

Case Studies on Managing Government Compensation and Employment - Institutions, Policies, and Reform Challenges



June 2016

CASE STUDIES ON MANAGING GOVERNMENT COMPENSATION AND EMPLOYMENT— INSTITUTIONS, POLICIES, AND REFORM CHALLENGES

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following document has been released and is included in this package:

Informal Session to Brief: Case Studies on Managing Government Compensation and Employment—Institutions, Policies, and Reform Challenges

The report prepared by IMF staff and presented to the Executive Board in an informal session on May 6, 2016. Such informal sessions are used to brief Executive Directors on policy issues. No decisions are taken at these informal sessions. The views expressed in this paper are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board.

The document listed below has been separately released:

- Managing Government Compensation and Employment—Institutions, Policies, and Reform Challenges

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Electronic copies of IMF Policy Papers
are available to the public from
<http://www.imf.org/external/pp/ppindex.aspx>

**International Monetary Fund
Washington, D.C.**



April 8, 2016

CASE STUDIES ON MANAGING GOVERNMENT COMPENSATION AND EMPLOYMENT—INSTITUTIONS, POLICIES, AND REFORM CHALLENGES

Approved By
Vitor Gaspar

Prepared by a Fiscal Affairs Department (FAD) staff team led by Sanjeev Gupta and comprising David Coady, Manal Fouad, Richard Hughes, Mercedes Garcia-Escribano, Mauricio Soto, Masahiro Nozaki, Teresa Curristine, Chadi Abdallah, Emine Hanedar, La-Bhus Fah Jirasavetakul, Javier Kapsoli, Roland Kpodar, Lewis Murara, Florian Misch, Brian Olden, Maximilien Queyranne, Ivohasina Razafimahefa, Anam Shahab, Matthew Simmonds, and Benoit Taiclet. Research assistance was provided by Amyra Asamoah, Kaitlyn Douglass, Candice Liu, and Rohini Ray. Production assistance was by Liza Prado, Adam Boyd, and Ana Popovich.

CONTENTS

Glossary	6
INTRODUCTION	7
CÔTE D’IVOIRE	9
A. Institutional Background	9
B. Trends and Issues	10
C. Reform Challenges and Lessons	12
EL SALVADOR	13
A. Institutional Background	13
B. Trends and Issues	14
C. Reform Challenges and Lessons	15
FRANCE	16
A. Institutional Background	16
B. Trends and Issues	17
C. Reform Challenges and Lessons	20

GHANA	22
A. Institutional Background	22
B. Trends and Issues	22
C. Reform Challenges and Lessons	24
HONDURAS	27
A. Institutional Background	27
B. Trends and Issues	27
C. Reform Challenges and Lessons	29
IRELAND	31
A. Institutional Background	31
B. Trends and Issues	32
C. Reform Challenges and Lessons	34
JAMAICA	35
A. Institutional Background	35
B. Trends and issues	36
C. Reform Challenges and Lessons	37
KENYA	39
A. Institutional Background	39
B. Trends and Issues	39
C. Reform Challenges and Lessons	41
KOSOVO	43
A. Institutional Background	43
B. Trends and Issues	43
C. Reform Challenges and Lessons	44
MALAYSIA	46
A. Institutional Background	46
B. Trends and Issues	47
C. Reform Challenges and Lessons	48
MALI	50
A. Institutional Background	50
B. Trends and Issues	51

C. Reform Challenges and Lessons	53
MOLDOVA	54
A. Institutional Background	54
B. Trends and Issues	55
C. Reform Challenges and Lessons	56
NETHERLANDS	59
A. Institutional Background	59
B. Trends and Issues	59
C. Reform Challenges and Lessons	60
PHILIPPINES	62
A. Institutional Background	62
B. Trends and Issues	62
C. Reform Challenges and Lessons	63
PORTUGAL	66
A. Institutional Background	66
B. Trends and Issues	67
C. Reform Challenges and Lessons	68
ROMANIA	71
A. Institutional Background	71
B. Trends and Issues	71
C. Reform Challenges and Lessons	72
SOUTH AFRICA	75
A. Institutional Background	75
B. Trends and Issues	76
C. Reform Challenges and Lessons	78
TUNISIA	81
A. Institutional Background	81
B. Trends and Issues	82
C. Reform Challenges and Lessons	84

UNITED KINGDOM	85
A. Institutional Background	85
B. Trends and Issues	86
C. Reform Challenges and Lessons	88
ZIMBABWE	90
A. Institutional Background	90
B. Trends and Issues	91
C. Reform Challenges and Lessons	92
BOX	
1. United Kingdom: Public and Private Sector Wage Developments Compared	87
FIGURES	
1. Côte d'Ivoire: Wage Bill and Employment	10
2. El Salvador: Wage Bill and Employment	14
3. France: Wage Bill and Employment	18
4. France: Public Sector Wage Premium	18
5. France: Teachers' Statutory Salaries after 15 Years, 2012	19
6. France: Wage Bill by Levels of Government	19
7. Employment by Levels of Government	19
8. Ghana: Wage Bill and Employment	23
9. Honduras: Wage Bill and Employment	28
10. Ireland: Wage Bill and Employment	33
11. Jamaica: Wage Bill and Employment	36
12. Kenya: Wage Bill and Employment	40
13. Kenya: Average Earnings by Sector, 2008–2013	41
14. Kenya: General Government Wage Bill by Sector	41
15. Kosovo: Wage Bill and Employment	44
16. Malaysia: Wage Bill and Employment	47
17. Malaysia: Trends in Federal Level Personnel Emoluments	48
18. Mali: Wage Bill and Employment	52
19. Mali: Wage/Taxes, Regional Comparison	52
20. Mali: Wage/GDP, Regional Comparison	52
21. Moldova: Wage Bill and Employment	55
22. Moldova: Remuneration of the Government Relative to the Private Sector	56
23. Netherlands: Wage Bill and Employment	60
24. Philippines: Wage Bill and Employment	63
25. Portugal: Wage Bill and Employment	67
26. Portugal: Public Sector Wage Premium	68
27. Romania: Wage Bill and Employment	72

28. Romania: Average Monthly Wages	73
29. South Africa: Wage Bill and Employment	76
30. South Africa: Medium-Term Wage Bill Projections and Outturns	78
31. Tunisia: Wage Bill and Employment	82
32. Tunisia: Relative Contributions of Wages and Employment to Wage Bill Growth, 2010–2014	83
33. Tunisia: Central Government Wage Bill by Component	83
34. United Kingdom: Wage Bill and Employment	86
35. Zimbabwe: Wage Bill and Employment	91

TABLES

1. List of Case Studies	8
2. Ghana: Compensation of Employees, 2010–2014	24
3. Jamaica: Government Employment by Contract Type	35
4. Moldova: Student-Teacher Ratio and Average School Size	57
5. Philippines: The Amount of the Performance-Based Bonus in 2012	64

REFERENCES	94
------------	----

Glossary

CIS	Commonwealth of Independent States
CSD	Mali Civil Service Department
COFOG	Classification of Functions of the Government
DPER	Irish Department of Public Expenditure and Reform
ENEE	Honduras Empresa Nacional de Energía Eléctrica
EU	European Union
FAD	Fiscal Affairs Department
GFS	Government Finance Statistics
CG	Central Government
GG	General Government
GUSS	Ghana Universal Salary Structure
HR	Human Resources
HONDUTEL	Empresa Hondureña de Telecomunicaciones
IBEC	Irish Business and Employers Confederation
IT	Information Technology
KIPPRA	Kenya Institute for Public Policy Research and Analysis
LIDCs	Low-Income and Developing Countries
MoF	Ministry of Finance
MTEF	Medium-term Expenditure Framework
NFPS	Non Financial Public Sector
ODAC	Organisme divers d'administration centrale
OECD	Organisation for Economic Co-operation Development
OSD	South Africa's Occupation Specific Dispensation
MDA	Ministries, Departments, and Agencies
PBB	Performance-Based Bonus
PRP	Performance Related Pay
PSBB	Irish Public Service Benchmarking Body
PSCBC	South Africa's Public Service Coordinating Bargaining Council
TPSD	Malaysian Public Service Department
SNG	Subnational Governments
SOE	State Owned Enterprises
SSL	Philippines' Salary Standardization Law
SPS	Single Spine Salary
WAEMU	West African Economic and Monetary Union

INTRODUCTION

This supplement presents country case studies reviewing country experiences with managing wage bill pressures, which are the basis for the compensation and employment reform lessons identified in the main paper. The selection of countries for the case studies reflects past studies carried out by either the IMF or the World Bank in the context of technical assistance or bilateral surveillance (Table 1). These studies provide important insights into the different sources of wage bill pressures as well as the reform challenges governments have faced when addressing these pressures over the short and medium term. The studies cover 20 countries, including five advanced economies, six countries from sub-Saharan Africa, two countries in developing Asia, one country in the Middle East and North Africa, three countries in Latin America and the Caribbean, and three countries in Central and Eastern Europe and the CIS. The structure of each case study is similar, with each study starting with a presentation of the institutional coverage and framework for setting and managing the wage bill; a description of employment and compensation levels, including their comparison with the private sector; and a discussion of the challenges that motivated the need for reforms and, when applicable, the reforms implemented and lessons derived from these.

The case studies provide an overview of wage bill reform strategies, which include both short-term wage and employment measures as well as structural and institutional reforms (Table 1). Most of the case study countries relied heavily on wage freezes (typically across-the-board) as part of the reform design. A few countries also relied on reforms to the compensation structure. The studies include cases where countries consolidated employment levels by limiting new hiring, mainly by relying on attrition-based employment reductions. A few countries reduced government employment levels permanently through restructuring of the public sector. Cases where strengthening payroll management played an important role are also included.

Table 1. List of Case Studies

	Country Characteristics 1/				Reform Measures					
	GDP per capita PPP\$ (in thousands)	Government wage bill (percent of GDP)	Government wage bill (percent of total spending)	Government employment (percent of working-age population) 2/	Ad hoc wage adjustment	Structural pay policy reform	Attrition- based employment reduction	Targeted employment reduction	Public sector restructuring	Strengthening payroll management
Advanced economies										
France	40.5	12.5	22.0	15.2	✓		✓	✓		
Ireland	51.3	9.7	27.2	10.8	✓		✓	✓	✓	✓
Netherlands	48.0	8.9	19.9	9.8	✓		✓	✓		
Portugal	27.1	11.0	23.1	9.8	✓	✓	✓		✓	✓
United Kingdom	39.8	9.3	23.0	13.1	✓	✓	✓	✓		
Emerging Europe										
Kosovo	9.1	9.3	31.8	6.4						✓
Moldova	5.0	9.1	22.8	6.3				✓		
Romania	19.7	7.3	21.6	11.8	✓	✓	✓			
Developing Asia										
Malaysia	25.1	5.8	22.5	7.3						✓
Philippines	7.0	5.1	26.0	4.9		✓				
Latin America and the Caribbean										
El Salvador	8.1	9.3	43.4	5.1						✓
Honduras	4.7	10.9	38.6	3.6	✓			✓	✓	
Jamaica	8.6	10.0	35.9		✓		✓	✓		
Middle East and North Africa										
Tunisia	11.3	13.5	45.6		✓					
Sub-Saharan Africa										
Côte d'Ivoire	3.1	7.4	32.6	1.8	✓					
Ghana	4.1	9.2	36.0	4.1	✓	✓	✓			
Kenya	3.1	5.2	18.3	4.1			✓			
Mali	1.7	5.5	20.8			✓				✓
South Africa	13.1	11.5	34.7	7.1		✓	✓			
Zimbabwe	2.1	16.5	56.2		✓		✓			✓

Source: IMF staff.

Notes:

1/ 2015 or most recent data.

2/ Working age population is defined as the population age 15 to 64 years.

CÔTE D'IVOIRE

The wage bill grew rapidly in Côte d'Ivoire over the last 15 years, reflecting an expansion in government employment accompanied by increases in supplements for specific sectors. To rein in compensation spending in a way consistent with effective service delivery, the Ivorian authorities adopted a medium-term reform strategy in 2014. However, the proposed measures might not provide buffers to mitigate spending pressures. Centralizing wage bill management could improve compensation and wage policies.

A. Institutional Background

The wage bill covers central government (including police and armed forces) and part of staff costs in local governments and public entities outside the general government.¹ However, civil servants paid by externally financed projects, and some contractuels (temporary teachers) are not included in the wage bill.

The management of government compensation and employment is fragmented. Management of payroll and human resources is separated within the central government. The payroll is managed by the ministry of finance. The civil service ministry regulates recruitments and defines general terms and conditions of employment in the public sector. Furthermore, police and military forces (about 30 percent of employment) manage both their compensation and employment policies independently. This fragmentation often leads to inefficiencies—for example, different information technology (IT) systems have inconsistencies in the headcount of workers for the same institutions. In addition, human resource processes (including hiring, promotions, retirements) are not integrated in budget preparation. It usually takes more than one year between recruitment and the payment of the first salary. This results in poor motivation of new hires and large carryovers from one fiscal year to another which disrupt wage bill and cash management.

Côte d'Ivoire has a career-based employment system with compensation poorly linked to performance. Recruitment is based on open competition and assessment of merit at entry level. Civil servants have tenure and benefit from specific legal provisions (called statutes).² They are positioned in salary grids in four categories (A, B, C, D), according to their qualifications and the sector in which they work. They are guaranteed an automatic progression every two years.³ Compensation is the sum of a base salary and supplements. The base salary is calculated using a

¹ It covers civil servants that are seconded to local governments and public entities, as well as current transfers to partially cover other compensation spending.

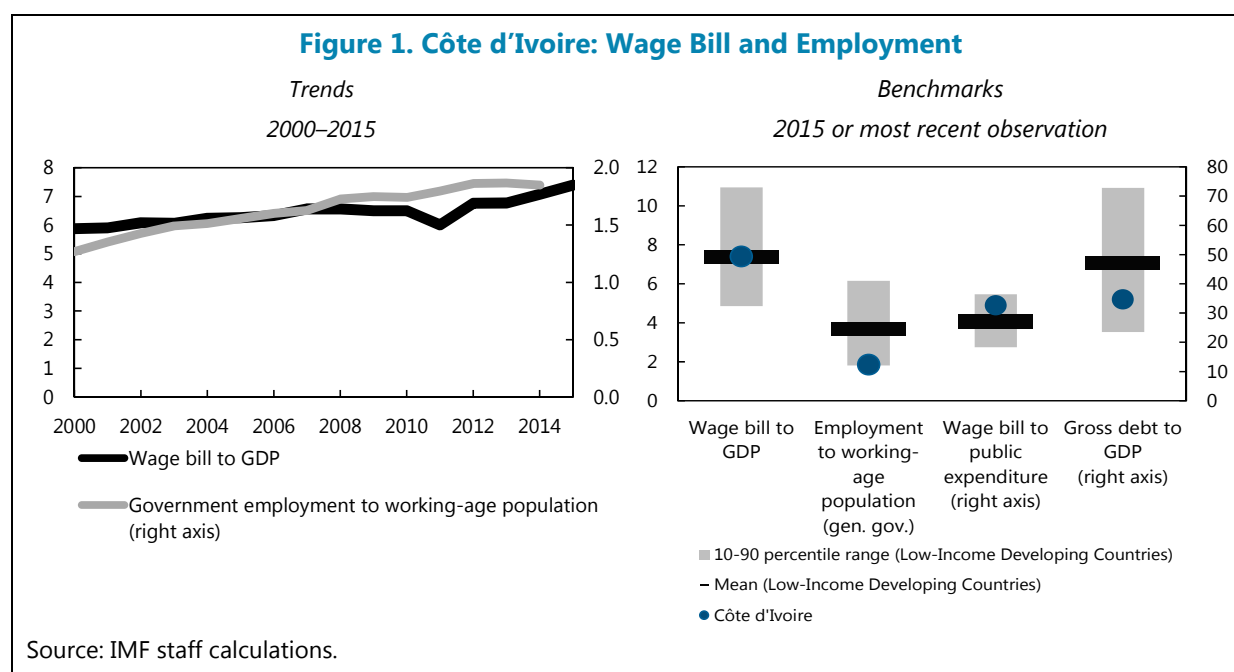
² A statute, unlike a contract, is a set of laws and regulations that defines the general terms and conditions of civil servants. In Côte d'Ivoire, in addition to the general civil service statute, special statutes apply to police, armed forces, diplomats, judges, and teachers.

³ However, to contain the wage bill, this automatic progression mechanism was frozen for 20 years, as were promotions for highly skilled and executive employees from 2007 to 2013.

point system determined by employment category and grade level. The value of the points is set by decree. In addition, civil servants receive bonuses and allowances representing about a third of civil service pay. The bonuses and allowances vary across sectors, categories, and points, and can be in cash or in kind.⁴ Bonuses and allowances have been granted without a coherent strategy, and are attributed without reference to performance requirements. In-kind benefits are often attributed in a discretionary manner.

B. Trends and Issues

The wage bill grew steadily in the past decade, crowding out other spending. In 2005–2015, it increased from 6.3 to 7.4 percent of GDP, above the West African Economic and Monetary Union (WAEMU) average of 6.5 percent of GDP (Figure 1).⁵ The wage bill is just at about the low income and developing countries (LIDCs) average. The wage bill expansion did not directly lead to a deterioration in the overall balance, but it seems to have crowded out other productive expenditure.



An increase in government employment contributed to the expansion of the wage bill.

General government employment increased from 1.3 to nearly 2 percent of the working-age population in 2000–2014. Expanding public employment has been driven primarily by the education and health sectors, which have represented more than two-thirds of total recruitments. Since 2012, the integration of former combatants also contributed to the sharp increase in public employment. Finally, higher statutory retirement ages have generated a smaller natural attrition than initially

⁴ They include in particular housing benefits in-kind or in cash, transportation allowances, and family benefits (Bonherbe and others, forthcoming).

⁵ WAEMU members are Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo.

expected. Regarding wages, despite an across-the-board freeze in automatic progression for more than twenty years, government compensation grew on the back of successive pay increases granted to specific sectors (teachers, judges, police forces, health workers, etc.). The gradual unfreezing of wages that started in 2010 has also contributed to a rapid growth in the wage bill in recent years.

The government faced significant pressure to increase wages and address public compensation inequities. A 20-year freeze in public wages eroded purchasing power, and inequalities rose within the civil service as targeted wage increases benefited certain categories of employees more than others. In the context of a divided country (the government had lost the control of the Northern part of the territory) and social unrest, the previous government committed in 2009 to increase wages by about 3.2 percent of GDP, of which only 1.2 percent of GDP increase was approved and partially implemented. In addition, the authorities recognized about 2.0 percent of GDP in arrears due to the wage freeze. After the postelectoral crisis, civil servants' unions asked the new authorities to honor past commitments.

Recruitments were also expected to be large in the medium run. The net increase in employment was initially projected at about 60 percent in 2014–2022, with about two-thirds in the education and health sectors. These projections did not take into account the universal schooling program announced in 2015, which would increase recruitment needs by about 20 percent in the medium term. In addition, the government wanted to reinforce public order and safety with additional police and military personnel.

