in motivating service in remote areas. Hongoro and Normand provide examples for material incentives from the health sector. Premium payments, higher salaries or location allowances, for working in rural areas were found to be successful in Thailand (**box 7**).

#### **Box 7: Material incentives for retaining doctors in rural areas of Thailand**

In general, public doctors prefer to practice in urban areas, where conditions are usually more attractive and opportunities for private practice are better. Thailand pays public doctors who work in rural and remote areas significantly more than those working in urban areas, and this incentive has persuaded some to move (Wibulpolprasert and Pengpaiboon 2003).

The government also added non financial incentives, such as changing physicians' employment status from civil servants to contracted public employees, providing housing, and introducing a system of peer review and recognition. These initiatives were coupled with significant environmental changes, including sustained rural development. In most developing countries, providers in rural areas are paid less than those in cities, and it is hard to recruit and retain health workers in rural areas.

Source: Chapter 71 Health Workers: Building and Motivating the Workforce Charles Hongoro and Charles Normand

In Ghana and Zimbabwe retention in rural areas was aided by requiring service in defined areas as condition of licensing or speciality training. (Chimbari 2003) Providing housing and good quality educational opportunities for health workers' families was found useful to motivate nurses in Nepal. It did not work well for doctors. Minding the risk developing into bribes financial incentives may also come from the demand side. China provides an example of how changes in the environment—for example, the introduction of pro-market policies—can change provider behaviour, in this case from relying on government salaries alone to the use of “red packages” (Bloom, Han, and Li 2001). These red packages were gifts that were traditionally exchanged as an expression of mutual

<sup>9</sup> Compare PN Accountability

appreciation, but they have now evolved into informal cash payments from patients to health workers. This may be an example of cultural adaptation that can be rather risky in other contexts.

An experience from a Kenyan education scheme points to the intricacies of devising appropriate incentive schemes. An evaluation of a programme that provided primary school teachers in rural Kenya with incentives based on students' test score shows that incentives may lead to "teaching to the test" rather than sustainable improvements.

### 3.3.3. Non-material incentives

Also at the local level, non-materialistic social and intrinsic motivation can play a major role that needs to be explored. It is understandable that many people may be reluctant to be posted faraway from home. Those used to urban life will find it particularly difficult to move to a remote area. In Thailand the challenge has been turned around into an asset by recruiting trainees from the very areas they were supposed to serve in. This approach was found successful. ( Hongoro 2002) It also has the additional advantage that workers will be inserted into societies with a moral obligation to do a good job. It is akin to localizing informal accountability relations. A cautionary note, however, is that local environments also can be fragmented and tying service providers to their kin can work at the expense of others. Where it is possible to monitor actual performance, contract-type arrangements and the use of competition in the bidding process have proven useful.

Intrinsic and moral motivation to serve the poor can cut across such divides, which is particularly important where monitoring is difficult. "A study of faith-based health care providers in Uganda estimates that they work for 28 percent less than government and private for profit staff, and yet provide a significantly higher quality of care than the public sector. (WDR 2004)

### 3.3.4 Private-Public Partnerships

At the local level, Private-Public Partnerships (PPP) have shown to be useful mechanisms. Various parties come together under a PPP arrangement for different reasons. When PPPs are well designed, structured and implemented with clear distribution of roles, responsibilities and risks associated, they can upgrade the quality of service and broaden coverage, improve welfare, make new services affordable and generate other communal benefits.

The key incentive for local governments is to tap human and financial resources and good business principles from the private and civil society sector to address service delivery challenges and extend services to the needy, especially in poor neighbourhoods. PPPs allow governments to focus on critical core functions and services (including planning, standard setting, budgeting, management, resource mobilization, monitoring and compliance enforcement) and free up space for interventions by other partners. In some countries, Local Government Acts mandate local governments to perform service provision. PPPs provide opportunities for employment creation through provision of municipal services and local economic development activities.

