

Private Sector Lessons for Public Sector Reform in Indonesia

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ABSTRACT: Development economists often analyse the performance of particular sectors of the economy, yet they have largely ignored that of one of the most important sectors, namely, the public sector, the performance of which is demonstrably poor. They are also continually giving recommendations to the Indonesian government as to what constitutes sound economic policy, whereas there is abundant evidence that the bureaucracy has neither the incentive nor the competence to implement such policy. Civil service reform is therefore crucial to improving Indonesia's economic performance. This paper argues that the key to such reform is the adoption of human resource management practices similar to those that can be observed in successful, large business enterprises: namely, creating an environment of open and fair competition for all positions within the organisation.

Key words: civil service reform, human resource management, performance evaluation, competition, incentives

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INTRODUCTION

The missing sector in sectoral studies

Research on economic development frequently focuses on particular sectors of the economy, such as agriculture, forestry, fishing, manufacturing, mining, telecommunications, transportation, financial services, and so on. Studies of these sectors are often concerned with their efficiency, factors that affect this, and policies that might increase it. One of the most important sectors of the economy (because of its influence on other sectors) is the public sector, yet economists have done very little to analyse its efficiency and how this might be improved. Perhaps the most obvious explanation for this is that it is almost impossible to measure the output of the public sector. With no measure of output, there can be no measure of efficiency.

And yet there can be little doubt that the efficiency of the public sector in Indonesia leaves a great deal to be desired; nobody with any knowledge of its functioning could argue otherwise. We could draw up an endless list of examples, such as the failure of the taxation and customs authorities to collect anything like the full value of revenues legally due; the abysmal state of infrastructure; the poor quality of the state education and health systems; the fact that individuals and firms see the police and the judiciary more as predators than protectors; and the seeming inability of the bureaucracy to draft coherent legislation. At present, one of the great threats to output growth is that the bureaucracy is failing to spend at anywhere near the level already authorised in the budget. The level of corruption is very widely known, but the problem is much wider than this. The simple fact is that the public sector is grossly inefficient, which necessarily holds back the performance of the economy as a whole. It seems quite strange that economists have not devoted more of their energies to analysing this problem.

Growth accounting

Another of the strong focuses of the development literature in recent years has been so-called 'growth accounting', in which the attempt is made to explain differences in countries' growth rates by looking at factors such as spending on education and health, and the types of policies followed by their governments—particularly in relation to foreign trade, investment and industrialisation. These kinds of studies generate recommendations as to what constitute 'good' policies, but the question as to whether the bureaucracies in question are even interested in 'good' policies, let alone capable of discerning what they are and implementing them, is largely ignored.

This is not particularly helpful. It is logically inconsistent for economists to continue to feed policy recommendations to the government when we are confronted on a daily basis with clear evidence that its civil service is highly dysfunctional, which implies that those recommendations are very unlikely to be implemented properly, if at all. For this reason a great deal of the work of economists in the development field in Indonesia seems fairly sterile. The most pressing priority, surely, is to focus on the bureaucracy itself, and to try to find ways to improve its capability and performance. The greater the extent to which this can be achieved, the less the need for outside advice as to what constitutes sound economic policy. Thus the aim here is to think about the factors that make organisations effective, and to use ideas from outside the realm of government itself to generate a reform package for Indonesia's civil service.

ORGANISATION PERFORMANCE AND COMPETITION

Progress through emulation

In all forms of human endeavour, some progress is possible through formal training. But probably the main path to advancement is by emulating what others are doing if their performance is clearly superior. There is little need for any deep analysis here. The principle is basic commonsense. If my friend can hit the golf ball twice as far as I can, then I should try to swing the club more like he does. If one fisherman comes home with a much bigger catch than another, the latter will do well to use similar techniques. If one farmer gets a significantly higher yield from his rice crop, his neighbour would be well advised to copy his methods.

Thus, an obvious point to make is that the Indonesian government could quite easily learn some good ideas about how to improve the performance of its bureaucracy

simply by looking at how the civil service operates in any number of other countries. Indeed, sending bureaucrats and politicians on comparative study tours overseas is a well practised art in Indonesia. Unfortunately, however, most of these study tours have no impact, not least because those who make them regard them as little more than opportunities to see the world, and are under no illusion that they will be initiating any grand reforms when they return.