In the medium term, one key objective is containing government compensation to provide fiscal space to scale up public investment. In 2014, the Ivoirian authorities adopted a medium-term strategy for 2014–2020 to lower the wage bill from 44 to 35 percent of tax revenue (a convergence criterion in the WAEMU). This strategy aims at reducing the wage bill while ending the wage freeze and recruiting civil servants in priority sectors. Overall, the strategy moves from a short-term approach, focused on preparing the next year's budget, to a more medium-term approach to ensuring fiscal sustainability. It reorients wage policy toward more durable measures, including paying in-full previous wage commitments, cancelling wage arrears, shifting some of the pension contribution to the employees, reinstating automatic progression in the wage grid, boosting wages for high-skilled staff and priority sectors, reducing recruitment targets, and committing to introduce a new wage grid to address equity issues. The strategy has helped to improved coordination within the central government, as the civil service ministry and the ministry of finance have worked jointly on its design. It has also provided a formal framework for wage bargaining.

However, the strategy might not provide sufficient buffers to mitigate spending pressures in the short term. The design of the strategy will sharply increase the wage bill to tax revenue ratio in 2014–2015, with the reduction in the wage bill postponed at the end of the projection period. As a consequence, risks of fiscal slippages are significant during the implementation of the strategy. The

strategy also relies on optimistic projections (real GDP growth of 10 percent).⁶ Finally, the strategy lacks contingencies to accommodate additional wage pressures.

C. Reform Challenges and Lessons

Ensuring wage bill sustainability requires integrating the administrative and financial management of human resources. Allocating human resources management and financial management to separate ministries is detrimental to a comprehensive approach to the wage bill. The capacity to manage various factors that determine medium- and long-term compensation spending is necessary to ensure fiscal sustainability. The government should centralize wage bill management to control the various drivers of spending such as recruitment needs, retirement projections, promotion policies, and compensation structure and dynamics.

Developing countries face specific challenges for setting and managing compensation and employment policies. Priority is usually given to ad hoc measures in response to a crisis, rather than to establishing a systematic approach to wage negotiations and recruitments. In addition, containing the wage bill proves difficult in countries where the wage bill is used as a stabilizing tool for the country, such as reintegrating former combatants.

As a consequence, a medium-term approach to wage bill management would help put the wage bill on a sounder footing. An across-the-board wage freeze is not an effective tool to contain the wage bill over the medium term. A prolonged period of wage freeze, particularly when applied to base salary and/or automatic progression mechanisms, is not sustainable. As seen in Côte d'Ivoire, it leads to non-transparent increases in pay supplements (bonuses and allowances) that are often granted in an erratic manner. In addition, it creates inequities among civil servants without any performance-related rationale and reinforces distortions in the public compensation system. Finally, it makes human resource management more complex and less transparent. The adoption of a medium-term wage bill strategy—as recently adopted by the authorities in Côte d'Ivoire—is a positive development to contain the wage bill. However, achieving fiscal targets will require careful design and implementation of recruitment and compensation policies going forward, and additional containment measures in case of slippages.

⁶ IMF staff projects an annual real GDP growth of about 7.5–8 percent over the medium term.

EL SALVADOR

Partly to close gaps in El Salvador's coverage in health care and education, government employment was expanded in 2008–2014. This has proved costly because government pay is substantially higher than in the private sector. In addition, the pay structure is fragmented and perceived as inequitable within the public sector, with some sectors—health care in particular—receiving substantially higher pay for similar types of work. Looking forward, it seems crucial to organize the pay structure and realign it to the private sector to ensure fiscal sustainability while addressing existing coverage gaps in key areas such as education, health care, and security.

A. Institutional Background

This case study focuses on the general government employment and compensation in El Salvador. This includes the central government (with most of the employment in education, health care and hospitals, justice and security, and the judiciary), decentralized institutions, and local authorities.

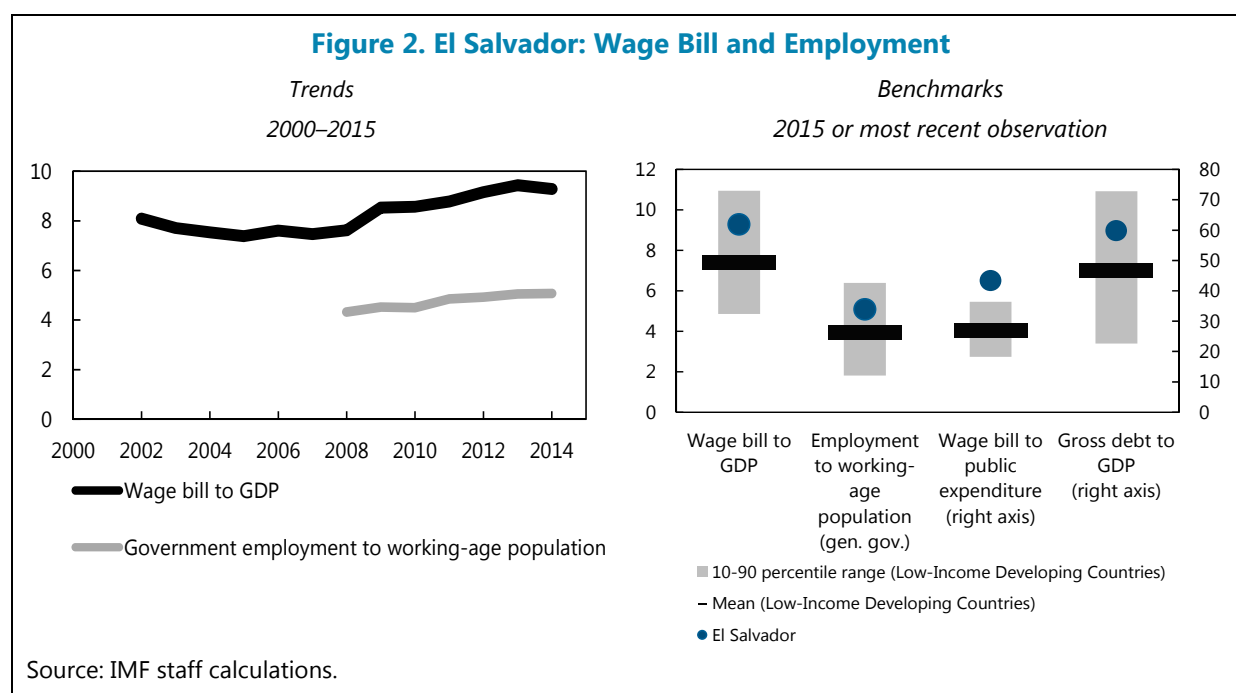
Most government compensation reflects wage pay, but in-kind benefits are also provided. Wages are about 90 percent of total pay (base wages and social security contributions). The rest corresponds to bonuses (sometimes provided in lieu of wage raises), allowances (including a Christmas bonus equal to about 1.5 times the minimum wage), and over time. In-kind pay is also provided including a basic consumption basket, uniforms, and child care subsidies. Pay structures, including the use of allowances and in-kind pay vary by institution.

The public employment system is generally position based. In most institutions, employees are hired for specific positions at all hierarchical levels. In each position, promotion is based on length of service and does not entail a change in responsibilities—there are pay grades but no career advancement system. Two notable exceptions are the National Civil Police and education, where employment is career based: employees are hired at low organizational levels and promotions are clearly defined within a career advancement structure. Most employees hold a permanent contract, backed with legal protections that provide nearly absolute employment stability.

Human resources management is decentralized. A few processes—such as the disciplinary process and employment stability—are carried out in a homogeneous way across institutions. However, crucial practices (including personnel selection and hiring policy, the compensation policy, and promotions) are managed at the institutional level, following internal regulations and in accordance with collective agreements with more than 90 general government institutions.

B. Trends and Issues

Government wage expenditure has increased rapidly in recent years, reflecting marked employment growth, combined with major discretionary wage increases in education and the impact of the generous health care sector wage regime (*health escalafon*). General government compensation increased 1.8 percentage points of GDP between 2008 and 2014 (Figure 2). At the general government level, the growth in the number of positions explains much of the increase in wage expenditure. Although the population grew less than 2 percent during 2008–2014, the number of general government positions grew by more than 25 percent. The jump in wage expenditure also reflects discretionary wage increases in education and the impact of the *health escalafon*, which sets annual salary increase of 5–8 percent for employees in this sector.⁷ These two sectors combined account for about 0.4 percentage point of the total increase in general government compensation between 2008 and 2014. Today, El Salvador’s wage bill is high relative to peers, in share of GDP and in share of public expenditure.



In part, the expansion in employment was done to address coverage gaps in health care and education. Coverage in health care and education (particularly secondary education) remains low relative to Latin American comparators. This explains part of the increase in employment. However, employment expansion went beyond these areas—of the 41,000 general government jobs created between 2008 and 2014, approximately 19,000 reflect growth in areas other than health care, education, or security.

⁷ The *health escalafon* was introduced in the mid-1990s, during a period of elevated inflation and before the dollar was adopted as legal tender.

On average, public sector wages considerably exceed those of the private sector. Data from household surveys for 2010 and 2013 suggests, on average, a wage premium of 70 percent between the public and private sectors, after controlling for characteristics such as education and work experience. The gap is even more pronounced for those with relatively little education. The results of both surveys are similar, that is, the premium does not appear to have increased in recent years.

The fragmentation of the system has contributed to a large wage disparity. The managers of various units have broad discretion regarding the basic parameters of each new position—from the job description to the level of compensation. This has resulted in a multiplicity of salaries for positions with similar responsibilities across various institutions. The most common case is the health care sector (Ministry of Health and public hospitals), where the average base salary for comparable positions—also because of the workings of the *health escalafon*—is much higher than the average base for general government positions of this type.

C. Reform Challenges and Lessons

Looking forward, it is essential to realign compensation with the private sector. General wage increases should be kept below inflation. It is natural to adjust wages periodically to reflect changes in the level of prices and productivity gains, but this should also take account of macroeconomic conditions, fiscal availability, and the competitiveness of public sector wages relative to those in the private sector. Moreover, it is essential that wage increases not exacerbate the perceived inequities in the system. The high premium of public sector wages vis-à-vis those in the private sector indicates that there is sufficient room for rationalizing wages without affecting the government's competitiveness in attracting and motivating employees.

The parameters of the health care sector pay scale could be revised. In the health care sector, employees receive automatic raises of up to 8 percent a year, depending on seniority and performance. This is explosive for public finances, and could be suspended—as was done in various years before 2009—at least until the pay scale parameters have been revised. Other alternatives with similar savings include adjusting the pay regime to make it comparable to that of teachers or limiting pay scale increases to 2 percent.

Avoiding further growth in the number of positions is also crucial. Following a sharp increase in the number of positions observed in recent years, it would seem appropriate to limit new hiring, at least until the challenge posed by the health care sector pay scale is resolved. Ideally, the efforts should be targeted to ensure the provision of effective services in strategic areas (health care, education, security).

FRANCE

France has a strong institutional framework for managing government compensation, although control over local governments' hiring and compensation practices could be improved. The wage bill as a share of GDP has remained stable over the past decade, but at a relatively high level. Because the wage bill accounts for about a quarter of government spending, it has been an important part of fiscal adjustment efforts. The containment strategy first relied on reducing employment based on attrition and then containing wages across the board. This approach had only limited effect on the wage bill-to-GDP ratio, as public employment reduction was reversed, and low inflation has limited the effectiveness of the wage freeze. Going forward, potential pressures to the wage bill could be related to needs for recruitment in the defense sector and the wage drift embedded in the system.

A. Institutional Background

Compensation and public employment are well recorded and captured in the fiscal accounts.

Data covers central and local governments, across all sectors including civil service, education, health, and security. General government employment represents about 20 percent of the total labor force. Public entities outside the general government (state-owned enterprises) and private entities mostly financed by public resources account for about 5 percent of the total labor force.⁸

The ministry of finance (MoF) oversees the wage bill, while the civil service ministry defines recruitments needs and conditions of employment. The government sets a ceiling on the total wage bill for central government, which is broken down by programs. The MoF approves recruitments, manages payroll (including internal controls, reconciliation, and audits), and oversees line-ministries compensation budgets. A unified legal framework covers wage bargaining for all government employees. The prime minister decides on wage increases, generally after intensive social dialogue. Unions are particularly strong in the public transport sector, education, tax administration, and police. Pay agreements cover base pay and working conditions. Base wages are not indexed with inflation and have been frozen since 2010.

A career-based system with a common set of rules across the general government ensures that recruitment and promotion are merit based. Recruitment is based on open competition and assessment of merit at all levels. Civil servants are positioned in salary grids in three categories (A, B, C) according to their qualifications and the sector in which they work, and they benefit from automatic progression mechanisms. The base wage is calculated using an index system, depending on employment category and grade level. There are separate wage scales by profession, by individual sectors, and by ministries. Civil servants receive bonuses and allowances (20–30 percent of the wage bill) which vary significantly across sectors and categories of employees and could be in cash or in kind. Compensation has become progressively linked to performance, with different performance pay systems across ministries.

⁸ Appendix to the draft 2015 Budget Law (Ministère de la décentralisation et de la fonction publique, 2015).

Flexibility in staff management is relatively low. Civil servants have a special legal framework (statute), including protections and severance benefits beyond those in the general labor market regulation. Political appointments are only at senior levels. While line ministries decide on promotion, the MoF sets a ratio for promotions in the central government (number of people promoted/number of people eligible for promotion). Government employees can only relocate with the joint consent of the ministry and the employee. Staff can be employed on a contractual basis (more flexible frameworks) in some sectors and job categories.⁹

B. Trends and Issues

The wage bill is stable but above peers, reflecting relatively high employment levels.

Expenditure in government wages hovered around 13 percent of GDP in 2000–2015 (Figure 3). Government employment has also remained stable as a share of the working-age population. However, these have stabilized at high levels relative to other advanced economies.¹⁰ France seems to rely more on public employment to achieve policy goals, including tackling unemployment—for example, short-term contracts for the unemployed accounted for about two-thirds of the net increase in public employment in 2013 and 2014. In contrast, there does not seem to be a public wage premium (Figure 4).¹¹ For example, experienced teachers receive comparatively lower salaries than the European average and large European Union (EU) countries (except Italy) (Figure 5).

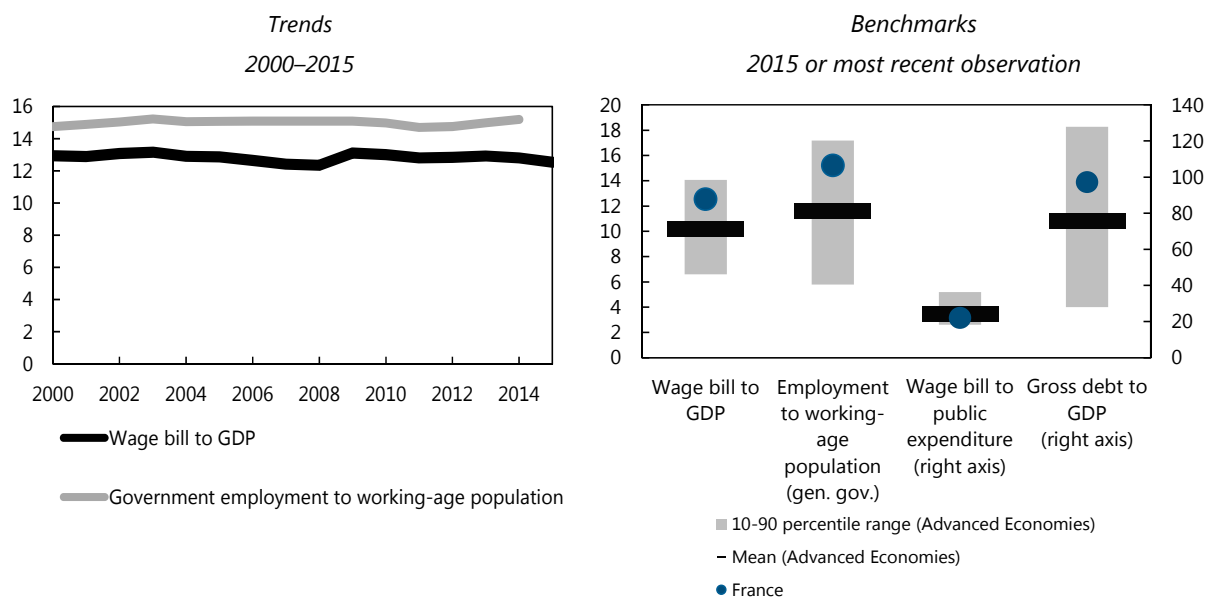
Although the aggregate wage bill has remained stable, a shift has occurred from central to local governments where controls seem weaker. The wage bill for the central government has declined over the last twenty years. Some of the reduction reflects the decentralization process which has shifted part of the wage bill to local governments and autonomous entities (*Organisme divers d'administration centrale*, ODAC), partly to bypass budget constraints (Figures 6 and 7).¹² But the rapid increase in local governments' wage bills was also related to loose hiring practices and rapid promotions, particularly at the municipal level—in 2002–2009, local governments created more than a quarter million jobs (about 5 percent of public employment) beyond those related to decentralization (Cour des comptes, 2009 and 2012). The central government has limited leverage because of constitutionally guaranteed fiscal autonomy, requiring indirect measures to contain local government spending (including reducing in transfers, rationalizing regional governments, eliminating the general competency clause, and introducing an indicative target for the evolution of local public expenditure).

⁹ Contractual employees accounted for 17 percent of general government employment in 2013 (Ministère de la décentralisation et de la fonction publique, 2015).

¹⁰ Relative to the European average, compensation spending to GDP is higher in 8 out of 10 Classification of Functions of the Government (COFOG). Education, health, and social protection explain over half of the gap.

¹¹ Controlling for employee characteristics, public wages are 3½ percent lower than in the private sector. This seems related to lower pay to the better educated who have a *negative* wage gap of about 10 percent, while the less educated receive wages that are about 6 percent higher than in the private sector (De Castro et al., 2013).

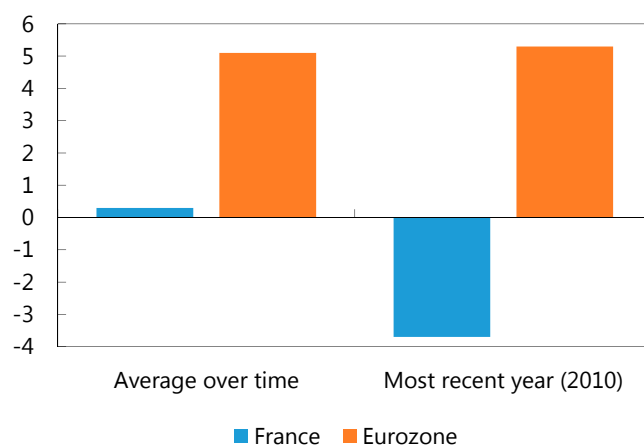
¹² About 150,000 employees were transferred to ODAC since 2009, particularly universities (Cour des comptes, 2015b).

Figure 3. France: Wage Bill and Employment

Source: IMF staff calculations.