Most instructive are insights on what can attract private sector interest to engage in PPPs:

- **New business opportunities:** PPPs create opportunities to diversify and do business with municipalities. They further helps to reach out to the untapped market, namely people at the bottom of the pyramid and market, may lead to up-scaling in other parts of the country or in the region.
- **Reduced risk:** Private investors make profits by responding to identified and reliable market demand that includes demonstrated consumer ability to pay for the services.
- **Incentives and tariff structure:** Tax rebates, subsidies, free trade zone incentives, equipment importation incentives associated with PPP arrangements. Benefits from public funding windows such as Venture capital, government sovereign guarantees to source business capital from the markets.
- **Transparency and fairness:** An open procurement process, fair treatment in awarding the contract to the best bid, are important in building investor confidence.
- **Reliability of terms:** Any mechanisms, such as tariff setting by the government, without clauses that guarantee acceptable return on investment through government subsidies for example, will reduce the incentives of a PPP from the private sector perspective.

- **Access to information:** Decisions to invest in a PPP are based on available information. The quality and availability of this information is therefore important, as its unrestricted access to it.
- **Independent operation:** The private sector expects that once the contract has been agreed and signed, it will be able to make business decisions independent of government as long as this does not violate contract provisions.
- **Adequate regulation and conflict resolution mechanisms:** Local courts of justice, which even if independent, may still be perceived by the private party as government agents. Investors usually prefer international or local arbitration by an independent party.

### **3.4. Enabling mechanisms for the poor to claim their rights**

There has been increasing recognition that focusing on supply alone may not actually lead to actual improved service delivery, because the demand is not strong enough. Reasons for lack of demand relate to the fact that people are poor and less aware. It can also relate to social differences and cultural conditions.

#### **3.4.1. Information, awareness and participation**

Addressing demand side motivation can take various forms. Outreach and awareness-raising in an accessible way (including language) is fundamental. This relates closely to discussions of stakeholders' accountability, mechanisms that combine transparency with means to claim adequate delivery of services.

There are many examples of how powerful the provision of information can be. One comes from Uganda where the publication of budget allocation to local schools empowered parents to claim delivery. In the course of 5 years the percentage of intended funds that actually reached local schools grew from 30% in 1995 to 90% in 2000. Popular versions of government policy and budgets in local languages should be a standard feature for empowering poor stakeholders. Local Human Development Reports similarly help informing and motivating poor people to claim their rights and use available services<sup>10</sup>.

Demand side approaches can take different forms. In the context of the health sector, these include: behaviour change to influence health outcomes; rights-based approaches; improving accountability through the demand side; participatory approaches; multi-sectoral/multiple stakeholder approaches; and demand side financing. In most of them experience is widely available. Demand side financing as a particular innovation however should be considered because of its direct and indirect benefits as well as of its potential for up-scaling as the availability of aid resources increases.

#### **3.4.2. Demand Side Financing (DSF)**

There also exists significant experience with schemes that provide material incentives directly to poor people. The prime characteristic is that the incentive payment does not go to a third party service provider but to where the demand ought to be, i.e. on household level. Mexico's Education, Health, and Nutrition Program (Progresa) offers one well documented example. It gives cash to families if their children are enrolled in school and they regularly visit a clinic. Indeed most experience with what has been termed "Demand Side Financing" (DSF)<sup>11</sup> is currently available from the education sector with some experiments in health and nutrition (see box 8).

It is important to explore carefully how the household subsidies are targeted. One evaluation of Progresa, for instance, suggests "that an approximately revenue neutral change in the program that would increase the grant for secondary school children while eliminating for the primary school children would have a substantially larger effect on enrollment of the latter, while having minor effects on the former." (Attanasio 2005) A conscious gender bias can also improve the efficiency of such schemes. "Bolsa Escola" in Brazil has entrusted the mothers with the administration of the resources. This decision came about after a study of social and economic patterns revealed that they are more efficient than fathers in making the best use of the allowance.