Learning from sport

An alternative learning approach involves making comparisons, not with other countries' bureaucracies, but with other kinds of organisation in quite different fields of activity. The first that I have in mind is competitive sport. What can the government learn from this kind of activity? Hundreds of millions of people around the world play individual sports such as tennis and golf, or team sports such as football and basketball. Competition takes place at all levels, from neighbourhood streets and school yards all the way to world famous venues like Wimbledon and Wembley. The essence of competition is to measure and rank performance of each player or team, and it is the desire to win the competition and reap whatever rewards are on offer that leads to improved performance.

Of course, many people also engage in sporting activity without being in competitions, but part of the enjoyment often comes from measuring one's own performance and comparing it with what has been achieved in the past. We like to swim faster than last time, or ski more gracefully, or climb a more difficult rock face. And even if we only play sport on a social basis, we still keep score: in other words, we measure our performance relative to our friends. Nevertheless, if we do not engage in formal competitions, our performance progress is likely to be slow, and we are never likely to rise to a very high level of competence. Where we observe truly spectacular performance relative to the norm is in sporting competitions in which there are huge incentives to win: professional sports with big prizes and sponsorship deals on offer. By contrast, nobody is likely to work at improving his or her game for many hours a day, seven days a week, year in year out, if they think they have no real chance of reaping large financial rewards as a result.

What governments and bureaucracies can learn from sport, therefore, is that when there are significant rewards from good performance, and where people are able to compete on a level playing field, good performance will be forthcoming. Individuals will work extremely hard at their chosen sport if there are strong incentives for them to do so. Note that training people can never be the complete answer to the need for

reform. If individuals do not see it as in their interests to perform well, devoting training resources to them will waste those resources. Conversely, provided they see it as in their interests to improve their skills, they will seek out training and suitable work experience on their own initiative. The fundamental problem in Indonesia's bureaucracy is, for the most part, not a lack of skills but simply the lack of strong incentives to use them optimally.

Learning from business

A second area where governments can learn a lot about how to improve the performance of their bureaucracies is the private sector. This idea is anathema to many, perhaps most, Indonesian civil servants, who are accustomed to believing that the economy could hardly function were it not for their wise guidance. My own view on this is quite the opposite: the civil service and its associated state enterprise sector is, by and large, a blight on economic performance. Indonesia's economic progress to date has been in spite of, rather than because of, the bureaucracy.

Why should we imagine that the public sector has anything to learn from the private sector? The answer is exactly analogous to the case of professional level sporting activity. Nearly all firms have competitors, and if they do not perform as well as these competitors their profits will be low, if not negative. With the passage of time, the more efficient firms will gain larger shares of the market, while others will wither and ultimately die. As poorly performing firms disappear, the resources they would otherwise employ—labour, capital, land and other natural resources—become available for reallocation to more efficient firms and industries, where their now higher productivity will increase the overall size of national income. In short, the whole process is strongly geared to steady improvement in performance over time.

Doing business in the private sector is therefore very much like participation in professional sporting activity. The keys are financial incentives and competition. The financial incentive is the owners' prospect of making large profits by performing well, combined with the risk of losing previously accumulated savings (wealth) by performing poorly. A significant difference, however, is that there is much less need for rules or referees, as the competition is adjudicated by the market. The firms that can supply products with superior combinations of price and characteristics desired by their customers will be those that prevail.

The eventual disappearance (through closure or takeover) of relatively poorly managed firms has no counterpart in the public sector. Broadly speaking, bureaucracies have no competitors. Thus there is no natural or automatic process that pushes public sector bureaucracies continually to improve their performance. Having made the point that such a process is of crucial importance in the field of business enterprise, it is an obvious next step to infer that its absence helps explain why bureaucracies like those in Indonesia suffer from chronic poor performance, and to suggest that a solution may be found in emulating the practices of well managed private sector firms in the area of human resource management.