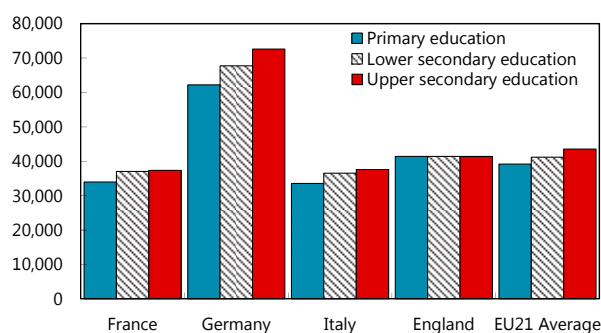
Figure 4. France: Public Sector Wage Premium

(Public-private wage differential as a percent of private wage)



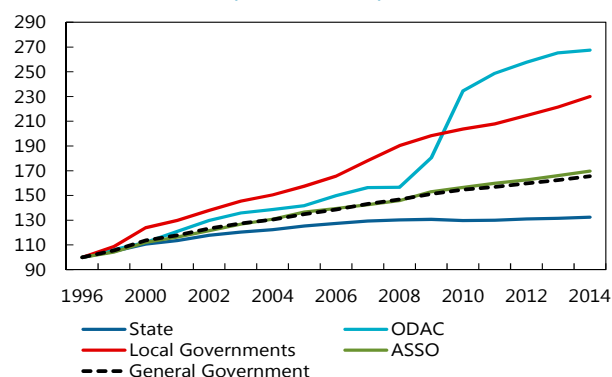
Sources: IMF staff estimates.

Figure 5. France: Teachers' Statutory Salaries after 15 Years, 2012
(PPP U.S. dollars)



Sources: Eurostat, OECD, and IMF staff calculations.

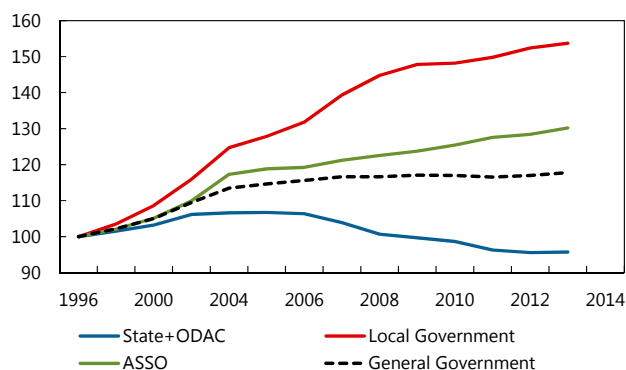
Figure 6. France: Wage Bill by Levels of Government
(1996 = 100)



Sources: Eurostat, INSEE, WEO database, and IMF staff calculation.

Note: 2014 data for wages, 2012 or latest data for employment. Dashed lines represent the European median.

Figure 7. Employment by Levels of Government
(1996 = 100)



Sources: Eurostat, INSEE, WEO database, and IMF staff calculation.

Note: Excludes the "contrats aidés."

In recent years, execution of the wage bill has proven difficult to contain. Different rules exist to control the wage bill, including requirements for supplementary budgets when the wage bill exceeds the budget, restrictions to carry underspending to future years, and bans to reallocate resources from other budget categories to wages. Despite these rules, the central government wage bill was overexecuted by about 0.5 percent on average from 2009–2014. This seems due to underestimation of the wage bill in the defense sector and weaker control in local governments and hospitals.

The automatic progression system results in a rapid attainment of the highest step in the wage grid for most employees. The positive wage drift (impact of step progression and promotions) is estimated at about 2 percent a year. This has been above the negative wage drift (impact of recruitments with lower wages replacing employees retiring with higher wages). This might reflect accelerated advancement through the grid, which can be costly and affect morale—employees reaching the top of the scale quickly have diminished prospects for progression.

C. Reform Challenges and Lessons

Limiting the wage bill growth has been an important part of the spending containment strategy recently. The high levels of government spending and debt are limiting the fiscal room for maneuver, and imposing a substantial tax burden on the economy. Given that the wage bill accounts for about a quarter of public spending, containment efforts have focused on limiting its nominal growth. In 2007, an ambitious spending review was launched to restructure the public sector and improve its efficiency. However, its implementation fell short of its initial objectives, and France relied on spending containment rather than on spending reforms, with a focus on the wage bill and intermediate consumption.

The containment strategy has relied on reducing employment through attrition and freezing pay, with little impact on the share of compensation in GDP. Employment reduction was achieved through the introduction of employment caps from 2006, and the implementation of attrition targets (replacing only 1 of 2 retiring civil servants) from 2007–12. Since 2012, the government has favored stabilization of employment, with large recruitments in education to be offset by a decrease in other sectors, particularly defense. In addition, since 2010 the public sector wage scale has been frozen for all levels of government, though wage increases were granted at the lower levels of the wage scale, for equity reasons. Overall, reduced the wage bill modestly (0.3 percentage points of GDP in 2009–2011), partly reflecting the modest impact of wage freezes in low inflation periods. In addition, employment started to bounce back after 2013.

Greater coordination could facilitate wage bargaining and oversight. The wage bill is projected over the medium term, but ad hoc wage negotiations tend to disrupt compensation planning and budgeting. There is a disconnect between wage setting and budgeting. Decisions on wage increases are made on an ongoing basis during the course of the year without linkages to the budget process. This signals potential inefficiencies, which could be addressed by adopting a more medium-term approach to recruitment and compensation policies. Hence, priority sectors for recruitments and pay

increases could be identified, and wage negotiations could focus on addressing sector-specific issues through some decentralization in bargaining, while containing the base pay increase that applies to all civil servants in the current centralized system. This would require an effective control and monitoring of recruitments and wage negotiations by the MoF. Furthermore, the local governments would benefit from enhanced payroll and recruitment management systems, potentially mimicking those used at the central government.

Going forward, potential pressures to the wage bill could be related to needs for recruitments in the defense sector and the wage drift.

Pressures associated with the need for expansion in employment in key areas (including defense) are likely to arise. In this context, a durable and sustainable containment of the wage bill would require a focus on employment rather than wages, given that government pay seems low relative to private sector comparators. This will require thorough reviews of staffing in administration, underpinned by streamlining of processes. Employment practices in labor-intensive public sectors such as health and education should also be assessed. Employment could also be rationalized at the municipal level, supported by reforms to reduce overlap (*intercommunalités*). Other EU countries have succeeded in reducing public employment during the crisis (including Germany, Italy, Portugal, and the United Kingdom). This was generally done by setting a binding entry-to-exit ratio, and voluntary departures schemes. To maintain effective service delivery, it seems crucial to ensure that working hours are effectively not lower than the 35 hour work week, particularly the impact of the reduction in employment (Cour des comptes, 2015a). This would require a more stringent legal control of local governments' employment practices by the central government offices at the local level (*préfectures*).

GHANA

In 2010, Ghana introduced a single spine salary (SPS) structure to increase equity, ensure fiscal sustainability, simplify bargaining, and better connect pay and productivity. The SPS succeeded in covering most general government employees under a common compensation framework, but this came at a high cost—it is estimated that the SPS raised the wage bill by about 2 percentage points of GDP, potentially threatening fiscal sustainability.

A. Institutional Background

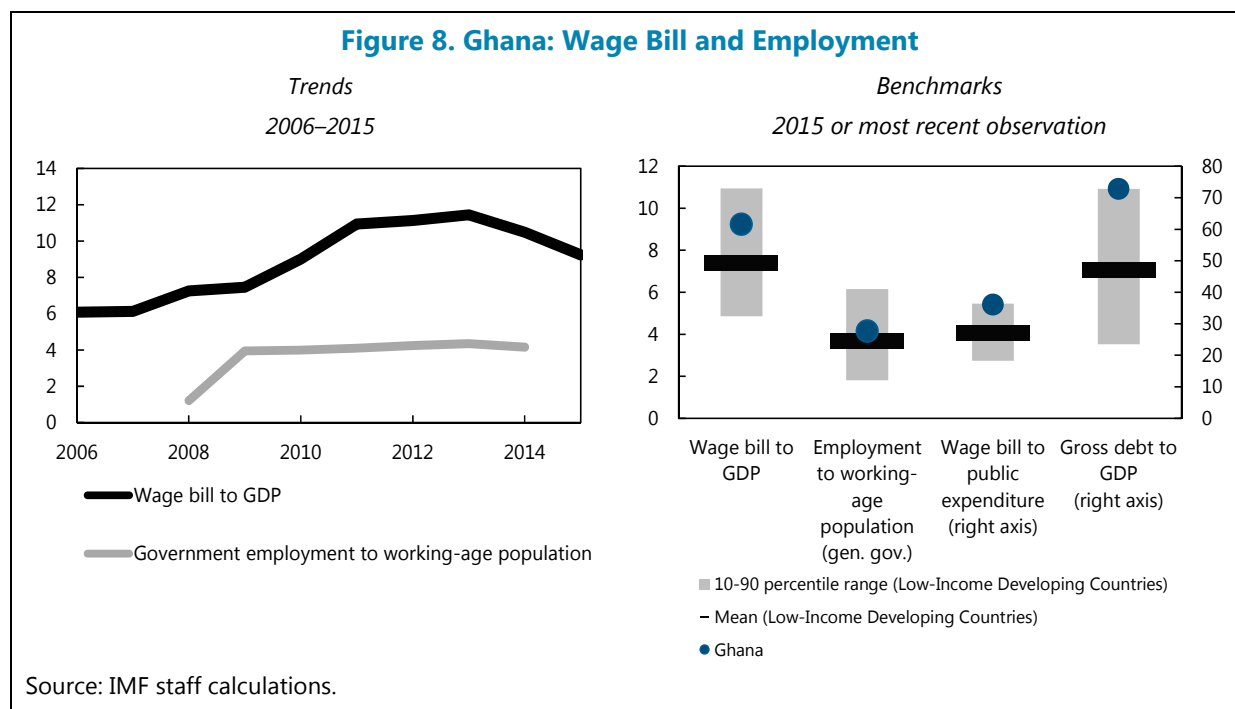
This case study focuses on the recent experience of the Ghana Public Services in introducing a new salary structure. The public services broadly correspond to the general government, with 19 public services defined in Article 190 of the Constitution (including civil service, education health, judiciary, police, and non-commercial public corporations), as well as other public services prescribed by law (including local government service).

Four main entities are in charge of managing public service compensation and employment in Ghana. The *Public Services Commission* is in charge of human resource management, including setting the criteria for appointments, overseeing career development (hiring, advancement, retirement practices), and periodically reviewing the manpower requirements in the public services. The *Fair Wages and Salaries Commission* is responsible for the implementation of pay policies, including wage setting, grading of posts, and linking pay with productivity. The *Ministry of Finance* (MoF) sets the compensation budget consistent with existing wage policies and employment levels; monitors the payroll to ensure budget implementation; and provides advice on wage negotiations to the *Fair Wages and Salaries Commission* based on the availability of fiscal resources. And the *Controller and Accountant General's Department* manages the government payroll and processes, pays, and oversees all government workers' wages, salaries, and allowances.

Each service has some latitude to manage its own workforce. For example, the *Office of the Head of the Civil Service* is in charge of the proper development of civil servants (who belong to one of the 19 public services) to ensure the effective implementation of government policies and plans. This includes facilitating training of civil servants, tracking the performance of all civil service organizations, and monitoring the implementation of government programs. Similar offices exist in other services.

B. Trends and Issues

Expenditure in public compensation increased dramatically in 2008–2014. Although pressures seem to have abated recently (Figure 8), Ghana stands out relative to a wide set of developing economies in terms of compensation to GDP (9¼ percent of GDP in 2014) and compensation to public expenditure (40 percent in 2014). Public services employment has been relatively stable and seems in line with comparators.



These increases coincided with introduction of a new wage structure in 2010. A new compensation structure—the SPS—became effective January 1, 2010, for public service workers. The goals of the SPS were to increase equity within the public service, ensure the fiscal sustainability of the wage bill, simplify wage negotiations, and better connect pay and productivity.¹³ Public employees were shifted only gradually to the new structure, with retroactive payments (“deferred wages”) given to those who were transferred after the effective date. In this context, the impact of the SPS introduction on the wage bill can be estimated by comparing current wages in 2014 (when the vast majority of the public service workers were on the SPS) with 2009 (before the introduction of the SPS). Since public service employment remained at about 5½ percent of the labor force, this suggests that the SPS raised the wage bill by about 2 percentage points of GDP—an increase of about 28 percent (Table 2).

The SPS raised public pay beyond that in the private sector. As the reform guaranteed that no employee was worse off in terms of pay after the implementation of the SPS, salaries could only be higher. In addition, the SPS focused on improving internal equity, which effectively meant reducing compression—increasing salaries for those with low wages by a higher proportion than those with high wages. This helps explain why public pay increased beyond that in the private sector, particularly for unskilled workers. After controlling for gender, education, and years of experience, there is no pay gap for professionals while for the low skilled the public-private pay gap is about 18 percent.¹⁴ While this might be consistent with the SPS objective of increasing equity in the public

¹³ For more details on the SPS introduction, see the Government White Paper on the Single Spine Pay Policy (Fair Wages and Salaries Commission, 2009).

¹⁴ Using data from the 2012–2013 Ghana Living Standards Survey (GLSS6).

Table 2. Ghana: Compensation of Employees, 2010–2014
(In percent of GDP)

	2009	2010	2011	2012	2013	2014	Change 2009–2014
Compensation of employees	7.9	8.8	10.2	13.2	11.7	10.5	2.6
Current wages	7.2	7.4	8.4	10.0	9.7	9.2	2.0
Deferred wages	0.0	0.7	1.0	2.6	1.1	0.5	0.5
Pensions and gratuities	0.7	0.7	0.8	0.6	0.8	0.9	0.2
Public service employment (percent of labor force)	5.4	5.4	5.6	5.8	5.9	5.6	0.2

Sources: IMF staff calculations using data from the CAGD and MoF.

Note: Deferred payments largely reflect retroactive payments related to the SPS corresponding to adjustments to previous year pay, because employees were transitioned to the new system over a number of years, but all had the same effective date of January 1, 2010.

service, it was also costly: an 18 percent pay premium for those with lower skills added about 0.6 percentage points to the wage bill.

In the medium term, the goal is to keep the share of public wages in revenue under 35 percent, while maintaining the competitiveness of public service compensation and ensuring service delivery.¹⁵ Following the introduction of the SPS, the focus of the authorities has been on containing annual wage increments (for example, by limiting the nominal increment under inflation in 2015), curtailing hiring (restraining the establishment of posts, except in key areas such as education and health care), reigning in the payroll (conducting a human resource audit and personnel headcount), and strengthening oversight of employment and compensation (modernizing the HR management information system). These are part of a broad Public Service Reform Strategy unveiled in early 2016, aiming to increase the productivity the public services (Government of Ghana, 2016).

C. Reform Challenges and Lessons

The fragmentation of human resource management across services and agencies made it difficult to advance reforms. For example, the introduction of the Ghana Universal Salary Structure (GUSS) in 1997 intended to organize pay in the public services; but recognizing the fragmentation, authorities allowed individual services to opt out. Over time, a few large services replaced GUSS with their own pay structures, including the Ghana Health Service which introduced the Health Salary Structure in 2006. This eroded the aims of the GUSS and renewed a sense of inequity of pay across services. The fragmentation of human resource practices also has consequences beyond pay: disparities have arisen in practices related to hiring, development, promotion, mobility, and separation. In some instances, services have created posts and awarded promotions without proper

¹⁵ The 35 percent wage bill to tax revenue is a convergence criterion in the West African Economic and Monetary Union (WAEMU).

coordination with the Ministry of Finance. This weakens the budget process and can result in arrears and delayed salary payments.

The gradual implementation of the SPS introduced pressures to increase wages for those who remained in the old pay structure. The SPS became effective for all workers in January 2010, but workers were integrated gradually over 2010–2014. This created a timing issue, as workers who were integrated later kept receiving (lower) salaries from the old pay structure until switching to the SPS (at which point they were also entitled to retroactive pay to compensate for the difference between the SPS pay and the old-structure pay since January 2010). Thus, those under the old pay structure continue to push for generalized wage increases which compounded the impact of the SPS—absent these discretionary adjustments, the wage bill would have remained under 7.5 percent of GDP and average public pay would still have increased during 2009–2014 in line with GDP per worker. This should be less of an issue going forward, as the vast majority of the public service workforce has already been integrated into the SPS.

Wage bargaining was not simplified by the SPS. In theory, under the SPS, wage negotiations should center on the periodic increase to the first step of the spine, which would then trickle up the wage structure while maintaining pay relativity. However, in the course of recent wage negotiations, adjustments to the wage relativity (via a revision to the increment from each step in the SPS) have been discussed. This introduces two challenges. First, changing the relativity of pay across jobs should not be done without a careful review of job responsibilities, potentially requiring a remapping of positions to the SPS grid. Second, changing the step increment would increase wages disproportionately for those at higher grades, which can be costly and raise the perception of inequity.

It is important to strengthen collaboration across the different agencies involved in payroll oversight. In Ghana, the fragmentation of the services provides some degree of flexibility to identify the needs of each service in terms of staffing, which is crucial for priority sectors such as health care and education. Nevertheless, greater coordination could be achieved by strengthening oversight and centralizing some roles. For example, explicitly assigning a gatekeeper in each service for the different stages of the HR process (establishment of new posts, inclusion of new employees to the payroll, promotions, and separations) in coordination with the Ministry of Finance would ensure that each post is accurately reflected and supported in the budget. In terms of promotions, the MoF could consider the use of explicit promotion budgets, implying a ceiling in the number of promotions for each year by government agency. In the medium term, this can be facilitated by better managing, sharing, and cross-checking wage bill information supported by modern IT systems.

The introduction of a new pay scale requires fiscal space. The gradual adoption of the SPS over the past five years has been relatively successful in meeting some of its objectives, including increasing pay equity within the public service. Furthermore, the use of a careful job evaluation to determine pay relativities helped simplify administration and oversight by including the vast majority of the public service workers under a unified pay structure. However, it must be

emphasized that introducing a new pay scale would typically increase expenditure in compensation, since gathering support for a new system requires not making any worker worse off than under the old pay system while making others better off. In theory, this could be only a temporary effect, as new workers who join under the new wage grid would have the appropriate pay in the new grid. Nevertheless, this suggests the need for caution and proper budgeting when introducing a new pay scale. In addition, the transition to the new grid needs to be carefully thought out to prevent deepening perceptions of inequities, which might result in pressure to further increase compensation beyond that implied by the new pay system.

It is crucial to ensure that public pay is competitive to attract and retain top talent. In Ghana, public pay seems at competitive levels for professional staff, but a wide gap exists between the public and private pay for clerical and unskilled workers. Attracting talent and maintaining a motivated public service workforce requires periodic reviews of compensation vis-à-vis the private sector, which should make inputs to the wage negotiation process. Instead of relying on ad hoc adjustments to the SPS (including allowances), proper protocols to evaluate revisions of career paths and occupations, including pay relativity, should be put in place to ensure that grade re-evaluation is granted based only on skills and labor market developments.