<sup>10</sup> See also PN Accountability

<sup>11</sup> 'Demand side financing' (DSF) is a relatively new term. It seems to have been first used by the World Bank in relation to experience with vouchers in the education sector (Patrinos and Ariasingham 1997). Quoted from DFID Issues paper (2004): Understanding the 'demand side' in service delivery definitions, frameworks and tools from the health sector, Hilary Standing

It is evident that any DSF scheme faces particular challenges. Such schemes are actually widely used in developed countries embedded in contexts where populations are well registered, bureaucracies function, and accountability mechanisms are in place. Managing such schemes is more challenging in contexts where these are lacking. These schemes are also not palliatives for serious structural concerns that remain to be addressed in national socioeconomic plans and budgets. The lack of fair and functioning systems that undermine supply side interventions will also affect demand side ones.

#### **Box 8: Conditional Cash Transfers To Strengthen Demand**

##### **The Issue**

Whilst public service reform aims to enhance service delivery capacity and to improve performance, the process of change is often slow and can be easily derailed. It also does not guarantee that services will actually be used, unless consumers are able and motivated to do so. Supply side approaches to performance improvement need therefore to be combined with demand side approaches that empower the poor to claim their rights and to make demands on the state to deliver relevant and quality services. With rising levels of development finance, and attention focused on attaining the MDGs through scaling up, the merits of demand side approaches, as complementary to supply side approaches are attracting increasing attention.

##### **Proposed Strategy**

Demand Side Financing (DSF) offers a potential innovation and is an example of one of several demand side approaches being explored across various sectors. To date experience has been from the education sector and to a lesser extent from health. DSF has been defined as 'A means of transferring purchasing power to specified groups for the purchase of defined goods or services' (Pearson 2001). Its attraction lies in the fact that it places financial incentives directly in the hands of the service user, not to a third party service provider. Although not without problems, DSF has demonstrated its potential in a number of cases. Brazil's Bolsa Escola scheme is an example of school stipends distributed to mothers as an incentive to promote primary school enrolment that has yielded impressive results (see annex). Mexico's Education, Health, and Nutrition Program (Progresa) is another well documented example. It gives cash to families if their children are enrolled in school and they regularly visit a clinic. The rationale and benefit of these programmes are multi-fold:

- The schemes are selective and target population groups that are generally underserved (linking demand to supply)
- They raise awareness among families about the importance of, for instance, placing their children in school. This leads to extended enrolment but also positive attitudes towards education
- Providing resources to families strengthens their demand and ability to consume "social sector goods" (changing demand side behaviour)
- It can also introduce an element of competition allowing poor people to choose their provider
- They create incentives to service users to demand services, and in turn strengthen downward accountability
- Bottom-up demand can be a driver for performance improvement creating incentives on public service staff to perform (changing provider behaviour).

DSF schemes face particular challenges especially in developing countries where bureaucratic capacity is weaker and where accountability mechanisms are not well established. The capacity to develop and manage accreditation schemes for providers is a case in point. Thus the lack of functioning systems that undermine supply side interventions can also affect demand side ones. It is equally important to assess the legitimacy and accountability of community groups that may seek to represent the consumer in their relationship with service providers. This may require focused capacity development work.

DSF is not a "quick fix" in a macroeconomic nor an institutional sense, and issues of corruption, asset distribution, leakage and mismanagement will have to be addressed." Further DSF should not be seen as a substitute for supply side interventions. Rather, it should be regarded as a different entry point to the same set of problems, which may have potential for addressing them from a fresh standpoint." (Standing, 2004) Also with larger amounts of development financing available there is a tendency to deliver through vertical arrangements. The potential of using higher volumes of aid for conditional cash transfers to households needs to be seriously considered.

- What potential is there to extend the experiences of education and health to other areas of social service provision?
- What scope is there for up-scaling experiences to national level and what are the implications for balancing service utilisation versus service quality considerations?
- How to avoid that such schemes undermine the legitimate role of decentralised government in social service provision and management, and the accountability of locally elected leaders?
- What are the implications for public-private partnership to respond to demand side financing?