BUILDING COMPETITIVE TEAMS

It is axiomatic that the performance of any organisation depends on the performance of the individuals that comprise it. To prosper in a competitive environment, firms need to use people with a range of skills: engineering, scientific, financial, marketing, procurement, administration, personnel management and so on. The decisions made, and the work done, by their employees determine whether the firm succeeds or fails. The job of marketers is to discover what products consumers want; that of engineers to design these and the corresponding production processes; of procurement officers to purchase material and services inputs from reliable, low-cost suppliers; and so on.

Most fundamental of all, the function of human resource management is to ensure that the company recruits sufficient numbers of people with all these kinds of skills, and provides them with strong incentives to perform well. If this function is poorly managed, the firm is unlikely to survive. In principle, all this is no different from the process of managing the players in a professional football team, where the objective is to put the most effective players in each of the different positions, subject to the price that must be paid to acquire their services.

Competing for places on the team

Though it is not often discussed or thought of in these terms, the key to the human resource management function is to operate a competition—or, rather, a large number of ongoing competitions for every position within the firm, from the highest to the lowest level. Each position needs to be clearly described as to what is expected of its occupant. Once that has been done, the next step is to invite people to compete for it. To ensure getting the best available person for the job this competition must be open to entry from people both within and outside the firm.

Of course, the number and quality of those who apply will depend upon the remuneration on offer, and the trick here is to seek the optimal trade-off between productivity and cost. Highly productive people will cost more, and it will be worthwhile to recruit somewhat less productive people if the saving in wages or salaries is sufficient to offset their lower productivity. Conversely, although low productivity personnel will be relatively cheap to hire, it will be worthwhile to recruit somewhat more productive people if the productivity gain exceeds the extra cost of wages or salaries.

The cost-productivity trade-off

Obviously, firms have no choice other than to offer wages and salaries similar to those offered by other firms; they will have difficulty recruiting workers other than those with low productivity if the wage offered is also low. And they will have difficulty keeping workers on the payroll if their productivity is high enough to get them a job at another, higher paying employer. Of course, payments may be made in kind as well as monetary wages, and firms often find it worthwhile to provide a package of benefits such as transportation, meals, health benefits, housing assistance and so on as part of the overall compensation package, if it is perceived that these benefits will be more highly valued by employees than the cost of providing them. But the point is that individuals are competing for jobs, employers are competing for workers, and the overall price paid is basically determined by the market.

An important aspect that makes jobs more or less attractive to employees is the prospect of promotion. If employees are confident they can expect promotion that properly reflects the increasing productivity that accompanies the accumulation of experience and skills (whether by formal or on-the-job training, or learning by doing) they will have good incentives to work hard and to increase their productivity in these ways.

In this sense the career trajectory of employees is rather like the evolution of firms: indeed, the employee is exactly analogous to a firm selling services to a customer, the customer in question here being the employer. Employees best able to convince their employer that they have a superior 'product' to sell will be those that obtain the most rapid promotions. Employers that don't want to be disappointed will take care to monitor the performance of current employees, to compare this with that of their peers, and to use these performance appraisals as important inputs to the promotions process. But basically, promotions are seen as recruitment to higher-

level jobs, for which the competitors include current employees at lower levels as well as people from outside.

CIVIL SERVICE REFORM

As mentioned above, thinking along these lines provides an explanation for why the functioning of Indonesia's civil service leaves so much to be desired, and thus puts us in a position to propose a set of principles to guide civil service reform. The discussion of the process of competition among sporting teams and among business enterprises has shown that the poor performance of the Indonesian bureaucracy can be explained by the fact that it has no competitors. It has comparators in the bureaucracies of other countries, of course, but these are largely ignored because they are not competitors for the privilege of managing the Indonesian economy and polity. Absence of the need to compete and thus to improve performance continuously has led to significant departures from all the fundamental principles of sound human resource management that we see in operation in financially-oriented sporting organisations and in the world of business.

First, all parts of the bureaucracy have a very rigid organisational structure in which the number of positions at each level in the hierarchy is fixed mechanically by formula, rather than by reference to the volume of work required to be carried out at that level (hence the ubiquitous gross overstaffing at the lower levels).