Overtime, changes in the wage structure can facilitate bargaining. Under a single spine, focusing on the base wage increase (the first step of the first grade of the SPS in the case of Ghana) would simplify wage negotiations and increase the transparency of public pay—a notable improvement relative to bargaining that involves different structures and parameters across diverse public services. Furthermore, with stable inflation, a transition from the annual wage reviews to a multiyear framework could be considered, as is done in a number of OECD countries (Canada, Denmark, Finland, Italy, and the United Kingdom) (OECD, 2012). This would facilitate bargaining and better link wage developments to the medium-term fiscal framework.

HONDURAS

The wage bill in Honduras has fluctuated between 11 and 14 over the past 15 years, partly reflecting relatively high pay in the public sector relative to the private sector. After a record fiscal deficit in 2013, the government has embarked on an ambitious fiscal consolidation program that includes controlling wage levels and rightsizing public employment as key objectives. These efforts appear to be having an effect on the wage bill to GDP, which declined by nearly 2 percentage points in 2013–2015.

A. Institutional Background

This case study focuses on reforms to employment and compensation in the government and public enterprises in Honduras. The public sector comprises the central administration, decentralized institutions, and public companies. The central administration comprises all executive power entities (line ministries) while decentralized institutions include several public pension funds, the social security administration, other small entities, and local governments. Honduras has eight main public enterprises, of which the telecommunications (HONDUTEL) and energy (ENEE) companies are the largest.

Honduras has separate compensation frameworks according to the type of worker. These include specific *estatutos* for civil servants, doctors, dentists, pharmaceutical chemists, teachers, microbiologists, social workers, and nurses. Public companies workers' pay is generally defined in collective agreements which are negotiated periodically. Around 95 percent of the public workforce has permanent positions, a difference from the current trend in Latin America where outsourcing has been widely used.

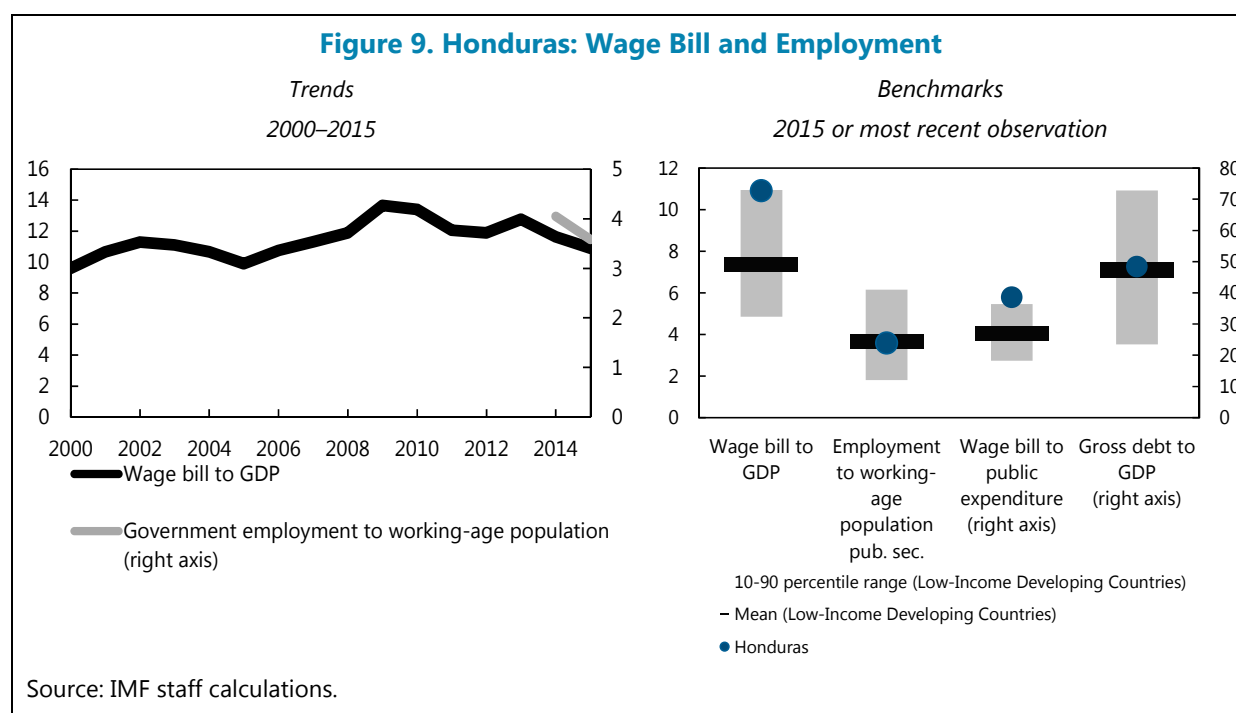
In general, public compensation includes a base wage, allowances (including bonuses for experience or seniority), and other benefits. On average, 60 percent of total compensation comes from base wages, 31 percent from allowances, and 9 percent from social benefits. Compensation frameworks typically differ in employment regulations and protections, the level and composition of pay, and the rules update wages over time. For example, in the teachers' *estatuto*, base wages are indexed to the minimum wage, while the pharmaceutical chemists' *estatuto* states a fixed 20 percent annual increase in wages, regardless of inflation or any other consideration.

B. Trends and Issues

The ratio of compensation to GDP has remained stubbornly high over the past 15 years, fluctuating between 11 and 14 percent of GDP. After reaching 13 percent of GDP in 2013, the wage bill has been declining gradually (Figure 9). Nevertheless, at 11 percent of GDP in 2015, the wage bill remains high relative to Latin American economies and other low-income and developing countries (LIDC). Expenditure in compensation also takes a larger share of government spending than peers, potentially crowding out other productive spending and limiting the margin to implement active fiscal policies in the event of an adverse shock. As a percent of the working-age

population, public sector employment is at about the LIDC average and has been declining in the past year, after remaining relatively stable in 2011–2013.

Public sector wages are high. Public workers appear to enjoy a substantial premium relative to their private sector peers. This premium, after controlling for variables measuring the quality of human capital (such as educational attainment or experience) is estimated at 34 percent. As in many other Latin-American countries the premium is biasedly distributed with a large gap for low-skilled workers (87 percent) and a 10 percent penalty at the top of the wage distribution (Mizala and others, 2010).



Significant pressures to the wage bill have come from the education sector. About 55 percent of the wage bill is devoted to education, and of this portion 90 percent is allotted to remuneration (the largest share in the region). Teachers have a strong political influence which has allowed them to gain some concessions overtime. For example, as part of a special agreement, the education sector bypassed the regulations issued in 2003 to put some order on the wage indexation rules; teachers received an average of 20 percent nominal increase in base wages in 2007–2009 and indexation to minimum wages starting in 2010.¹⁶ This contributed to the government wage bill reaching 14 percent of GDP in 2009. With personnel cost ballooning, the government suspended the indexation to minimum wages in 2010 with estimated savings of near 1 percent of GDP (IADB, 2014). This suspension was short-lived, and after its repeal in 2012 pressures resumed.

¹⁶ The agreement was called “Programa de ajuste social y calidad educativa”.

The wage bill contributed to a macroeconomic disequilibrium that peaked in 2013. A large wage bill combined with an ambitious public investment schedule contributed to a record fiscal deficit in 2013. As the government started to depend more on market financing—concessional loans generally cannot be used for budget—additional pressures on debt service were an unsustainable situation. This led to an ambitious fiscal consolidation program that includes controlling wage levels and rightsizing public employment as key objectives. At least from the fiscal perspective, these efforts are bearing fruit—the wage bill to GDP declined from 12.8 to 10.9 percent of GDP in 2013–2015.

C. Reform Challenges and Lessons

To open up fiscal space in the short term, the consolidation efforts included freezing wages, eliminating vacancies, and enhancing oversight. Since 2014 the government has implemented a fiscal consolidation plan with containing employment and wages as a centerpiece of the strategy. As a result, the NFPS wage bill declined 2.3 percent of GDP making a significant contribution to the 6.2 percent of GDP total fiscal adjustment observed in 2014–2015. To dent the relatively high levels of compensation, wages were frozen in nominal terms in 2014 and 2015. To control hiring, in sectors other than health care and education more than 80 percent of unfilled vacancies were eliminated. To strengthen oversight, a census of public employment was implemented to identify irregular (ghost) workers. Because of a corruption scandal, a sizeable reduction in the workforce was implemented in the social security administration.

This was accompanied by a determination to downsize the public sector in a targeted way. An overhaul has been implemented in the energy and telecommunications sectors. In the energy sector, ENEC will participate mainly in generation, leaving transmission and distribution to private operators. In telecommunications, HONDUTEL has been optimized to reduce costs and make it more attractive for private investment. In both companies, the reduction in the workforce is close to 60 percent of total employment with potential savings of up to 1 percent of GDP. These savings are partly offset by the cost of severance payments for dismissed workers.

There are still reforms that need to be implemented to achieve a modern and performance-based public workforce. Honduras has taken important steps in the reform of its public employment and compensation framework such as the public employees' census and the rightsizing of the workforce of the largest public companies. In the near future the reform agenda needs to be focused on an exit strategy from the short-term measures such as across-the-board freezes. This would require a reduction in the numerous compensation frameworks and a transparent mechanism to link increases in wages with productivity.

A flexible employment framework is critical. The sizeable downsizing in the public workforce is possible under the Honduran legal framework. While in many countries public workers have their jobs protected by law in Honduras the labor code allows the suspension of workers in cases when the company does not have profits. After four months suspension, redundant workers can be dismissed with the payment of their corresponding severances. The Honduran experience shows the

value of having a flexible employment framework. It also minimizes contingent risks as happened in the past in many Latin American countries where dismissed public workers won their reinstatements or other compensations through lawsuits.

Deeper fiscal reforms are needed to ensure the long-term sustainability of the recent fiscal gains. In a country with high social and infrastructure needs, new spending pressures are likely to emerge in the future. If the authorities want to address these demands in an ordered way without sacrificing long-term sustainability, they need to lock in the achievements of the last two years. This would require more structural reforms in fiscal management such as introducing an enforceable medium-term fiscal framework or strengthening their public financial management system. In addition, strengthening labor market institutions could support a more flexible wage policy based on productivity and merit indicators. A unified wage bill management could also address the current fragmentation of wage regimes.

IRELAND

Ireland has a long history, stretching back to 1987, of collective wage bargaining centered on a social partnership model. Between 1987 and 2008 seven separate national collective bargaining framework documents were agreed on, covering both the public and private sectors before the process collapsed during the economic crisis. Since then wage agreements have focused on the public sector and were primarily aimed at meeting challenging fiscal consolidation targets. Pressures are beginning to emerge to reverse cuts in both wage and employment levels, and careful monitoring will be required to ensure that any new agreements focus on further productivity gains and improved service delivery to safeguard Ireland's economic recovery and reduce fiscal vulnerabilities.

A. Institutional Background

Between 1987 and 2009, Ireland's national wage policies were centered on collective bargaining arrangements based on a social partnership model. Until 2009, the agreements encapsulated both public and private sector employees. This was a period of relative calm in industrial relations, as a series of seven successive collective national wage agreements were agreed on. The agreements focused on pay, but also included commitments on reforms to specific areas, including welfare, health, employment, and education. There were also conditional agreements about tax policy, in particular, the impact of tax reforms on lower-earning workers.¹⁷

The main negotiating agencies on behalf of the government were the Taoiseach's (Prime Minister's) office and the Department of Finance, and the national agreements included all of the major social partners.¹⁸ These included the main employer groups such as the Irish Business and Employers Confederation (IBEC) and the Construction Industry Federation, the trade unions (members of the Irish Congress of Trade Unions), and a number of civil society organizations.

Since 2009, when the last national agreement was abandoned, collective bargaining arrangements have focused on the narrower public sector. Two agreements the Public Service Agreement 2010–2014 (the “Croke Park Agreement”) and the Public Sector Stability Agreement 2103–16 (the “Haddington Road Agreement”) were the basis for wage policy during the period of fiscal consolidation following the severe economic crisis that required a period of significant fiscal consolidation between 2008 and 2014.

¹⁷ For example, the 1994 Programme for Prosperity and Fairness covering 2000–2003 set out a range of tax policy reform measures agreed between the social partners.

¹⁸ The Department of Finance was split into two entities in 2011 with the formation of a new coalition government made up of the Department of Finance and the Department of Public Expenditure and Reform (DPER). DPER has been responsible for wage negotiations since that time.

B. Trends and Issues

In the early 2000s, public wage levels were influenced by benchmarking exercises that sought to identify disparities between the levels of public and private sector pay. In 2000, a Public Service Benchmarking Body (PSBB) was established under the terms of the Programme for Prosperity and Fairness, with a remit that included administrative/clerical grades, civil servants, local authority workers, the Gardai (police), teachers, nurses, other health professionals, and the defense forces.¹⁹ The PSBB's 2002 report recommended increases in pay averaging 8.9 percent to public sector employees. It also recommended severing links with all previous pay links and establishing new absolute pay levels, despite producing no evidence of a public-private pay gap at the time. Senior public sector officials also received significant pay increases in separate reviews on pay levels at the higher end of the public service.²⁰ The government to agree with the unions to a second benchmarking exercise in 2004–2007, but this did not result in significant recommendations. The increases in public sector pay resulting from the benchmarking exercises were additional to pay increases agreed to across public and private sectors within the framework of the national pay agreements.

The various collective bargaining agreements and benchmarking exercises contributed to a significant increase in the public sector wage bill between 2000 and 2009 (Figure 10).

Subsequent research indicated that, contrary to popular belief, the public sector enjoyed a significant wage premium to the private sector, when all factors, including pensions were taken into account.²¹ Largely due to pay increases, the wage bill went from 8.3 percent to 12.3 percent of GDP in 2000–2009, before falling off, following the aforementioned fiscal consolidation measures.

Due to the economic crisis, the national collective bargaining process came under severe strain in 2008, leading to eventual collapse in 2009. This resulted from rising unemployment (from around 4 percent to over 14 percent between 2008 and 2011), a collapse in the construction sector, and demands for pay cuts and greater productivity in the public sector to support a significant fiscal consolidation requirement. A second stage of the 2006 social partnership agreement (“Towards 2016”) agreed on in 2008 collapsed in early 2009 as the government was forced to introduce cuts in the incomes of public employees averaging 13 percent, bringing to an end a period of over 20 years of collective bargaining at the national level.

Two agreements since 2010 focused on the narrower public sector. The “Croke Park Agreement,” which was originally agreed on as the framework for public sector wage policy between 2010 and 2014, committed the government not to enforce layoffs or further public sector wage cuts in return for agreement on productivity measures and a commitment not to engage in industrial action. However, the need for substantial further fiscal consolidation required a further follow up agreement in 2013 (“the Haddington Road Agreement”). This agreement laid out the framework for

¹⁹ The fifth national collective bargaining agreement (2000–2003).

²⁰ Senior civil servant remuneration was reviewed by the Review Body on Higher Remuneration in the Public Service.

²¹ Callen et al., 2010, and Kelley et al. 2009.

savings of €1 billion (0.5 percent of GDP) in the wage and pensions bill in 2013–2015. The main provisions related to cuts in pay ranging from 5.5 percent for low and medium earners up to a top level of 10 percent for the highest paid civil servants. Other productivity gains such as increased working hours and changes in overtime and other allowance rates were also introduced.



In 2015, the Haddington Road Agreement was extended by a new Public Service Stability Agreement 2013–18 (“The Lansdowne Road Agreement”), which increased public sector salaries for the first time since the onset of the crisis. Better than expected fiscal outturns created a small amount of fiscal space, and in light of an upcoming election (February 2016), some of the emergency measures taken over the previous six years were reconsidered.²² The new agreement is projected to add about €300 million (0.15 percent of GDP) to spending in 2016, mostly related to reversals of previously introduced net pay reductions and modest pay increases for the lower levels of the public sector, in return for agreement on industrial peace.

Despite six years of fiscal consolidation following the crisis, by 2015 public sector wage levels (9.7 percent) have only fallen back to 2005 levels (9.8 percent).²³ This lends further weight to the international experiences of the difficulty in introducing significant reductions in public sector wages. However, what was also unusual was the ability to get agreement on the need for wage reductions without significant industrial action by the public sector, something that was not as evident in other countries heavily affected by the effects of the economic crisis.

Reductions achieved resulted in the wage bill in the Irish public sector falling below the average of advanced economies (9.7 percent versus 10.2 percent) by 2015. The wage bill

²² Callen et al., 2010, and Kelley et al., 2009.

²³ The figures regarding public wages in the text and Figure 10 do not include pension levy contributions.

remains high (27.2 percent), as a percentage of overall public expenditure by advanced-country standards (24.5 percent) especially in an environment where gross government debt to remains higher than the advanced-country average.

Government employment levels as a percentage of the workforce also showed a sharp increase before the crisis, rising from 8.3 percent in 2000 to 11.6 percent by 2009. A

2008 OECD Report found that public sector employment rose by 30 percent between 1997 and 2005, albeit from a low base in comparison to other advanced economies (OECD, 2008). However, given relatively high levels of GDP growth at the time, this did not appear to be problematic as increases in government spending were rising at a slower pace than nominal GDP growth. Even at the height of the expansion of public sector employment (2009) Irish levels did not exceed the advanced-country average.

Since 2009, employment levels have fallen and remain below the average of advanced countries. There is no indication that a rapid increase in employment levels is envisaged over the medium term and therefore it is likely that Irish public employment levels will remain at the lower end of advanced countries.

C. Reform Challenges and Lessons

Looking forward, one challenge remains to ensure that wage increases reflect further improvements in productivity and greater flexibility. The recent election campaign focused on the availability of “fiscal space” owing to better than anticipated economic results (GDP growth is estimated at near 8 percent in 2015). However, fiscal vulnerabilities remain high with a relatively high debt to GDP ratio, and there appears to be limited room for significant increases in public pay. The recent “Lansdowne Road Agreement” was the first evidence of pressures emerging to reverse the consolidation measures taken since 2009. Most of the public sector pay agreements since 2009 have stressed the need for productivity gains. Difficult though it may prove, future collective agreements could continue this trend towards a more responsive and flexible public sector, including by maintaining a link between wage increases and productivity growth. In addition, it seems crucial to continue developing a performance orientation, beyond improving processes and toward achieving tangible results.

Over the longer term, comprehensive benchmarking exercises could help ensuring comparability of public and private sector pay. The 2002 benchmarking exercise was shown to have been flawed, as few of the recommendations on increasing pay were accompanied by compelling evidence, and little account appears to have been taken of nonwage pay such as pensions and greater job security. Future benchmarking exercises and reviews of public sector pay levels should take account of all factors that affect compensation levels. In addition, a comprehensive review of compensation could enhance the durability of the efforts made over the past few years, for example, by highlighting the groups for which wages remain below those in the private sector, and those for which these might remain substantially above.

JAMAICA

In Jamaica, the wage bill has been fluctuating around 10 percent of GDP for the past 15 years, with periods of sharp increases followed by sharp decreases, reflecting a pattern of persistent accumulation of wage arrears that are cleared every few years. A marked decline in the wage bill share in GDP since 2012 largely reflects efforts to contain wages and employment. In the medium term, one important goal is to maintain the wage bill at 9 percent of GDP.