### **3.5. How to align aid for capacity development**

In recent years power analysis and drivers of change approaches have rightly found a prominent place in the development discussion. It is however critical to accept from the outset, that the political economy of development is very much shaped by donors and the development industry. Countries dependent on development cooperation are more exposed to the pull of external motivators, which are often based on legitimate intentions that confront complex realities on the ground. Perverse incentives thrive on objectives and constraints on both sides of the aid relationship.

#### **3.5.1. Incentive dilemmas of aid**

A fundamental problem with the whole development cooperation industry is that so few of the goods and services it provides have a visible price tag, which tells the user how much money the service requires from the provider, or what the user has to sacrifice to get it. Even if both sides know all the sums, the recipient is very seldom aware of the possible alternative uses of the money. Eliminating perverse incentives is to a large extent a question of introducing more price consciousnesses among users, as well as among providers and intermediaries.<sup>12</sup>

Many of these fundamental dilemmas have been acknowledged and at least the commitments of the Paris declaration bear witness to rising awareness and concrete commitments around aligning and harmonizing aid around national priorities and systems. The Paris commitments if taken seriously will go some way in simplifying. They do acknowledge that the epicentre for negotiation and collaboration is the country level. The mutual commitments are cognisant of the power differentials inherent in aid. Developing countries can seize this opportunity by strengthening significantly their aid management and enter into mutual accountability arrangements with their external partners.

#### **3.5.2. Incentive schemes and de-motivation**

Motivated by the need to ensure quick delivery of projects, donors provide additional incentives in the form of salary supplements, travel and meeting allowances. Yet these practices drain the public service of its most able employees and reduce the motivation for a comprehensive reform of public administration. The problem has many parallels to those related to brain drain and in effect donor projects are one window of entering the international labour market and its conditions. The fundamental issue is a dual salary structure. The salary differentials are enormous between internationally recruited experts and local staff. It is useful to understand how from a psychological perspective a vicious circle of demotivation due to salary differentials may work.<sup>13</sup> A recent study based on empirical analysis describes the scenario of “double demotivation” in both foreign experts and their national counterparts. **(Box 9)**

#### **Box 9: A Vicious Circle of Double Demotivation**

First, groups will compare their pay for equity (Equity Comparison). Among the higher paid group (e.g., Foreign Expatriate) there may be some discomfort (e.g., Guilt), which combines with other stressors to precipitate turnover (Exit). Alternatively, there may be some early effort to work harder, to match the higher pay (Inflate Input). Because nobody however can work 10 or 20 times harder than others, the likely end-result of the equity comparison process is to restore equity psychologically, by implicitly reasoning: “If we are paid more, we must be worth more.” Self-attributions like this are not likely to optimize input to the job, and thereby surreptitiously undermine motivation (demotivation 1). That inflated sense of self is then projected to, and sensed among, the lower paid groups. These groups are already feeling Indignation at their lower pay. If they do not Exit (and perhaps contribute to the brain drain) they will Reduce Input to reflect the extent of their under-payment (demotivation 2). This reduction is then sensed in the higher paid groups, becoming a self-fulfilling prophecy for their own self-inflation. That increment in self-inflation then reinforces another round of reduced input, and so on – which ultimately creates a vicious circle. Thus over time double demotivation is observed, a demotivation in both the foreign expatriate’s and the local aid worker’s behaviour.” (Source: MacLachlan 2005).

<sup>12</sup> Berg et al., 1993; Ajayi et al., 2002

<sup>13</sup> see also Lopes/Theisohn and UNDP 2003, p42/43

### 3.5.3. PIUs and parallel arrangements

Similar mechanisms are at work in arrangements such as parallel implementation structures or topped-up project positions. While project implementation units can be quite effective in getting the job done, they introduce high risks. Ultimately “fast-tracking” may not necessarily be compatible with institutional learning and sustainability objectives. PIUs can be used as a cop-out for fundamental reforms and powerful PIUs may even drive a development agenda and impose prescriptions on how a government should work.<sup>14</sup> Greater use of short-term advisors, coaching models and local consultants; institutional twinning; time-bound gap-filling; costing of technical cooperation incorporated within national budget systems; the use of volunteers and independent oversight mechanisms are modalities more consistent with positive incentives.