Second, there is very little by way of job classification, except for a few highly specialised professions such as medicine, which means that there is little matching of professional skills and qualifications to the tasks to be carried out (hence the frequent occurrence of a lack of requisite skills at the higher levels). It is not widely known that Indonesia had a system of classification or categorisation of positions throughout the civil service until very early in the Soeharto era, when this system was dropped in favour of a military kind of organisational structure in which new recruits were not differentiated other than by the level of education attained (ADB 2004: 58). Yet there is a considerable variety of types of work to be done in the civil service as a whole and within individual ministries, many of which require particular kinds of professional skills. It makes no sense to recruit history graduates if what is required is engineers, so it is hardly surprising that many people find themselves undertaking work for which they are not properly trained. This means not only that they won't be able to do their jobs well, but also that their valuable skills will be wasted.

Third, the incentives for good performance on the part of civil servants are very weak, since the current approach ensures that they face no competition from outside: almost the only competition is *among* (not *from*) new secondary and tertiary graduates for entry-level positions. Incumbents also face no competition from below, as individuals can only be promoted when positions become vacant because of promotion, relocation, retirement, death or incapacitation of the previous incumbent. Moreover, competition for vacant positions is further limited by obstacles to moving around different parts of the civil service, and by the imposition of seniority (minimum years of service) requirements, the effect of which is to reduce the number of individuals eligible to be considered.

Finally, to the extent there is competition for positions, the rules of the game are weak and the playing field is far from level, such that it is common for people to seek promotion not by demonstrating superior performance than their peers but by ingratiating themselves with their superiors and by bribing officials who have the authority to make the appointments in question.

As to the process of reform, there is of course no scope for creating competition for the central government bureaucracy: it has a permanent monopoly. (By contrast, with the devolution of many functions of government to regional governments [‘decentralisation’] in 2001 the opportunity exists for provincial, district and municipal governments to compete amongst themselves to attract labour and capital from other parts of the country.) Rather, the key to reform is to recognise that, as with all other organisations, the performance of the civil service depends on the performance of the individuals that comprise it—and that this, in turn, depends on the incentives they face and on their capabilities relative to the jobs they are required to do.

It follows that the most promising path to reform involves trying to emulate the human resource management practices of organisations that compete strongly among themselves—in particular, professional sporting teams and profit-oriented businesses. The key to success, first and foremost, is human resource management: putting superior teams of individuals together, and providing them with the appropriate incentives to do well. The way to do this is wholeheartedly to embrace the notion of creating ongoing and vigorous competition for all positions within the civil service, and this commitment needs to be supported by a clear set of rules governing that competition, and by provisions for enforcement of those rules: the competition must be fair.

THE PROCESS OF ORGANISATIONAL REFORM

Once the desirability of encouraging strong competition for civil service positions is accepted, the first concrete step in civil service reform is to properly document all the different kinds of jobs that need to be undertaken in each part of the bureaucracy. For each position, the skill and experience requirements should be described. An implication of this is that in the future, the civil service will not simply recruit high school and university graduates regardless of their fields of specialisation. If a particular job requires an engineer, then an engineer will be recruited to fill it, accounting jobs will be done by trained accountants, and so on.

Next is to determine an appropriate salary for each position, based on research into the private sector labour market directed to discovering the going rates for all relevant combinations of skills and experience. The end result will be a complete listing of all positions in each department, together with their corresponding salary levels or ranges. This listing would replace the current exceedingly complex and non-transparent system, in which total remuneration has numerous components and depends heavily on characteristics of the individual—including educational qualifications, years of service and number of dependants—as well as the characteristics of the position—most importantly, its level in the hierarchy.

Efficiency and attention to the interests of the general public require that the government does not pay more than necessary to attract people with the necessary skills and experience. It also requires that the salaries offered are in line with what is being offered by the private sector. In other words, salaries should be differentiated by the type of qualification and by the level of experience, as distinct from the number of years of service and the level in the hierarchy. A person who has served for a long time but at relatively low levels of responsibility should not be paid as much as someone who has served successfully, perhaps for a shorter time, but at a higher level of responsibility.

