ICAC
Independent Commission Against Corruption
SOUTH AUSTRALIA

Integrity Spotlight

V1.0 – November 2022

Advisory

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Perverse Incentives

Public agencies often create incentive structures aimed at increasing productivity and value, and serving the public interest. These structures can be built into supplier and employment contracts, policies, regulations and business rules. But they don't always go according to plan.

A perverse incentive is an incentive that produces unforeseen and unwelcome results. Sometimes perverse incentives can inspire outcomes that are completely at odds with the intended purpose of an activity or program.

Incentive schemes that can be manipulated provide opportunities for corruption, misconduct and maladministration to flourish.

Rat Farms, Dinosaur Bones and Breath Tests

Incentives which are designed to motivate people to achieve desired outcomes are regularly used by government and industry because they often work – except when they don't. History is brimming with lessons of failed incentive design which should be considered in relation to any scheme your agency might be considering.

During French colonial rule in Vietnam, authorities sought to reduce the city of Hanoi's escalating rat infestation by offering monetary rewards for every rat tail they received. Locals responded by breeding rats. When authorities discovered the unintended outcome of their plan and cancelled the bounty program, the farmers released the rats and the city's rat population exploded.

Similarly, palaeontologists in 19th century China paid farmers for every dinosaur bone fragment they unearthed from their fields. The farmers were paid per bone fragment instead of by the size or completeness of a fossil, effectively incentivising them to break the bones into as many fragments as possible. Clearly this was an unintended adverse outcome.

Closer to home and contemporary times, in 2015 it was revealed that Victorian Police officers falsified 258,000 roadside alcohol breath tests over five and a half years, by taking the tests themselves. They did so to meet aggressive breath-testing quotas set by their superiors.

The relationship between incentives and corruption

Any government project, process or program that is designed to shape behaviour can be at risk of incentivising inappropriate behaviour. Inappropriate behaviour can manifest as task or rule avoidance, non-compliance with policy and procedure, misconduct, maladministration, and other impropriety. In the case of government contractors, perverse incentives can result in overselling, under-supplying, misreporting outcomes, exploiting reward schemes, hiding mistakes to avoid penalties, or otherwise manipulating contract terms. In some cases perverse incentives can encourage people to resort to corruption.

How are perverse incentives relevant to public administration and public officers?

State and local governments regularly seek to incentivise the conduct of their employees, contractors and constituents. Incentives are created to encourage the meeting of performance targets, the production and consumption of renewable energy, the early payment of fines and levies, the uptake of vaccination programs and participation in research and trials. Incentives designed to encourage preferred behaviours are everywhere in public administration. They are designed, implemented and managed by public officers on a daily basis.

The problem is that incentives are difficult to design and control, and when poorly designed they can direct people towards opportunities for exploitation. They also interact with other incentives, needs and obligations (either overlooked or impossible to anticipate), which can deter people from behaving in the anticipated manner.

The Commission has observed instances of improper conduct which might not have occurred if more attention had been given to the structures, expectations and performance settings which ultimately stimulated and sometimes excused improper conduct.

The most common areas where perverse incentives can emerge in public administration are in performance based contracts with government suppliers, and key performance indicator (KPI) schemes to encourage the achievement of agency targets and to manage staff performance.

The Commission has seen examples of public authorities devising ungovernable incentive structures in supplier contracts, which have led to fraudulent and deceptive practices. One such example involved a transport company who received a bonus for on time delivery of a service. The company ensured that it always received its bonus by cancelling and rebooking orders as they came close to expiring. The constant resetting of the clock meant the company could claim the bonus even when their service did not meet expectations.

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How do you avoid perverse incentives?

First, you must establish whether your agency's activities, programs or contracts contain incentives aimed at shaping behaviour towards desired outcomes.

If incentives are present, you must consider how those incentives might be perverted - could they encourage the taking of shortcuts, the development of improper methods or the need to misrepresent achievements in order to meet desired outcomes?

If you are designing an incentive structure, ask yourself:

- Is the desired outcome difficult or impossible to achieve?
- Is the incentive directed at the actual desired outcome, or at an indirect or proxy outcome?
- Can the incentive be misconstrued or misinterpreted?
- Could the outcome be dishonestly achieved, or appear to be fulfilled without actually being fulfilled?
- Are controls in place to detect and deal with improper, fraudulant or deceptive practices engaged in to "game" the incentive scheme?

Incentive schemes that work well can deliver excellent results, but those that don't could work against the public interest and enable corruption.

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