Whether within PIUs projects or other arrangements, selectively raising some civil servants’ salaries (‘topping-up’) is distorting and ultimately unsustainable. Various attempts have been made to find transitory solutions, by bringing ‘top-ups’ formally within the pay regime. In some cases, temporary reform teams are offered exceptionally high wages for a limited engagement in order to implement a reform programme (for example, in Kenya). In others, selected civil servants considered especially critical to the reform programme are given higher salaries such as in the Tanzania SASE or Cambodia Priority Mission approaches (see also box 3).

#### **In Conclusion - A Hierarchy of Preferred Options**

In practice it is often claimed to be the only way to achieve results in most capacity constrained countries. It is true that in a fragmented aid system individual donors or agencies will not be able to change practice or be outpaced by better paying partners. Also country situations differ widely and collective solutions need to be tailored to local conditions. The points below are attempts to delineate a sequence, from the most preferable to the least preferable courses of action for dealing with incentive schemes. (Lopes 2003)

- Nationally led schemes are preferable to donor-led solutions.
- The donor community, including multilateral partners, should not shy away from funding such schemes through pooling resources, ideally through the national budget.
- When this is not feasible, governments should be encouraged to lead, while possibly outsourcing the pooling arrangement. Where government does not take the lead, for instance in conflict or post crisis situations, a collective approach negotiated and coordinated by donors and relevant national stakeholders may be a possible solution.
- In cases where a national anchor cannot be found or constructed, collective harmonized solutions are preferable to a multitude of different schemes, e.g., from UN agencies, international financial institutions and bilateral donors.
- Anarchic incentive schemes in cash or kind are the least preferable avenue and should be ruled out as a “no-go” option.
- An exit strategy is absolutely indispensable, regardless of the option selected.

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<sup>14</sup> See also UNDP Practice Note on PIUs

## ANNEXES

### Annex 1: 3 Case Studies

#### Tanzania: From “Top-Ups” To Sustainable Incentives For Civil Servants

The government and donors have come together in Tanzania to institutionalize a system of public service incentives. The Selective Accelerated Salary Enhancement scheme (SASE) offers a potentially sustainable solution to salary incentive problems within the wider context of pay reform, and is part of the overall government’s Public Service Reform Programme. Aimed at addressing low motivation, uncompetitive salary structures and constraints on capacity development, SASE targets personnel with the greatest impact on service delivery. In providing an opportunity for donors to harmonize their practices around national systems, it strives to reduce inducements that distort the local labour market.

In 1999, the government of Tanzania adopted a medium-term pay reform strategy. Recognizing the centrality of capacity development in improving public sector performance, the government considered enhancements in public service pay, especially in technical and professional grades, as a precondition for building and utilizing capabilities. While recognizing that more income itself is not a sufficient condition for better performance, it reasoned that there was little likelihood of sustaining reforms without fair compensation for work and access to requisite skills. Striving for a system perceived as fair, objective and transparent, the government came up with the SASE scheme.

Qualification is selective, targeting personnel in positions having the greatest impact on service delivery and wider reform efforts. Nominees sign performance agreements that serve as the basis for determining acceptable performance, and are appraised annually, using an objective assessment system. From its inception, the plan for SASE implementation was as follows:

- Government would set a medium-term target pay structure for the period 2000/01 through 2004/05, while donor budget support would, *inter alia*, supplement salaries of SASE-funded positions.
- All personnel of a particular grade and step/increment, whether a SASE scheme beneficiary or not, would be entitled to the same basic salary for a given fiscal year. The difference in compensation between SASE beneficiaries and non-beneficiaries would be the difference between the target salary and the basic salary for the given fiscal year.
- Donors would agree to phase out other supplementation arrangements. The SASE salary scales would serve as the benchmark for the payment of any salary supplements, as this would allow the government to internalize such supplementation as and when donor support was phased out.
- Each fiscal year, as the government would make salary adjustments, the gap between actual and target pay would be reduced, thus lowering donors’ financial commitment as the government’s ability to pay competitive compensation rose.