This requires rethinking what constitutes 'fairness' in salary-setting in the civil service. I contend that the only thing that can be called 'fair' is a salary structure that matches what is available in the market. Civil service salaries should not have any welfare payment component (i.e. they should not include a subsidy by being set above market rates), nor should they try to save money by being set deliberately below market levels. As argued above, this is false economy: artificially low salaries will attract only relatively low productivity people, or they will attract people whose intention is to engage in corrupt activity in order to achieve at least what they could

earn outside the civil service. In both cases the saving in salaries is offset by some combination of low productivity and 'leakages'.

The next step is to compare what is needed with what is already available. Inevitably, the following will be found:

- a surplus of employees in many positions as a result of a promotions process that treats promotion as a right rather than something to be earned through superior performance, and organisational structures that take no account of the number of people actually needed to do each kind of work within the organisation;
- a relatively large number of individuals who have been promoted into particular positions simply because they have the requisite formal qualifications and a sufficient level of seniority, and yet which they are incapable of filling adequately;
- many other individuals who are deserving of promotion to higher positions but who have been held back by lack of seniority or lack of formal qualifications; and
- a lack of needed skills and experience in key areas, especially at the higher levels.

The next element of the reform package is to implement a system that is as competitive as possible: one that is open to competition from below and from outside. Each position must be contestable by anyone. Current civil servants should be able to apply for higher positions regardless of their level of seniority; and recruitment from outside should not be restricted only to new graduates from high schools and tertiary education institutions, but should be open to older workers whose experience has been gained in the private sector, in academia, or wherever.

In short, it is fair if everybody in the society has the right to offer himself or herself for employment in the civil service. By contrast, it is *not* fair if people already in the service are protected from competition from outsiders who may be prepared to work harder, or who may be more capable. By increasing salaries to market levels it will be possible to dispense with the convenient notion that incumbent civil servants are making big sacrifices and therefore deserve to be protected in their positions. Nobody will be expected to make any sacrifices, so nobody will have any grounds for claiming special treatment.

Leading organisational change

Dealing in this manner with the current human resource management shortcomings of the bureaucracy is an extremely difficult task, to be sure, but it is not something that has never been done before. The process of turning around an underperforming organisation very often requires dealing with precisely these kinds of issues. Again, lessons can be learned from the experience of competitive business enterprises.

Radical change to any organisation requires the appointment of a person at its apex with demonstrated high management and leadership skills who is given the responsibility for restructuring, along with the autonomy to push ahead relatively free from outside interference. The next step is for this new leader to establish a team of support professionals capable of putting his or her plan into action. Although there will no doubt be other matters of concern, probably nothing will be more important than implementing the steps just outlined, which may be summarised as follows:

- determining an appropriate organisational structure and the kinds of people needed to fill it;
- establishing a simple and transparent remuneration structure that closely reflects earnings in the labour market in the private sector;
- selecting and promoting those who appear to be capable of performing well at levels higher than their current positions;
- recruiting individuals from outside if the appropriate people are not available from within; and
- encouraging the departure of individuals who are surplus to requirements, including those previously promoted to levels beyond their capabilities.

Obviously it is no easy matter to rid the organisation of employees that are not needed, or to change a system in which people are accustomed to think of regular promotions as their entitlement, even though both changes are clearly in the interests of the general public. But we need look no further than the relatively recent restructuring of the then highly unprofitable national airline, Garuda, and the merger of four large and insolvent state-owned banks to form Bank Mandiri, to see that radical surgery on the workforces of state institutions (with a great deal in common with the civil service) is feasible (Djohan no date). In both cases, the

government brought in Robby Djohan, a highly respected CEO from the (private) banking sector, to restructure these very large enterprises.¹

In this, Mr Djohan was being asked to repeat something that he had achieved more than two decades earlier with the privately owned Bank Niaga. In all three cases, the shareholders gave him near total freedom to do what was necessary to turn these firms around. He did so by installing his own top management team, selecting the best people within the organisations to fill the remaining positions, and providing generous voluntary retirement packages to other employees no longer needed. In each case he was able eventually to obtain the support of those being let go, not to mention those being rewarded by way of promotion into positions of greater responsibility.