A. Institutional Background

This report focuses on the budgetary government wage bill. This is reported in the budget, and comprises wage bill spending by central administrative units, executive agencies, and public bodies that are fully or partially funded by the Consolidated Fund. The resulting coverage is narrower than general government because local governments are excluded. Over two-thirds of public workers are in the health, education and security sectors.

Allowances count for a large share of compensation. About one-third of the wage bill is devoted to non-base pay allowances and bonuses. Almost half of this amount was attributable to nonrecurring allowances, paid mainly to teachers, doctors, nurses, and security officers—over . These include allowances regarding travel, overtime, meals, emergency duty by doctors and nurses, and books and software for teachers. Policies governing allowances seem to be subject to comparatively less scrutiny than the base wage.

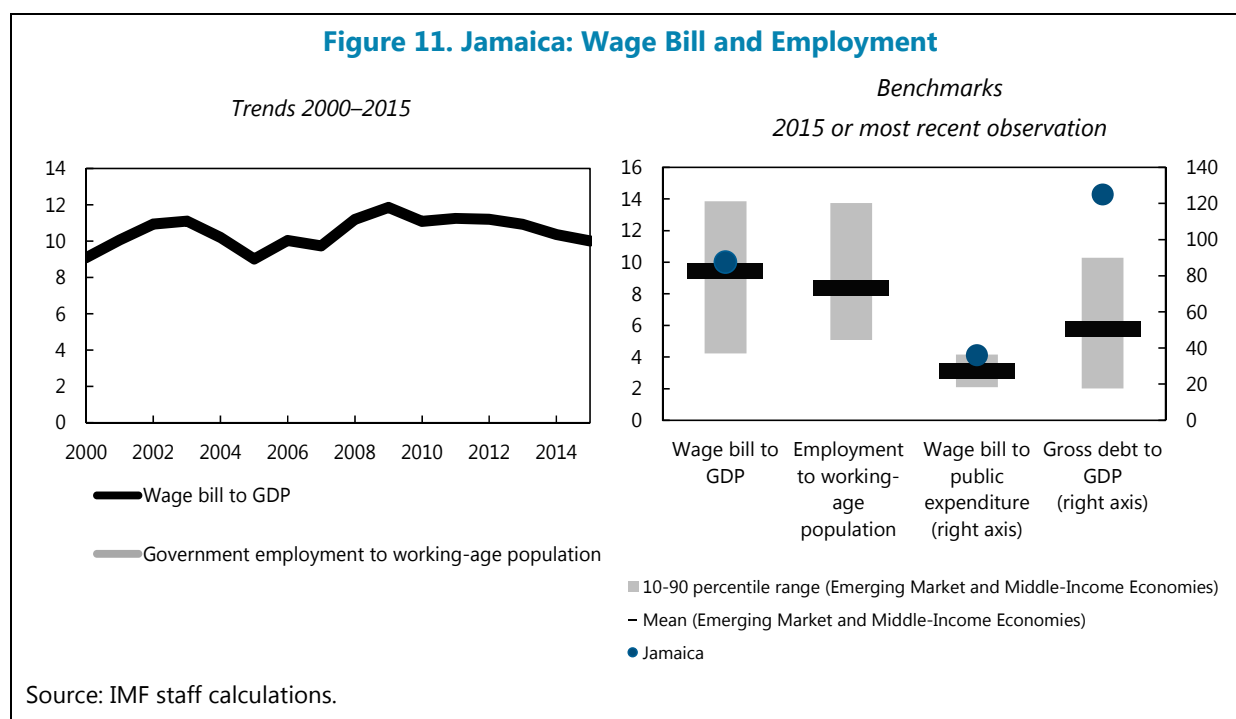
Contractual and temporary workers comprise a significant share of the government workforce. Such workers are not subject to the Civil Service Establishment Order and its related regulations, which protect the rest of government employees. The compensation paid to temporary and contractual workers constituted around 20 percent of the wage bill in 2015 (Table 3). Of these about 30 percent have contracts of less than one year. However, many temporary workers appear to perform essential duties: roughly 63 percent of the total wage bill for contractual workers is attributable to the health and education sectors.

Table 3. Jamaica: Government Employment by Contract Type

Category	Number of workers in percent of Total	Wage bill in percent of Total
Permanent	73.5	81.3
Temporary	20.3	12.2
Contract	5.8	6.4
Part Time	0.4	0.1
Total	100.0	100.0

B. Trends and issues

The public wage bill has been around 10 percent of GDP for the past 15 years, with a decline in recent years. The wage has shown subsequent periods of sharp increases followed by sharp decreases—the recent decline largely reflects a wage freeze (Figure 11). In part, the volatility reflects a pattern of persistent accumulation of wage arrears that are cleared every few years. Nevertheless, Jamaica’s wage bill is relatively high compared to other emerging economies (median 8.9 percent of GDP). Jamaica’s wage bill accounted for 52 percent of non-interest spending—the highest share in the region. This implies that the fiscal space for nonwage social transfers and capital spending has been severely compressed in Jamaica.



The public-private pay gap has been increasing. After accounting for the fact that government workers are, on average, more skilled and educated than are private workers, the premium has remained positive, increasing from 10 percent in October 2011 to 23 percent in October 2014. The premium is substantially higher for government workers with secondary education, estimated at 44 percent in 2014. Nevertheless, caution is warranted in light of an increase in the number of resignations among government employees in 2014/15, which might signal problems in recruiting and retention linked to pay—in the past, large numbers of professionals have migrated to OECD economies searching for better paying jobs (Mishra, 2006).

The wage bill for the education sector decreased slightly both relative to GDP and relative to the total government wage bill. The wage bill for education decreased steadily from 4.2 percent of GDP in 2011/12 to 3.6 percent of GDP in 2014/15. As a percent of the total government wage bill, the wage bill decreased slightly from 39 percent in 2011/12 to 38 percent in 2014/15. These

decreases resulted from reductions in the number of teachers as well as in average compensation for teachers in real terms. Nevertheless, average compensation for teachers grew by 13 percent during this period in nominal terms despite a wage freeze, likely reflecting reclassifications of base salaries and promotions.

The wage bill for public healthcare providers increased in recent years. The wage bill in the health sector has risen—both as a percent of GDP and as a share of the government wage bill—since 2012/13. This is attributable to a significant increase in the average compensation paid to doctors and nurses because of the reclassification of base salaries for doctors and nurses. This brought also concomitant increases in those allowances linked to base salaries. Doctors and nurses receive sizable allowances, ranging from 26 percent to a very high level of 60 percent of their total compensation. While some allowances are justified (e.g., incentives for relocation to remote areas), others only raise wage costs without improving the efficiency or equity of the healthcare system. Also, the large share of overtime paid to secondary care doctors is indicative of inefficiency, since overtime pay is about 25 percent more costly than providing medical services during normal working hours.

C. Reform Challenges and Lessons

The government has taken measures to reduce the wage bill over recent years. A wage freeze had been in place for 2010/11–2011/12. In March 2013, the government signed a wage agreement with the public sector unions for 2012/13–2014/15. The agreement recognized the government's wage bill target of 9 percent of GDP and agreed to a wage freeze during the period, with exceptions for promotions, "increments" (a 2.5 percent increase in base salary; while it is awarded conditional on performance, the current practice is such that essentially everybody receives the increment), and salary reclassifications agreed before March 2012 (including those for healthcare providers). The agreement for 2012/13–2014/15 expired in March 2015.

A policy has been established to require that the filling of vacated posts be reviewed and approved by the Post Operations Committee, a tripartite body represented by the Ministry of Finance and Planning, the Office of Services Commission, and public sector unions. Also, the Ministry of Education has made progress in rationalizing the number of teachers. Nevertheless, for some functions of the government, new posts have been created and headcounts have increased (e.g., tax administrators).

However, the recently signed two-year wage agreement for 2015/16–2016/17 reflects generous allowances agreed with the teachers' union as part of the current wage round. The agreement is signed with the Jamaica Confederation of Trade Unions, a confederation of 12 unions, and with the Jamaica Teachers' Association, covering the majority of public sector employees. The agreement envisaged a wage increase of 4 percent and 3 percent in 2015/2016 and 2016/2017, respectively. These were lower than most increases historically, partly reflecting the single-digit inflation levels during recent years. The wage bill is projected at 10.1 percent of GDP in FY2015/16.

Hiring restrictions during the past decade appear to have reduced the relative number of younger fulltime permanent workers. The number of workers aged 20–29 is about 40 percent of those aged 30–39. This has potentially serious long-term repercussions for the structure of the civil service labor force as the population ages. Because the compensation paid to younger workers is comparatively low and there is need to prevent aggravating future shortages among this cohort, measures to reduce employment should generally avoid targeting workers under the age of 30.

In the medium term, one goal is to maintain the wage bill at 9 percent of GDP, the authorities' medium term plan (stipulated in the 2015/16 Fiscal Policy Paper) aims to reach a wage bill of 9 percent of GDP by 2018/19. This will be part of systematic effort to modernize the public sector and contain government employment by enhancing efficiency through shared services, modernizing information technology (IT) resources to enhance oversight, prioritizing government functions and the associated employment, and beginning to modernize selected ministries.

KENYA

Public wage spending is relatively high in Kenya, crowding out social and infrastructure spending. The large wage bill mainly reflects high wages rather than high employment, and is the result of the absence of a clear and legally binding wage and remuneration policy. Public wages significantly exceed those of the private sector. The rolling out of decentralization in 2013 has also been adding to the challenges ahead. The authorities are in the process of designing a comprehensive set of reforms to help contain the wage bill and ensure its sustainability.

A. Institutional Background

Kenya's public sector lacks a transparent, unified, and harmonized framework for determining pay. Administrative reviews conducted by ad hoc taskforces, committees, and commissions to address these issues have proven ineffective. Government wage determination involves many institutions and processes. Collective bargaining agreements have created intermittent demands for sizeable wage increases for different sectors over the years.

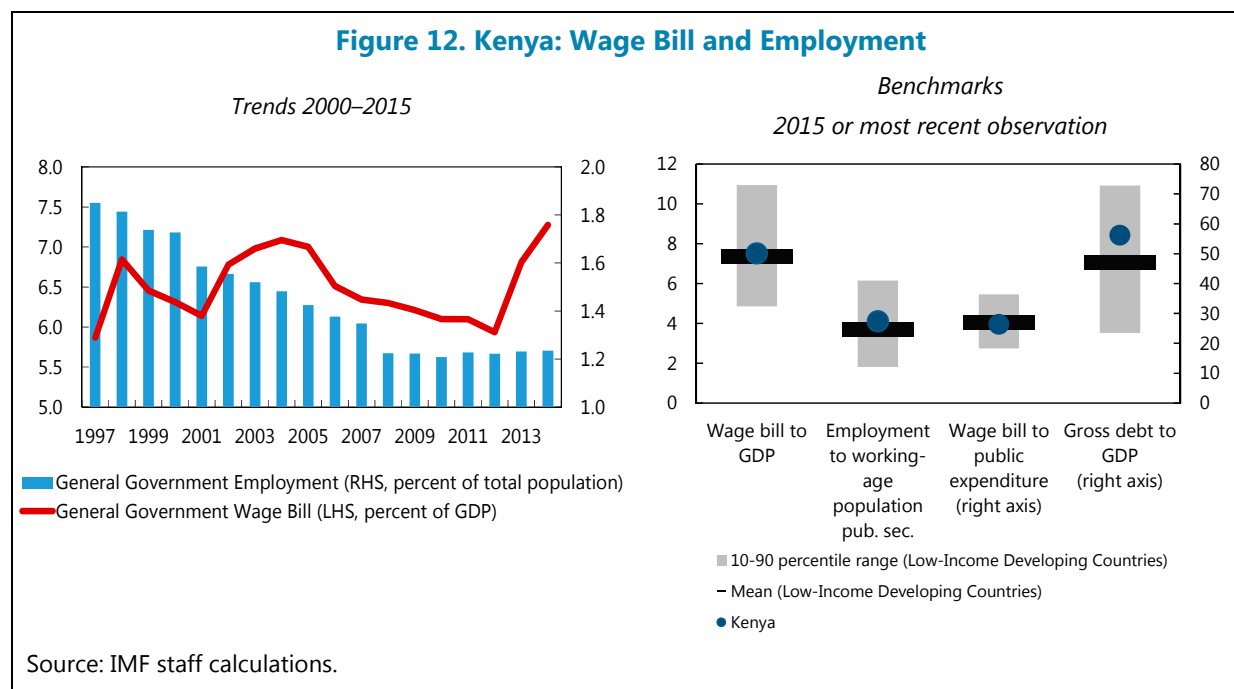
This non-unified existing remuneration structure has worsened wage disparities and inequalities across government subsectors. Performance appraisal is not used as a basis of base pay determination, but it is applied to bonus sharing and other non-permanent benefits, which different government sectors opt to advance to employees in their institutions. This has led to some job categories (higher and middle job cadres) in the civil service being entitled to more allowances than others, with individual incomes from allowances supplementing to a large extent the basic remuneration. This has contributed to inequalities in wages across job categories and across government subsectors.

Allowances are an important component of compensation. The proportion of allowances in gross salaries accounts for well over 50 percent across all job groups in the public sector. The bulk of these allowances (e.g., extraneous, acting, responsibility, special salary allowances) seem to accrue to public service employees that are at the highest end of the job scale.

B. Trends and Issues

The public wage bill in Kenya has been rising significantly in recent years, creating a risk to fiscal sustainability. General government wages stood at about 7.4 percent of GDP in FY 2013/14, an increase from 5.7 percent in FY 2009/10 (Figure 12), mainly owing to the rollout of decentralization in FY 2013/14, by which subnational governments were able to increase their wage

spending by 1.5 percent of GDP compared to 2011/12.²⁴ The general government wage bill is at about the LIDC average both as a share of GDP and relative to total public spending.



On average, public wages exceed their private comparators by about 20 percent. Wages are higher in the public sector, and the wage gap with the private sector has been widening in recent years (Figure 13). According to a 2013 study by the Salaries and Remuneration Commission and the Kenya Institute for Public Policy Research and Analysis, there exists a sizeable wage differential in Kenya in favor of public sector employees, even after accounting for differences in socioeconomic characteristics such as age, education, and experience, among other factors (KIPPRA, 2013).

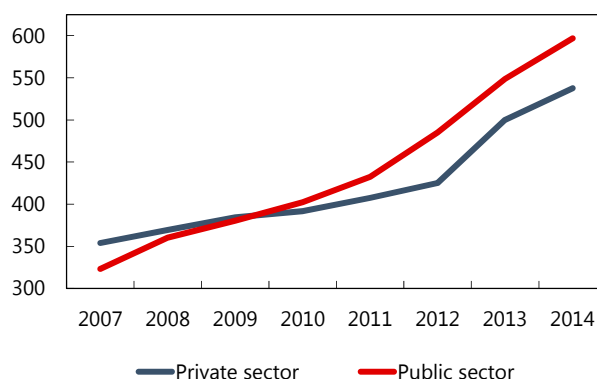
Decentralization challenges are further complicating the wage bill issues in the near term.

Spending by subnational governments increased substantially after the rollout of decentralization (Figure 14). Aside from transitional payroll complications between the subnational government and the central government, other decentralization related wage bill issues could potentially have negative implications on the general government wage bill in the medium term. First, subnational governments have embarked on an ambitious hiring process, with a cost estimated at about 0.8 percent of GDP in 2014/15. Second, former local authority staff and members of county assemblies have recently awarded themselves substantial wage increases. These challenges add to long-standing issues in rebalancing current and capital spending and containing the wage bill, and

²⁴ For consistency and comparability across years, general government is defined as the sum of budgetary central government and subnational governments (counties). However, Official Government Financial Statistics (GFS) statistics for general government finances were recently released for FY 2013/14 and suggest that the general government wage bill is potentially about 10 percent of GDP.

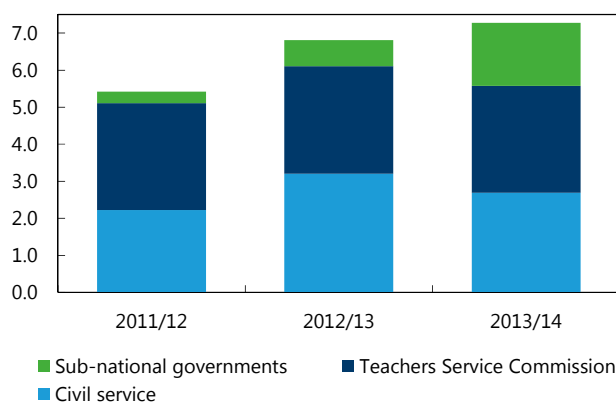
could—if left unaddressed—have negative implications on the general government wage bill and sustainability in the medium term.

Figure 13. Kenya: Average Earnings by Sector, 2008–2013
(Thousand of Kenyan Shillings)



Source: IMF staff calculations.

Figure 14. Kenya: General Government Wage Bill by Sector
(In percent of GDP)



Source: IMF staff calculations.

C. Reform Challenges and Lessons

The government in Kenya has attempted to implement reforms in the past, but these were derailed by a series of wage hikes over the years. The run-up to elections in 1997 marked the start of periodic pressures to increase wages and was accompanied by an ambitious wage agreement whereby teachers were awarded a 200 percent wage increase (spread over five years), while civil servants enjoyed an increase of 18 percent during that year. Between 2005 and 2009, a relative reduction in the wage bill took place (though mainly due to high GDP growth). However, a review and consolidation of allowances did not materialize as planned, different review bodies were

not harmonized, and ad hoc salary increases were revived. For instance, in 2012 the government approved pay hikes to its civil servants, with wage increases varying between 18 percent and 22 percent.

The authorities are developing a comprehensive public employment and compensation reform. They committed to addressing the high wage bill, engaging in a national debate and a social dialogue on the issue. While awaiting the enactment of a wage policy plan by the Salaries and Remuneration Commission, a hiring freeze has been put in place as a short-term measure. Furthermore, the Government is in the process of approving (expected in August 2016) a plan to continue implementation of the Capacity Assessment and Rationalization of the Public Service program, aiming at a significant rationalization of the public service to ensure public service delivery at national and subnational levels.

Going forward, it is essential to devising a wage policy plan that will help in putting the wage bill on a sustainable path. The wage policy plan and the ensuing policy measures should cover subnational governments as well, and the focus should be on the general government wage bill. This could include eliminating overlap and duplication across different government levels, tightening eligibility for allowances, and adopting a remuneration policy that is based on a wage grid that ensures comparability of salaries with the private sector (Clements and others, 2010). These measures should aim to eliminating inefficiencies, fostering transparency, and reducing the crowding out of private sector employment. These policy reforms should be implemented gradually and within the context of a social dialogue to ensure that they are sustained and not reversed over time.

KOSOVO

Since independence in 2008, government wages have grown almost three times faster than nominal GDP, while an expansion in government employment added to the pressure on the public wage bill. Wage hikes and additional hiring have tended to happen before elections. High government wages are affecting private labor costs and holding back competitiveness. To isolate the wage bill from the political cycle and ensure fiscal sustainability, a budget wage rule was introduced to limit the increase in the wage bill to no more than nominal GDP growth starting in 2018.