SASE has had much going for it in seeking to provide a sustainable solution to the issue of salary incentives. However, difficulties in implementation have highlighted some of the factors that can derail such schemes. The roll out of the programme has taken longer than expected. By the time the first batch of SASE beneficiaries was in a position to benefit from the scheme, the salary supplements were no longer sufficient to induce any change in work behaviour. Gradual pay reform became the reality while traditional supplementary payments persisted. The Government was also unable to conduct performance reviews and adhere to the envisaged annual salary adjustments. Without the convergence of actual salary levels with the target salary levels, there was no clear time horizon for phasing out the salary supplement and no exit strategy for donor funding.

- A complex system that ties the government and various donors to an agreed course of action only works when the partners are able and willing to combine their efforts. However, factors beyond the control of any stakeholder can result in the partners reneging on their commitments.
- Initiatives of this nature are time sensitive and technically complex, and any departure from the agreed schedule of implementation can undermine the whole roll out. Issues of the capacity to manage the system arise.
- It was originally envisaged that SASE would be funded through donors contributing to a common pool. As government sectors qualify, they may solicit sponsorship of their own SASE schemes directly from donors. This type of arrangement runs the risk of “projectizing” whole ministries.
- A robust and transparent performance appraisal system is required to ensure that bogus applications for SASE entitlements are avoided, and that the system does not breed resentment. Either way, a scheme like SASE is likely to place extreme pressure on management to extend benefits even to those who do not necessarily merit them.

### The Rwanda Revenue Authority – Incentives to Perform

The experience of the Rwanda Revenue Authority (RRA) provides insights into the role that non-material incentives can play in mobilising capacity and performance. While pay has been and will remain an important driver of performance, experience demonstrates how important other motivators have been at both the organisational and individual level.

The RRA was established in 1997 as a semi-autonomous agency to administer the collection of taxes and customs & excise duties on behalf of the government. In just 6 years, the organisation was transformed from a defunct government department into a performing and respected organisation. Revenue was increased from 9 – 13 % of GDP while the costs of collection had also decreased. Levels of corruption had been reduced significantly while the general standing and legitimacy of the organisation among the tax paying public had improved dramatically.

This was a far cry from the situation before 1997. As one senior manager put it: “We were in a deep hole.... .incompetent, inefficient and corrupt”. There was little pressure to perform from the side of government, and there was a complete lack of legitimacy and stakeholder support. Human and organisational capacity had been devastated by neglect as well as by the wider repercussions of civil strife.

Various non-material incentives have played a part in the transformation of the agency, and performance orientation - some external to the organisation, others carefully nurtured by the management team. Some of the more significant include:

- *National pride.* There has been a palpable drive to re-build the nation and to prove that the country can pick itself up from the brink. Members of the diaspora have been anxious to play their part in the transformation of the public institutions.
- *Support from the highest political levels and broad based donor support* aligned around a country driven strategy has ensured a high level of political ownership, has bestowed a new legitimacy on the organization, and has placed an expectation on the organisation to perform.
- *A clear mandate, agency status and management autonomy* has given the space and opportunity to break with past, develop a new set of corporate values and principles, and to focus on results. It has allowed the organisation to adopt performance-oriented management practices; rewards, sanctions, decision-making processes etc.
- *Corporate values and reputation.* Staff emphasise the organisation’s leadership and management style that encourages performance and integrity, and a commitment to learning. Staff is also proud to be part of an organisation that has developed a positive reputation among peers and is a sought-after place of employment.
- *Human Resources Management.* Beyond pay, the organisation offers an attractive package of in-service training opportunities, and career advancement valued by staff. It also offers a modern working environment including access to modern information technology facilities.
- *Client Focus.* The organisation has worked hard to understand its diverse customer base and to tailor services accordingly. Increasingly, it has become more sensitive and aware of the different needs and demands of its clients resulting in stronger downward accountability.