Sustaining high performance

Beyond the initial transition and rationalisation of the workforce, it will also be necessary to set up a system for dealing with subsequent personnel movements. Again, this will involve creating an environment in which there is ongoing, open competition for all positions within the firm. Of fundamental importance here is a set of rules of the game that make that competition fair, combined with mechanisms for enforcing those rules. This is basically about transparency. Positions should be openly advertised; applications should be properly recorded; selections should be determined by small committees rather than by individuals; the reasons for choosing particular applicants and not others should be documented; and unsuccessful applicants should have the right of appeal to a higher authority. The function of the latter in such cases is to review all of the documentation and try to ensure that the only consideration in choosing the successful applicant has been the attempt to get the best person for the job in question.

To the extent that applicants come from outside the civil service it will be necessary for them to demonstrate the adequacy of their qualifications and skills, and to bring with them references from past employers. Again, all of this will need to be documented. On the other hand, for individuals seeking promotions or lateral movements within the civil service, records will need to be kept of those individuals'

¹ No longer under Djohan's leadership, both organisations have subsequently fallen on hard times, which is a reflection of the desirability of privatisation. Even though some progress can be made under sound leadership, back-sliding is always a strong possibility when the leadership changes.

working experience and performance appraisals. Performance appraisals will be required to be undertaken at regular intervals via the individual's superior officer, and the individual should have the right to see these appraisals and to comment on them and contest them, again by appeal to a higher authority. The objective must be to ensure that individuals' work is honestly and adequately appraised.

These kinds of systems have been developed in other countries and in large business enterprises, from which much can be learned. Presumably there is no such thing as the perfect system, but there can be little doubt that some systems are much closer to perfection than others. The aim should be to emulate systems that appear to function well in other organisations, with due regard for the local context.

SUMMARY

The key points of the argument presented here in relation to civil service reform in Indonesia are as follows.

First, economic performance overall depends, to a significant extent, on the economic policies designed by governments and bureaucracies in the countries in question. Whether sound policies are chosen, and then designed and implemented properly, depends, to a significant extent, on the quality of the civil service. As with all other organisations, the performance of the civil service depends on the performance of the individuals that comprise it, which, in turn, depends on the incentives they face and on their capabilities relative to the jobs they are required to do. Performance of individuals can be improved—and indeed maximised—if the guiding principle of personnel management is to encourage strong competition for positions within the civil service, thus emulating the practices of successful professional sporting teams and business enterprises. A commitment to competition needs to be supported by a clear set of rules governing that competition, and by provisions for enforcement of those rules: the competition must be fair.

Second, the present system of personnel management within Indonesia's civil service departs significantly from all these basic principles, which explains why its performance is clearly sub-standard. All parts of the bureaucracy have a very rigid organisational structure, in which the number of positions at each level in the hierarchy is fixed by a formula, not by reference to the volume of work required to be carried out at that level. There is very little by way of job classification in the civil service except for a few highly specialised professions such as medicine, which means that there is little matching of professional skills and qualifications to the

tasks to be carried out. Civil service incumbents face no competition from outside. The only competition is *among* (not *from*) new secondary and tertiary graduates for entry-level positions. Civil service incumbents face no competition from below: individuals can only be promoted when positions become vacant because of promotion, relocation, retirement, death or incapacitation of the previous incumbent. Competition for vacant positions is limited not only by the ban on recruitment from outside the civil service but also by obstacles to moving around different parts of the civil service, and by the imposition of seniority (length of service) requirements to limit the number of individuals eligible to be considered. To the extent there is competition for positions, the rules of the game are weak and poorly enforced, such that it is common for people to seek promotions by ingratiating themselves with their superior officers and by bribing officials that have the authority to make the appointments in question.

On the basis of these arguments and observations it is my contention that the key to reform of the civil service, and therefore to maximising the contribution of the public sector to Indonesia's development, is to implement vigorous and fair competition for positions within the civil service.

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