A. Institutional Background

The government is an important player in the labor market. The central and local governments provide almost a quarter of all jobs. In part, this reflects relatively low employment in the private sector—the employment to working-age population is 28 percent, reflecting low labor market participation rates (only 40 percent are economically active) and high unemployment rates (about 30 percent of the active are unemployed).

Government wages generate cost spillovers to the private sector. Following the increase of public sector wages in 2011, average private wage growth was more than 10 percent—among the highest in Europe—thereby undermining Kosovo’s competitiveness.²⁵ This is compounded by the widening of the gap between public and private sector wages over the last few years. The average public sector wage now exceeds the average private wage by more than 30 percent, making it difficult for the private sector to attract and retain competitive talent.

A newly introduced fiscal rule requires containing the wage bill. The fiscal rule prescribes a 2 percent deficit ceiling (with some escape clauses). The possibility of renewed increases in the public wage bill may undermine the credibility of the fiscal rule, in the sense that it may fuel expectations that the fiscal target will not be met in the future.

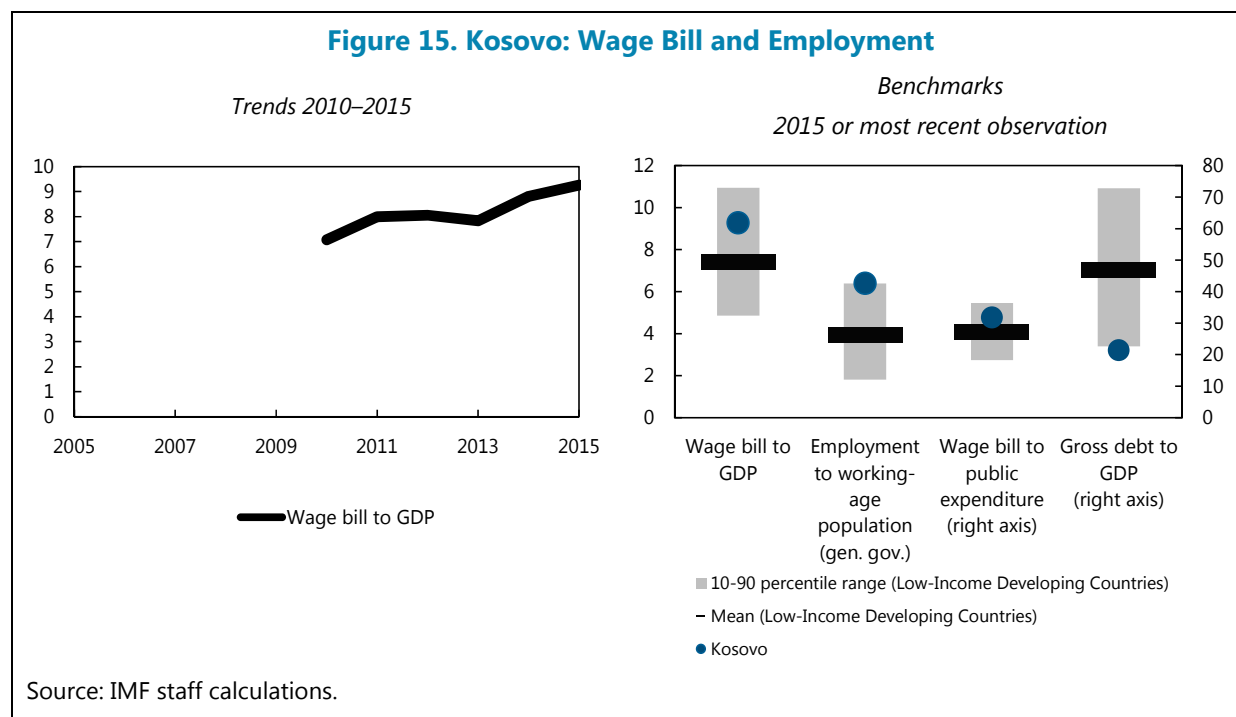
B. Trends and Issues

Significant increases of public wages before elections have led to unsustainable trends in the wage bill to GDP ratio. Before the 2011 elections, the government raised base wages (i.e., salaries excluding wage supplements) by 50 percent, resulting in an increase of the total wage bill of around 27 percent. In 2014, again before elections, the government implemented across-the-board salary increases of 25 percent without approval of parliament. All in all, the wage bill share in GDP increased by 2 percentage points in 2010–2015. Today, at nearly 9½ percent of GDP the wage bill is remains high compared to low-income economies, and slightly above the emerging Europe average of 9 percent of GDP (Figure 15).

²⁵ Kosovo’s average wage adjusted by a proxy for productivity was among the highest in Europe in 2011 reflecting low levels of competitiveness.

To a lesser extent, increased hiring in pre-election periods has also pushed up the wage bill.

Between January 2010 and November 2014, the increase in overall employment by the central and local governments amounted to about 5,100 staff. Almost 4,500 additional employees (equaling 85 percent of this increase) were before the 2010 and 2014 elections. In fairness, the increase in the number of civil servants partly reflects the creation of new institutions and the transfer of competencies from international organizations to the authorities of Kosovo.



C. Reform Challenges and Lessons

A recently agreed on public wage bill rule will significantly decelerate this trend by linking the public wage bill to economic developments. The rule will not go into effect until 2018, as the public wage bill for 2016 and 2017 will be governed by fiscal targets under the current Stand-By Arrangement. Specifically, the rule allows the public wage bill to grow by up to nominal GDP growth. By covering the total wage bill of central and local governments, the rule encompasses the aggregate that matters for fiscal sustainability, without “micromanaging” individual categories of wages, the trade-off between wages and employment, nor that between wage and non-wage compensation. To provide some flexibility in the event of a cyclical recession, the rule allows for the wage bill to increase by up to 0.5 percent when nominal GDP grows by less than 0.5 percent. However, in such circumstances, the wage rule requires the ratio of the wage bill to nominal GDP to revert back to its pre-increase level within three years, starting in the fiscal year in which nominal GDP growth exceeds 0.5 percent; this is to avoid permanent increases in the ratio of the wage bill to nominal GDP.

As designed, the wage bill rule is not perfect, but it is better than other potential rules-based alternatives. The approved rule will use the annual growth rate of nominal GDP of the latest calendar year for which data are available by the time of budget preparation. While this implies that changes in nominal GDP translate into caps of the public sector wage bill with a considerable lag, nominal GDP growth forecasts (a possible alternative) are subject to larger revisions, and they might introduce a stronger degree of pro-cyclicality in the public wage bill. In addition, using such forecasts as part of the wage rule could potentially politicize the forecasts. Finally, note that there are no data on public sector productivity or even aggregate productivity, and using inflation or real growth instead of nominal GDP growth as a cap would imply that the public wage bill continuously falls as a share of nominal GDP, which is politically unrealistic. Hence, past nominal GDP is the best among a range of imperfect indicators.

The wage rule will entail a sharp deceleration in public sector wage dynamics relative to those in the past, and will ensure Kosovo's wage bill to GDP stays within the levels of regional comparators. With nominal GDP growth expected in the 5–6 percent range in the medium term, the rule will involve a significant deceleration in wage growth relative to historical trends. It should also be noted that, following two years of consecutive nominal wage freezes in the program, the wage bill-to-GDP ratio is expected to fall to around 9 percent in 2017, at about the average of countries in emerging Europe.

MALAYSIA

Over the past five years, government spending on the wage bill has been increasing, although it is still below the mean for emerging economies. The wage bill is a large part of operating expenses, and the government aims to reduce its fiscal deficit over the medium term by restraining operating expenditures. The government is seeking to address the following reform challenges: (1) improving forecasting, budgeting, planning, and expenditure control of the wage bill, especially within spending ministries; (2) rebalancing the highly centralized human resource management system to provide spending ministries, within central guidelines, with more flexibility over staff management to enable them to achieve the government's performance goals.

A. Institutional Background

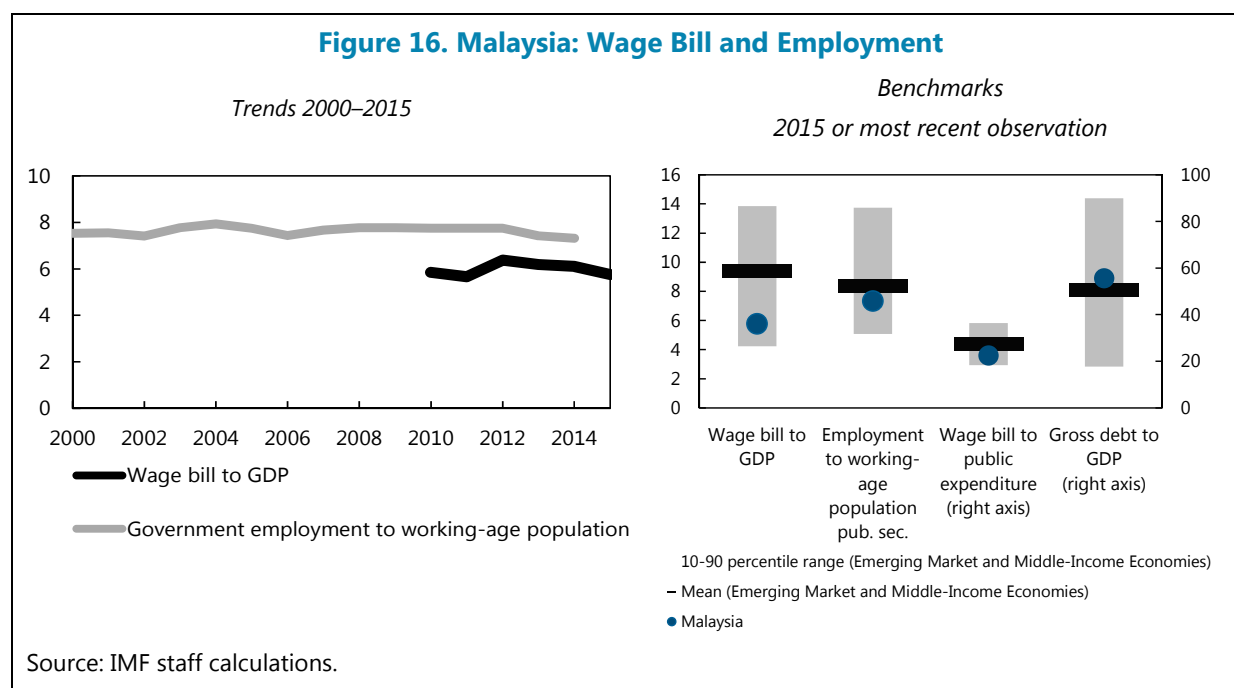
The Public Service Department (PSD) is responsible for human resource management, employment planning, and setting base wage increases. This department oversees 28 schemes of service, including the federal public service, the state public services, the joint public services, the education service, the judiciary, the legal service, the police and armed forces. The system is highly centralized with PSD controlling recruitment, placement, promotion, and the reallocation of staff within and across ministries except for the military, police, judiciary, and a few other specialized areas. There is only limited delegation to spending ministries in these areas.

Malaysia has a civil service system that combines recruitment based on merit and open competition with life tenure. Promotions are handled by an independent promotion board, largely based on merit, with formal examinations at various stages. There is a guideline on personnel rotation, which states that every three-to-five-years civil servants may go through job rotation. Salaries are considered competitive, particularly at entry levels. There is a common matrix of salaries according to specific categories and no variable remuneration in any category, but some allowances depend on locality and nature of the job. Allowances make up between 11 and 20 percent of the total wage bill. There is no performance related pay, and wage progression is automatic within wage scales. Although there are major restrictions, government employees do have the right to organize into trade unions and do engage in centralized collective pay negotiations on an ad hoc basis as required. There are also major restrictions on the right to strike.

In contrast to human resource management, ministries currently have considerable flexibility over their approved budget. Negotiations on wage increases are ongoing throughout the year without direct links to the budget process. The actual agreed wage increases are included in the approved budget, however bonuses are not, and are generally for all civil servants. It has proven challenging, for some ministries to stay within their allocated budgets. This reflects under-budgeting by ministries of personnel expenses, limitations in budget planning and personnel forecasting, and the tendency to introduce new unplanned policies during the course of the year. These new policies result in additional financial requests to the Ministry of Finance (MoF) and to PSD for new posts.

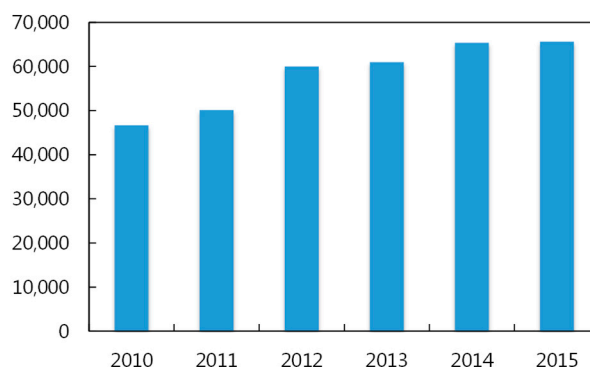
B. Trends and Issues

Since 2008, the wage bill has increased by 0.9 percentage points, reaching 6.2 percent of GDP in 2014 (5.8 percent of GDP in 2011). Malaysia is a high middle income country that in recent years has been growing at about 6 percent, with low inflation and low unemployment that has also been reducing its federal budget deficit to close to 3 percent of GDP. Wages account for a significant share of government expenditure, estimated at 20.4 percent in 2014. The personnel budget has increased in recent years, as the size of the government service has expanded and automatic pay raises have taken effect. This has medium-term implications, as growth in the civil service numbers or significant adjustments in pay scales, not only have an immediate impact on the budget through a higher wage bill but also long-term implications through higher pension liabilities.



Operational expenditures (most of which are personnel costs) have continued to increase as a proportion of total spending as investment spending has fallen. There has been overspending on wages, and salaries ranged from 10 to 26 percent relative to the original budget during 2006-12, averaging 15½ percent in that period. Wage bill overruns have occurred due to bonuses made available in supplementary budgets and also overspending by some ministries.

Figure 17. Malaysia: Trends in Federal Level Personnel Emoluments
(Millions Ringgit)



Source: IMF staff calculations.

C. Reform Challenges and Lessons

The government's major reform challenges are improving control over the wage bill while enhancing the capacity of ministries to achieve results within expenditure limits. The wage bill has been routinely overspent, highlighting the need to change incentives for ministries and to improve budget planning, forecasting, and information systems. Ministries have incentives to underestimate personnel costs and to reallocate funds to other programs knowing the government is required by law to cover all wages. The human resource management information system and payroll management system do not provide timely information or prevent or control overspending. This combined with a large number of service schemes and allowances make it difficult to accurately project wage bill growth in the current year and over the medium term.

The centralized system for civil service management is not sufficiently agile to focus on the localized skills needed by ministries to achieve governmental outcome priorities. It is important in any system to balance the need for central management of cross-cutting civil service policy and management (pensions, employment terms and conditions, training programs) with ministries' flexibility to recruit, reallocate, and reward civil servants. Increasing flexibility, within central guidelines would enable ministries to implement reforms to improve performance and efficiency including linking resources to outcomes, incentivizing performance, transferring staff positions, and undertaking ministry reorganization.

Malaysia has introduced a number of reform initiatives to improve government performance. As part of the government's 2020 vision, it has introduced the Government Transformation Programme, the Economic Transformation Programme, and Outcome Based Budgeting, which aim to improve the government's capacity to achieve key results and outcomes.

To address the challenges in wage management, PSD plans to introduce a new forecasting model to better project personnel costs, and to provide line ministries with better flexibility in managing their staff. Previously there have been initiatives to improve performance, including

efforts to link productivity to the wage increases and the introduction of a competency assessment performance management tool to assess skills and attributes before promotion. Other changes include the introduction of a minimum wage two years ago, and the government is currently implementing measures to restrict wage growth mainly focused on not filling vacant posts. Also attempts have been made to link pay and performance. Despite these changes there is a disconnect between the reward structure and performance, and annual bonuses are awarded centrally to all civil servants without regard to specific performance of ministries or staff.

Malaysia has undertaken some promising reform initiatives, but many challenges remain.

Many reforms remain to be fully implemented, including accurate forecasting and management of the wage bill and allowing flexibility in personnel planning and management.

MALI

Mali has largely stayed within the WAEMU rule and contained government wages under 35 percent of domestic tax revenue. However, structural reforms have been difficult to implement and have encountered strong resistance from the career civil service and unions. Endeavours to modernize the public sector have stalled, leaving the following challenges: (i) the decentralization of functions to the regions requires a large-scale transfer of staff from central to sub-national governments; (ii) to modernize the civil service to meet citizens needs it is important to move towards a more focused and skilled workforce.

A. Institutional Background

This case study focuses only on central government (CG) employees' wages covered by the state budget. In 2015, compensation for employees amounted to one-fifth of CG expenses and one-third of budgetary revenue (grants not included). Sub-national governments (761 SNGs) and state-owned agencies (more than 100 SOEs) report their employees' wages in their own budgets. The CG employs about 40,000 staff (including CG local branches) and SNGs employ a similar number. There are no consolidated data on staff employed by the SOEs.

Responsibilities for wage bill management are split between the Ministry of Finance and the Civil Service Department (CSD). The budget department of the MoF forecasts wage bill costs and manages the payroll. The CSD manages the employment framework including the recruitment policy and wage setting for the CG and SNGs with the exception of the military, security staff, justice, and contractual employees. The Department of Security sets its own recruitment targets and pay wages through its own system. Spending ministries have limited control over wages and human resource management,

Budget ceilings have largely been in line with medium-term projections and fiscal targets, but weak institutional arrangements affect the credibility of wage planning. Three-year forecasts are sent to parliament for pre-budget debate, and budget ceilings are set accordingly. However, the credibility of these forecasts is hindered by ad hoc wage negotiations. Pay agreements cover base pay, bonuses and allowances, and working conditions. Decisions on wage increases are often made with little consideration of the budget process. Pay adjustments decided before the budget submission are included in the budget; those that come afterwards must be accommodated in a supplemental budget. Wage expenditure cannot exceed approved primary budget ceilings unless a supplementary budget is issued, and budget reallocation through virements is limited, which has helped ensure fiscal discipline.