These non-material incentives have in different ways fuelled the on-going process of change. Crucially, the process has been locally driven and owned, allowing the development of capabilities, funded in large part from external sources, to translate into better performance. The process of capacity development and change has thus combined an *endogenous process* of organisational learning and adaptation, including the harnessing and nurturing of a set of incentives, and an *external support programme* of supply side organisational strengthening, system development and human resources development. The strategy has focused on both enhancing the internal functioning of the organisation, while also engaging with the external environment. It has also sought to strike a balance between developing technical and core management capabilities, and working on value systems, ownership, identity, learning.

### **Brazil: Bolsa Escola Helps Mothers Send Children To School**

Brazil has taken a new route to subsidising education, with dramatic results in terms of school enrolment, attendance and community participation. The government, through its municipalities, offers mothers a stipend for enrolling and keeping their children in school. This incentive has inspired strong commitment among parents, and has helped keep the subsidy from going to the potentially leaky state educational machinery. Crucial to the programme's success has been the broad-based partnership forged between state, municipal and private sector organizations, as well as considerable support across the political spectrum.

About 11 million Brazilian children aged 6 to 15 live in poverty and achieve little in school. In 2001, to reduce poverty and at the same time boost school enrolments, the Brazilian federal government launched a national initiative guaranteeing an income transfer for disadvantaged families, known as the Bolsa Escola (School Stipend) National Programme. It entails a monthly sum for families with an income lower than roughly \$30 per person, and whose children in the 6-15 age group attend primary school.

An allowance of \$6 is made for each child, with a maximum of \$18 per family, on the condition that children attend a minimum of 85 per cent of classes. Attendance rates are checked quarterly by the federal government before the money is released. The children's mothers then take a magnetic card to withdraw the allowance at ATM machines or at bank branches. The decision to entrust the mothers with the administration of these resources came about after a study revealed that they are more efficient than fathers in making the best use of the allowance. Despite the small amount, it is nonetheless an extremely important addition to family income in many economically deprived regions. Bolsa Escola's success can be attributed to:

- *Financial sustainability:* Programme funds are met by a federal tax collected by the banking system and guaranteed by federal legislation for the next ten years.
- *Targeting the poorest:* The programme attempts to reach the poorest people by prioritising municipalities presenting the lowest human development indicators, as well as those affected by natural calamities or reporting high rates of violence. It also mobilizes municipalities participating in the Comunidade Solidária – a federal programme that distributes basic food baskets.
- *Partnerships and networks:* A network of partners supports the initiative, from the federal to municipal levels. They include the Ministry of Education, development partners such as UNDP, research institutes, the association of municipal education managers, municipal authorities, the municipal social control council and the Brazilian Savings Bank.
- *Community participation, social control and after-school activities:* To be included in the programme, municipalities must select eligible families and supervise the allocation of grants. They are also responsible for running social and educational programmes after school hours and for setting up a municipal Social Control Council drawn from the local community. The involvement of the community in supervision greatly reduces patronage and misuse of funds.

Bolsa Escola is recognized as playing a fundamental role in retaining children at school and thus democratizing education in Brazil. The programme currently benefits over 5.1 million families and more than 8 million children, and has brought over a million children back to school. Although an extensive evaluation has yet to be completed, some conclusions can be drawn based on preliminary studies conducted by the National Secretary of Bolsa Escola. These suggest that Bolsa Escola has:

- Raised awareness among families of the importance of placing their children in school
- Improved access to schooling and attendance for those most affected by lack of formal schooling
- Involved families in the process of educating their children, thereby fostering positive attitudes towards education among segments of society traditionally excluded from schooling
- Assisted in combating child labour and discouraged the option of living on the streets as a way of life for the poor, thereby reducing exposure of children and adolescents to personal and social risk
- Improved the quality of life and financial status of families with very low per capita incomes, restored the dignity of excluded segments of the population, and stimulated self-esteem and the hope of a better future for their children.

Bolsa Escola proves what is needed to succeed: a high level of political commitment; involvement of the community (and especially parents) in management; assured and sustained funding; the participation of local government; and a high degree of coordination among multiple agencies.

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