CG payroll management has ensured wages are paid on time, however there are pervasive gaps between payroll and personnel lists. Wages have been paid without major delays or disruptions in the past five years, marked by social tensions and severe government liquidity constraints (including droughts in 2011, civil strife, and a military coup, followed by a suspension of

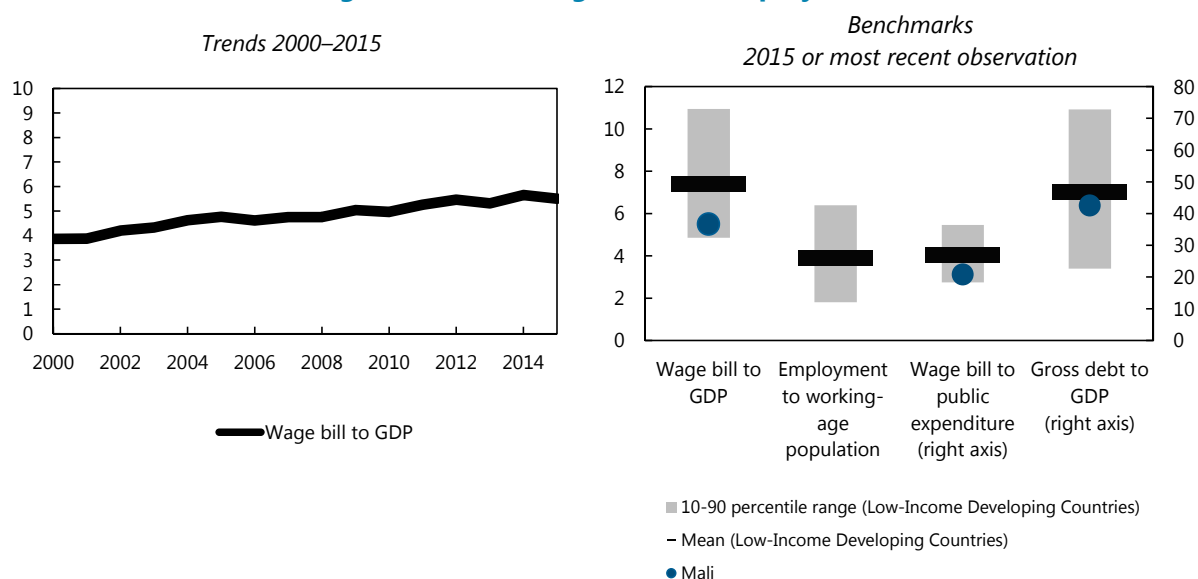
external financing in 2012). This outcome reflects a simple robust system of centralized payment for all civil servants and efforts made by the MOF to mobilize funds to properly cover wage expenditure. The reconciliation of payroll with personnel records is done only on an irregular basis. There have been delays in updating personnel lists (e.g., recruitment, promotion, retirement) and reflecting this in the payroll. As of 2015, a significant number of payments to new hires and promoted employees were overdue. In the same vein, a 2015 census identified ghost workers (e.g., departed or retired employees unduly paid under the system).

Mali has a career-based employment system with life tenure. A common set of rules applies to the whole public sector, most recruitments are carried out through open competition, and assessments of performance are conducted on a yearly basis. In practice, performance has little impact on government employees' salaries and careers. They benefit from automatic progression mechanisms within their grade level. In addition to their base pay, civil servants receive bonuses and allowances. Allowances and bonuses make up approximately 20 percent of the wage bill. Management of staff employed on a contractual basis is more flexible. Civilian government employees have the right to organize into unions and to strike. In the past few years unions have significantly influenced government decisions on bonuses and wage increases. In the past five years, contractual employees' salaries accounted for one-third of the central government payroll. This ratio, however, has steadily increased from 29 percent in 2011 to 41 percent (in 2015).

B. Trends and Issues

The wage bill has steadily increased over the years. The government wage bill increased by nearly 1½ percentage points of GDP in 2000–2015. The underlying causes of this steady rise are increasing recruitment in priority areas, and noticeable increases in base pay and allowances per capita in the years following presidential elections. While Mali has kept its wage bill under the WAEMU average for spending per domestic tax, there are non-trivial compensation payments to civil servants (e.g., incentives for tax and customs inspectors) that are not properly recorded and are not considered part of the wage bill—a feature that is far from good practice.

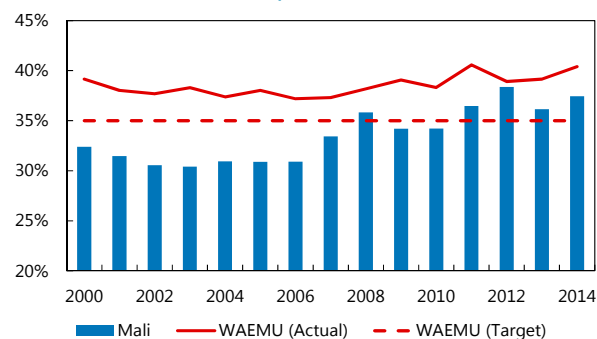
The increase in CG wages has come at the detriment of other growth friendly expenditure. The wage bill and the numbers of employees have stabilized at a slow but steady growth over the past five years even though Mali faced tremendous shocks. To sustain the wage bill at the same level when revenue dropped, the government had to reallocate funds from capital spending to the wage bill.

Figure 18. Mali: Wage Bill and Employment

Source: IMF staff and Mali Government Finance Statistics.

Figure 19. Mali: Wage/Taxes, Regional Comparison

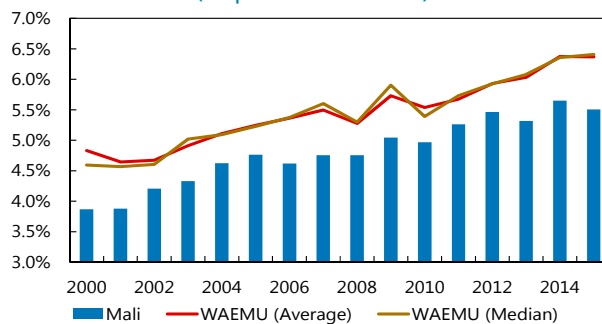
(In percent)



Sources: IMF staff and Mali Government Finance Statistics.

Figure 20. Mali: Wage/GDP, Regional Comparison

(In percent of GDP)



Sources: IMF staff and Mali Government Finance Statistics.

C. Reform Challenges and Lessons

The civil service has yet to transition from a low-skill and low-wage employment system to a modern, smaller, and more decentralized workforce. Challenges ahead are (i) stepping up the administrative capacity of government staff through competitive recruitment, education and training, and incentives; (ii) improving SNGs' staff capacity to manage the upcoming phase of enhanced decentralization; and (iii) finishing the decentralization of human resource management to line ministries.

The government has made a few attempts at reform including better linkage of employees' performance with their wages. In 2015, it attempted, but failed, to reform financial incentives for staff from the tax and customs departments. The civil service department is trying to better monitor its workforce, starting with staff numbers. There is a medium term plan to manage jobs and competencies but it is now outdated. In 2014 the civil service kicked off a count of the staff security forces and a cross-department census covering the whole civil service. As of 2016 the outcomes of the staff census were not disclosed.

Vigorous resistance has largely stalled policy reforms on human resources management. Underlying causes of this noticeable standoff in reforms are the rigidity in government employee management, the weight of unions, and the relatively stable demographics of government employees.

The government needs to set a reliable and transparent medium-term job and competencies plan, encompassing the whole public sector. This planning should start from a stock taking of government employees and an employment framework compatible with the Mali medium-term strategy for development. A significant effort in human resource (HR) management is needed, especially given the ongoing decentralization. SNGs' and SOEs' HR management needs to step up and keep, or bring back, hiring policies in line with central and local revenue.

Modernizing the civil service legal framework ("*code de la fonction publique*") would be major progress. This framework may be seen either as an impediment (if left unchanged) or a leverage (if the government explores all available opportunities) to create a better dynamic in careers, reduce the civil service fragmentation in multiple bodies and its related inequities, and promote performance. Given strong resistance to change, the government should steadily implement this reform over the long run.

The wage bill sustainability partly depends on continued efforts to step-up government revenue. In line with WAEMU targets for domestic revenue (i.e., 20 percent of GDP), revenue collection should improve at all levels, particularly in SNGs, to sustain the slow but steady increase of the wage bill without crowding out other growth friendly spending.

MOLDOVA

The wage bill remains relatively high at 9 percent of GDP, even after a gradual retrenchment in employment since the mid 2000s. Government employment still appears to be at relatively high levels; however, pay appears low relative to the private sector. Ad-hoc adjustments in wages seem to coincide with the electoral calendar. An important challenge is to maintain an affordable wage bill while ensuring service delivery. Efforts to optimize the educational system to address changing demographics seem crucial to this end.

A. Institutional Background

The public sector in Moldova comprises central and local governments, health and social security funds, and state-owned enterprises. The central administration includes the president's office, state chancellery, 16 ministries, various agencies, commissions, academies, and judicial institutions. Local governments administer civil service functions for 35 territorial regions. The public wage bill is defined as the sum of budget spending on wages and salaries of public sector employees in the general government—i.e., public sector employees who are compensated directly from central and local budgets (excluding state-owned enterprises (SOEs), and some health care providers that are compensated from the health fund itself).

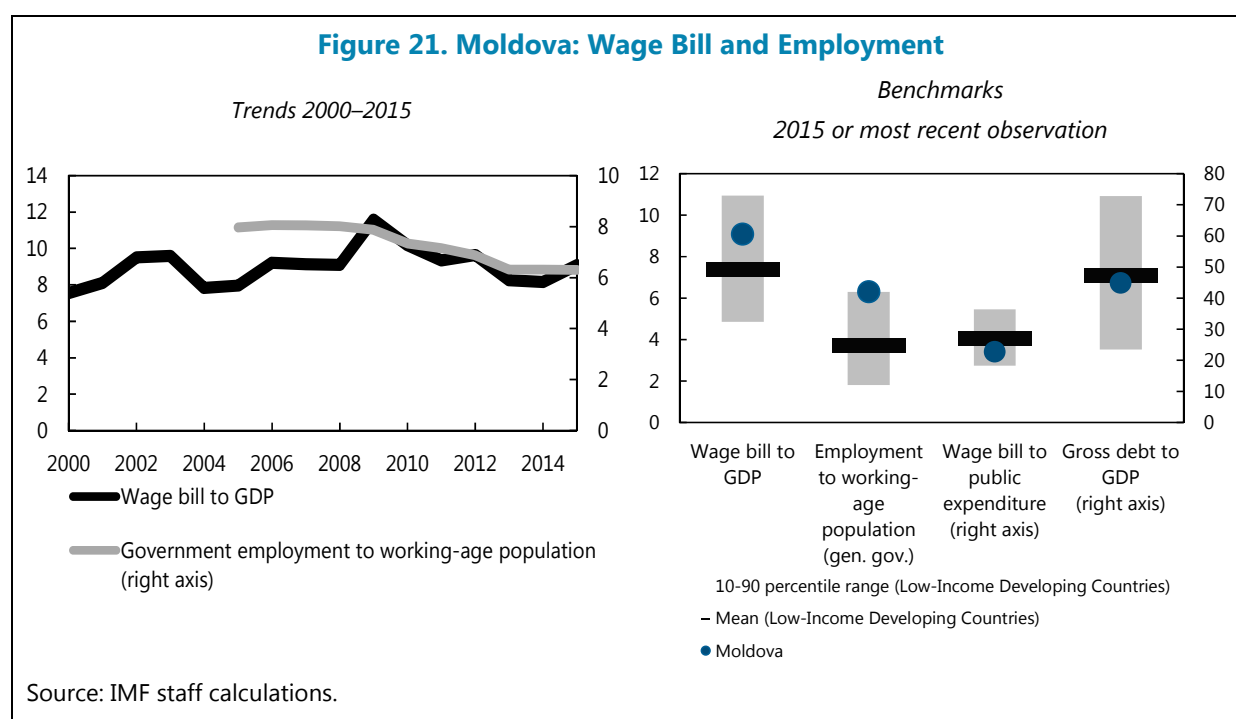
Public sector employees are divided into civil servants and public servants. Civil servants include staff of ministries and local governments. Public servants include for example administrative staff, teachers, health care providers (compensated from central and local budgets), and non-ranked police and military officers. Employment in education (both teachers and non-teaching staff) is sizeable and makes up more than half of the total public sector employment.

Total remuneration of civil servants consists of three components: basic pay related to grade, supplements, and bonuses. In 2011, the basic salary accounted for about 40 percent of total pay, on average. It is determined according to occupation, grade, and years of service. The variable component comprises the rest and has been the main source of ad hoc increases.²⁶ Supplements can be related to the employee's education, specific skills, workplace, or specific tasks/activities, while bonuses are performance related. Civil servants are also entitled to receive material aid on an annual basis, equivalent to a month's salary inclusive of supplements and performance bonus.

²⁶ In 2011, bonuses were 25 and 50 percent of the basic salaries for most positions among civil servants and service personnel/technical staff, respectively. Supplements for qualification/degree were a fixed amount, while other kinds of supplements ranged from 30 to 50 percent of basic salaries. This resulted in basic salaries being about 40 percent of the total monthly compensation for civil servants.

B. Trends and Issues

The total wage bill increased significantly 2004-2009 and 2014-2015. After a decline in 2004 related to reclassification of employees from the general government to public enterprises, the wage bill jumped sharply in 2006 driven by the phased-in implementation of a law aimed at simplifying budget sector wages, and in 2009 due to wage increases in the run-up to the parliamentary elections.²⁷ The wage bill declined in 2009-2014, before jumping back to nearly 9 percent of GDP in 2015 reflecting wage adjustments from election promises—as observed in earlier years, reform efforts were weakened during pre-election periods. This is largely explained by ad hoc wage increases (especially for military members, teachers, and non-teaching staff) granted ahead of the 2014 election. In contrast, government employment has been on a declining trend since 2007, largely reflecting a decline in the educational sector, which seems to explain the recent decline in the wage to GDP ratio (Figure 21). Nevertheless, at nearly 9 percent of GDP in 2015, Moldova's total wage bill exceeds other developing countries. The gap appears to be related by the relatively high levels of government employment, even after the reduction observed over the past decade.



Government pay is low relative to the private sector. Average government wages increased from slightly above 60 percent of average manufacturing sector wages in 2005 to around 90 percent in

²⁷ The law on the wage system in the public sector (Law No. 355) was implemented in 2006 with the objective of re-establishing order in the budget sector wage structure that had become internally inconsistent through years of ad hoc increases for individual sectors (Moldova, Republic of, 2005).

2009 (Figure 22).²⁸ However, there remain large inequalities within institutions (e.g., between support and skilled employees), and between sectors (education, health, and social insurance seem to have particularly low wages).

Figure 22. Moldova: Remuneration of the Government Relative to the Private Sector (Ratio)



Source: Moldovan authorities, and IMF World Economic Outlook (WEO).

C. Reform Challenges and Lessons

The reforms on the public wage bill and employment in Moldova were initiated at end-2009 and continued through 2012. Short-term measures to contain the total wage bill were implemented in 2010 and 2011. They included postponing the planned wage increases, freezing budgetary sector employment, and cutting permanently vacant staff positions. As part of the civil service reform, new job functions and responsibilities were set for staff in public administration. Subsequently, merit-based promotions and basic salary increases became more formalised in early 2012.²⁹ However, in practice, they have not been transparent due to a lack of clarity on the performance criteria, discretion in awarding promotions and pay increases, as well as the absence of systematic prior or post review of salary levels. Furthermore, the large variable component remains a potential source of ad hoc increases.

The authorities also took specific measures in the education sector, but a more comprehensive structural reform was implemented with delay. Because of exacerbated fiscal pressures, short-term measures such as a hiring freeze, a ceiling on the wage bill and employment, the elimination of permanent vacancies, and the enforcement of mandatory retirement were adopted—specifically in the education sector—in 2010 and 2011. Base wage increases for teachers were postponed to 2012. However, the reforms aimed at optimising the class and school network

²⁸ Since the average educational attainment of public employees has been higher than that of private sector workers, this ratio may be lower than observed when controlling for human capital (at least for skilled workers).

²⁹ The new law on wages of civil servants (Law No. 48) was implemented in March 2012 (Moldova, Republic of, 2012).

were implemented with delay and amid high resistance.³⁰ This resistance arose owing to a decrease in the number of classes and a worsening of access, especially in rural areas. The structural reforms in the education sector involved not only class and school network optimisation but also a transition towards a per-student financing system. As part of the fiscal decentralisation process, a per-student financing system was piloted in a few municipalities (rayons) in 2011–2012 and was implemented nationwide in 2013.³¹ This system was expected to create strong incentives to optimise schools' financial allocation and to further rationalise the school network, while ensuring access of students to quality education.

The cost of the civil service reform was not trivial. While being lower than the 2009 peak, the total wage bill in 2012 was 0.3 percentage points of GDP higher than the 2011 level. This is partly because the reform required salary adjustment for junior specialists (to make civil servant positions more attractive for young people) as well as support for persons previously poorly remunerated. The design of the pay structure should therefore be calibrated to avoid an increase in the total wage bill. Another reason for the increase in the total wage bill was that wage policies delayed from end-2009 were gradually resumed.

The education sector reforms resulted in a significantly lower number of teacher and non-teaching staff, but this is not sufficient to match the declining school-age population. The student-teacher ratio is still relatively low (Table 4), and local school districts do not have autonomy in employment decisions. At the same time, this low student-teacher ratio does not translate into better education outcomes. Furthermore, fears of losing access have caused resistance against the school network rationalisation. Structural reforms related to the school network should therefore be complemented with infrastructure development to ensure access to education for all children.

Table 4. Moldova: Student-Teacher Ratio and Average School Size

	1991	2001	2005	2006	2011	2012	2013
Student-teacher ratio	13.8	14.5	12.3	11.9	10.5	10.7	11
Average school size	437	381	319	300	260		256

Source: World Bank, 2015.

The structural reform efforts in the education sector were partially hindered by pressures from the outsized teachers' union. The Education and Science Trade Union of Moldova has about 120,000 members, which is substantial for a country of 3.5 million people. Their persistent demands for wage increases have played a significant role in the recent teachers' annual bonus and wage increase of 20 percent in 2014–2015.

³⁰ In close cooperation with the World Bank, this reform is part of the broader structural reform agenda to bring education spending to a fiscally sustainable level ("Action Plan for Education Structural Reform Implementation").

³¹ Prior to 2011, the system of education financing in Moldova was input-based. That is, funding for salaries was determined by the number of staff positions and/or class size. As a result, as the number of students declined, the student-teacher ratio fell and the per-student cost increased.

Non-structural reforms can contain the size of the public wage bill only in the short run. While these short-term measures yielded budgetary savings in 2010–2011, they could not guarantee a sustainable level of the total wage bill in the longer term. The trend reversed, partially because of the resumption of the planned wage increases and the end of the hiring freeze in some sectors. Furthermore, a strong political will is important for the reforms to succeed. As observed in Moldova, most of the reform efforts have been weakened during pre-election periods, resulting in a reversal of the trend in the total wage bill and public employment.

The implementation of structural reforms can be lacking and may require some complementary measures to improve access to public services. In Moldova, most of the reforms have been short-term, and it has been more difficult to implement structural reforms. First, the cost of making the public wage system more transparent and merit based can be substantial. Second, the structural reform may have to be implemented with infrastructure development to ensure access to public services. For example, to promote efficiency in the education sector, a clear distinction should be made between schools that should be optimised without impairing access and schools that should not be optimised because it would impair access. In addition, communication with communities to identify needs as well as addressing concerns about worsening access to public services could help smooth the implementation process.

NETHERLANDS

The Netherlands has a long history of public and private wage containment. Decades-long experience has shown that a sustainable development of the wage bill is only possible in coordination with wage development in the private sector or when structural measures are taken in attrition and employment. Depending on the economic conjuncture, public wages return after a wage freeze to their previous equilibrium value in three to four years. By contrast, a policy measure on private wages has a permanent effect on both private and public wages. Therefore although the government was successful in containing the wage bill in the short term through wage freezes and cuts, structural measures are needed to contain the wage bill in the medium and long term.

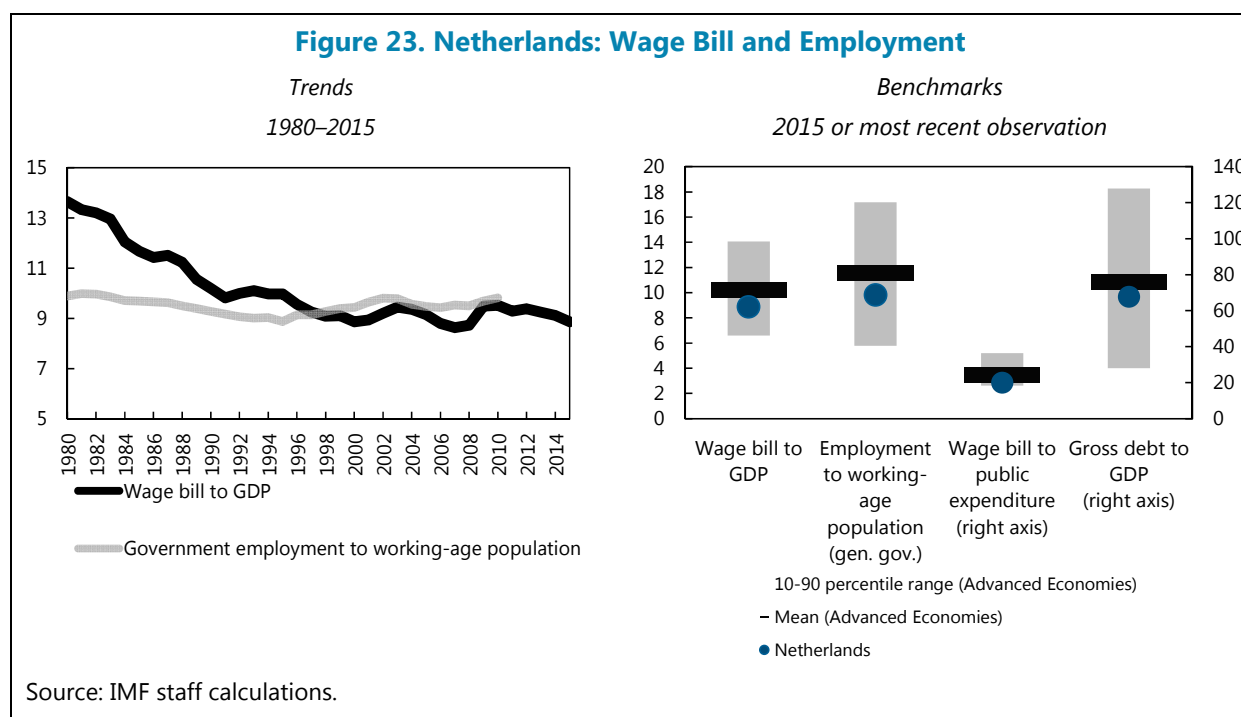
A. Institutional Background

This case study focuses on the experiences of the Dutch general government in managing the wage bill. This includes all ministries, defense, judiciary, police, education, and the public health care system. The public wage setting is based on the so-called “sectorenmodel”, whereby wage negotiations are held separately in each sector, with the ministers directly involved in the wage negotiations. The exception is the health care sector, which is separately regulated through the so-called “OVA-covenant”. The government does not participate in the negotiations for the health care sector and has therefore less impact on the wage setting in this sector.

The government wage envelope is determined by a reference system that takes into account the evolution of wages and labor costs in the private sector. The reference system takes into account the sum of the contract wage increases in the market, social premiums, and a budgeted salary increase. However, although the reference system forms the basis of the negotiations, the government can decide to temporarily deviate from this system. In the past, the government deviated for consolidation or labor market reasons. The OVA covenant for the health care system has a comparable reference system.

B. Trends and Issues

After a steady decline from 13½ to 9 percent of GDP in 1980–2000, the wage bill has hovered around 9 percent of GDP (Figure 23). The high level of the wage bill in the 1980s reflected relatively high wages that failed to adjust to a negative terms-of-trade shock and the increased number of civil servants in the period before. After reaching a nearly unsustainable level, the focus was on containing wages while maintaining the growth of employment in line with the working-age population. To this end, the government started a long period of wage freezes and cuts that ended in the late 1980s. During the early period, the discussions with the unions were often heated—1983 was characterized by the long public strikes, which ended with the court decisions that revoked “the right to strike for such a long period”.



Government employment has been stable, and its composition has been gradually shifting toward health care. While government employment remained slightly under 10 percent of the working-age population, an important compositional change in employment by sector has taken place in the past 15 years. The share of employment in health care increased sharply—the number of employees in health care increased by about 45 percent in the past decade—reflecting higher demand for health care, largely related to population ageing. Thus far, this has been offset by retrenchments in other sectors, including reductions in the central government, local governments, and education. Overall, the number of employees in the general government was reduced by 7 percent in 2006–2011. Excluding priority areas, the reduction in employment reached 10 percent. The size of the ministries was reduced, and ministries with overlapping functions were merged.

Salaries for employees working in public administration are on average higher than in the private sector, while salaries in education and health care sectors are lower. Differences in public and private sector compensation largely reflect differences in the characteristics of employees, including education level and years of experience. Employees in the public sector are on average better educated, older, and more often employed on fixed-term contracts. The percentage of women is also higher in the public sector. Salaries seem to be more compressed in the private sector—while younger, low-skilled workers might be better paid in the public sector, the gap disappears with age and skills level.

C. Reform Challenges and Lessons

Reforms have helped to contain the growth of the wage bill. In the past 15 years, the wage bill as a share of GDP has fluctuated, with pressures being relatively quickly abated with reforms. For

example, following an increase in the wage bill to GDP of about 0.6 percentage points in 2000–2003 the government introduced a wage freeze in 2004/05. A large scale package was launched with attrition cuts of 1 and 2 percent respectively in 2006 and 2007 for the general government, and all related agencies and institutions (except for customs and police sectors). The ministries were also mandated to decrease the hiring of short-term experts. In part due to these adjustments, the wage bill to GDP fell back to its 2000 level by 2007. Furthermore, following the 2009 global financial crisis, the wage bill increased sharply, from 8.7 to 9.5 percent of GDP in 2008–2010. As a consequence, the Dutch government implemented in 2010 an ambitious fiscal consolidation package, including a wage freeze for the public sector. With relatively low inflation levels, this had only a small impact. Two years later, the government announced another fiscal consolidation package including additional wage freezes for 2012–2014 and reductions in employment by attrition. By 2015, the wage bill declined to under 9 percent of GDP.

Beyond fiscal concerns, reforms have also aimed to increase the flexibility and productivity of the public sector. A set of measures introduced in 2007 required a thorough review of tasks, responsibilities, and administrative structure. Efforts were made to prevent duplication, identifying the role of different layers of government across two key levels of government involvement (the policy making level and the execution level). Decentralisation of responsibilities in combination with the transfer of the related resources was another key element of the package. At the general government level, the size and the levels of the policy departments were reduced. The attrition measures at the level of agencies allowed for some flexibility in the allocation of employment and responsibilities. In the health care sector, no attrition measures were implemented. Instead the government attempted to increase the efficiency and quality of the health care sector by innovative procedures. At the same time, measures were introduced to reduce the significantly increased sick leave in the health care, education, public transport, and police sectors. The related ministries were told to reduce sick leave to the same level as in 1997. The government also pursued efficiency in the police sector by more centralization of the wage setting mechanism and the declared costs of the police sector.

One common aim of the reforms is to increase competitiveness. In 2004/05 a wage freeze for the public and private sectors was introduced as a response to deteriorated competitiveness. In the early 2000s, the competitiveness of the Dutch economy was under pressure because of a high increase in the labor costs per unit. Lowering these costs was one of the main objectives of the cabinet at the time. The government introduced a freeze on the public sector wages and social benefits, and called on the private sector to follow the example of the government. After discussions with employers and workers associations, an agreement was reached with a nominal wage freeze for the private sector in 2004 and a close-to-zero wage increase in 2005.

In September 2015 the government announced an increase in the wages of the public sector to compensate for the loss in purchasing power in recent years. The government signed an agreement with the public sector, including the education, police, and defense sectors to increase wages to a maximum of 5.05 percent starting in 2015 and 2016. The parties underlined that wages were increased to improve purchasing power.

PHILIPPINES

In the past decade, the national government wage bill remained stable at around 5 percent of GDP. Strong economic growth has allowed targeted employment increases, with a noticeable expansion in the education payroll to expand compulsory education. In addition, the government started a performance-linked pay system in 2012 to enhance public service delivery and accountability which could eventually deliver efficiency gains to improve service delivery.

A. Institutional Background

This case study focuses on the experience of the Philippines national government in adopting a performance-related pay (PRP) system. The national government collects nearly 80 percent of general government revenues and accounts for 85 percent of general government spending.³² Education is provided by the national government, while provision of health care is the responsibility of local governments. Social security institutions manage the public pension system and national health insurance. In 2012, the national government introduced a PRP system.

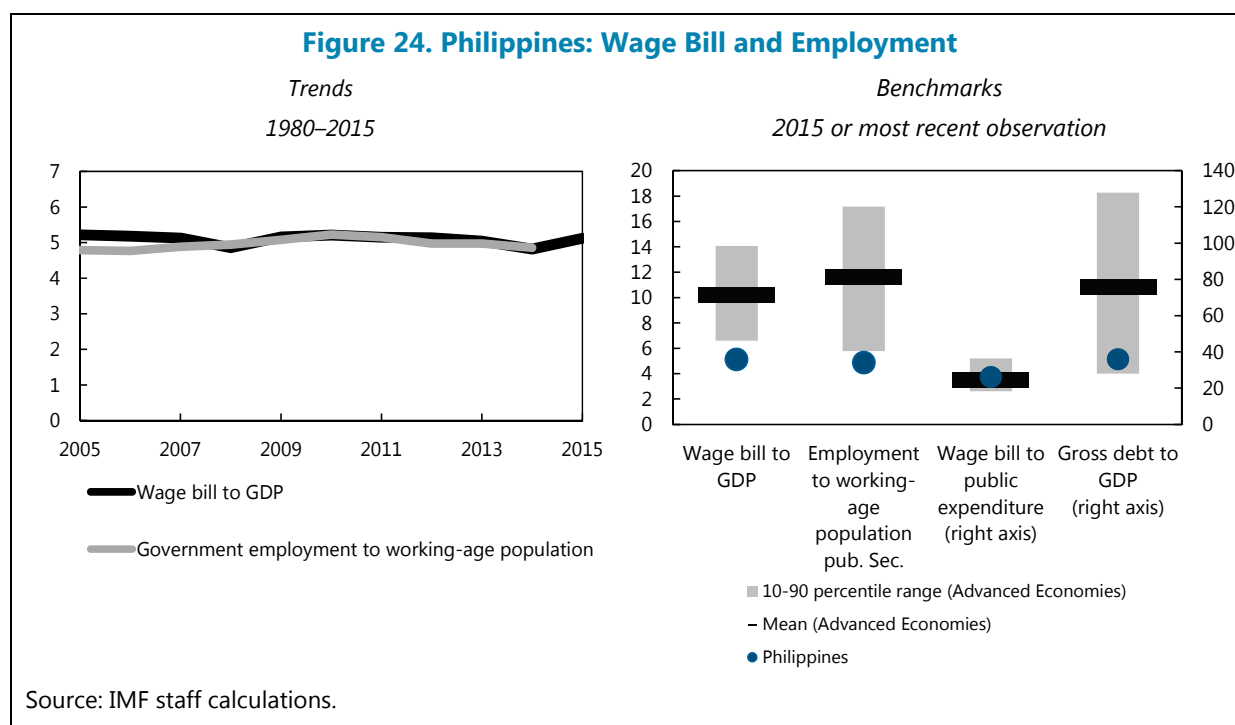
The wage bill is controlled under periodical executive orders and annual budget processes. An executive order to determine the compensation scheme for national government employees is called a Salary Standardization Law (SSL). The President issues an SSL to set a single salary scale for civil servants and a separate salary scale for military and security personnel for multiple years. The latest one, called the SSL-IV and issued in February 2016, sets the salary scales for 2016–19 to ensure the competitiveness of government employees' salaries. Employment is controlled through the budget process—the annual budget for the wage bill is set through the budget process in line with the SSL and the Staffing Summary, which specifies approved positions across departments and subunits (Department of Budget and Management, 2016). National government employees have the right to organize into unions and strike, with minor restrictions.

B. Trends and Issues

The wage bill has been stable in relation to GDP during recent years. In the past decade, the national government wage bill remained flat at around 5 percent of GDP, and employment at about 5 percent of the working-age population, both substantially below the median for emerging economies (Figure 24).³³ The ratio of general government debt to GDP decreased dramatically from 68 percent in 2003 to 36 percent in 2014.

³² The general government consists of the national government, local governments, and social security institutions.

³³ A precise comparison of the wage bill at the general government level is not feasible because wage bill data for local governments are not available for the Philippines. Nevertheless, the national government wage bill and local governments' current spending (including wage and non-wage spending) summed up to about 8 percent of GDP in 2014, which is still less than the median for the general government wage bill in developing Asian countries (8.4 percent of GDP).



Targeted employment increases on the back of economic growth have allowed an expansion in the education payroll without raising compensation to GDP. The government launched the K-12 initiative in 2011 to expand compulsory education (from the 1st through 10th grade to Kindergarten through 12th grade) (Department of Education, 2016). This was supported by 128,000 new teachers during 2010–14 (equivalent to 4 percent of the government workforce in 2015). The base salary of national government employees was raised on average by 12 percent per year in nominal terms during 2009–12 under the Salary Standardization Law III (SSL-III). The SSL-III also raised the dispersion ratio of the salary scale (the ratio of the highest to the lowest salary on the salary scale) by granting higher salary increases for professionals and managers than for supporting personnel, while improving the competitiveness of salaries of national government employees.³⁴ The impact of the salary increase and the teacher hiring were offset by a limited increase in overall government posts, which averaged 1.7 percent per year in 2009–12. Strong economic growth, which resulted in an average increase in nominal GDP by 8.6 percent per year for 2009–14, also contributed to stabilizing the ratio of the wage bill to GDP.

C. Reform Challenges and Lessons

The government started a performance-linked pay system in 2012 to enhance public service delivery and accountability. This started with the introduction of the Performance-Based Bonus

³⁴ Mincer-type wage regressions using labor force survey data suggest that the wage premium of civil servants over private sector workers in urban areas was not statistically significant before January 2010 but increased to a statistically significant level in January 2011 (6 percent).

(PBB), replacing across-the-board bonuses that were given uniformly to all civil servants. The main objective was to ensure that departments and agencies fulfill performance targets, while encouraging good performance at unit and individual levels. Another objective was to ensure that departments and agencies comply with governance-related laws, such as transparency in procurement, financial management, and disclosure of information. To achieve this, the government set preconditions for the PBB that departments and agencies must meet 90 percent of their agreed performance targets and comply with governance guidelines.

The PBB was granted based on the performance of units and individuals. Within departments, working-level units (or bureaus) were required to be ranked into three categories: a “best” rating was given to 10 percent of units, a “better” rating to 25 percent, and a “good” rating to the rest. Similarly, individual employees within each unit were also force-ranked into the three categories with the same proportion (10 percent, 25 percent, 65 percent). The amount of the PBB depended on the rating of the unit and the individual, ranging from 5,000 pesos (US\$120) and 35,000 pesos (US\$830), as illustrated in Table 5. The highest PBB was 10–18 percent of total compensation for clerical and junior technical staff, but less than 5 percent for senior management. All national government employees were subject to the PBB, including teachers.

Table 5. Philippines: The Amount of the Performance-Based Bonus in 2012
(Philippine pesos)

Performance Category	Best Performer (10 percent)	Better Performer (25 percent)	Good Performer (65 percent)
Best bureau (10 percent)	35,000	20,000	10,000
Better bureau (25 percent)	25,000	13,500	7,000
Good bureau (65 percent)	15,000	10,000	5,000

Source: Executive Order No. 80.

Overall, the experience of the Philippines in adopting a PRP system appears positive. The PBB has been in place since 2012. The wage bill has gradually decreased since 2011 as a percent of GDP indicating that the introduction of the PBB was not fiscally costly. While impact on service delivery is difficult to measure, the overall view of the PBP system was positive among government employees. A World Bank survey notes that with the PRP most staff perceived dedication on target setting and monitoring of objectives was consistent with serving the public. Employees also responded that the PRP had improved the performance appraisal framework.

Nevertheless, the PRP system has faced several challenges, reflecting difficulties in measuring performance in the public sector. First, according to the World Bank’s survey, government employees complained that performance ratings tended to be subjective and unfair, and that the

forced distribution of performance ratings could hurt employee morale. This view was more prevalent in employees with “good” ratings than in employees with “best” or “better” ratings. Second, in some cases, outcome indicators were not directly linked to the quality of public service delivery and hence were subject to gaming. For example, an indicator such as the number of advisories issued can be easily manipulated by splitting one advisory into two. By contrast, service delivery departments such as education and public works had more measurable and independently verifiable output indicators.

The PRP system has potential to improve public service delivery at a low fiscal cost. In particular, it can strengthen results-based management, accountability of government bodies toward outcomes, and performance culture in the bureaucracy. Nevertheless, forced distribution of performance ratings can hurt employee moral, especially if the performance appraisal system is viewed as untransparent and unfair. Establishing a credible performance appraisal system would be challenging for government functions where outputs are hard to measure objectively.

PORTUGAL

After a long expansion and unsuccessful consolidation efforts, Portugal has significantly reduced its wage bill since 2010, and is now closer to the European average. Government employment has declined and wages have been contained. However, some across-the-board wage cuts have been partially cancelled and will be fully reversed in 2016. Some structural reforms are also expected to be reversed or halted, and will not generate expected savings. The main challenge remains to build a more competent public administration, while containing employment and reducing the wage premium relative to the private sector. Identifying recruitment priorities for skills needed in the public sector, and better differentiation of wages could improve talent attraction.

A. Institutional Background

This case study focuses on the recent experience in containing the general government wage bill in Portugal. The wage bill includes central government, local governments (including autonomous regions), and social security funds. A large number of public entities, in particular hospitals, are also recognized as part of the general government.³⁵ In addition, Portugal has produced statistics on the public sector since 2012, which show an increase of about 10 percent in public employment compared to general government employment.

The compensation structure includes multiple contractual arrangements and extensive use of supplements (IMF, 2013). There are three main contractual arrangements: 11 percent of employees have a “permanent contract” (a fully tenured *nomeação* contract), 75 percent have an “open-ended contract” (a tenured *funções públicas* contract, which allows dismissal under some conditions), and 11 percent have an “individual contract” (without tenure and with the possibility of dismissal). In addition, although supplements are only about 5 percent of the wage bill, they add complexity to the pay systems—there are more than 280 different supplements and more than 410,000 supplement payment events.

The organization of civil service is characterized by large inefficiencies. In 2011, Portugal had the lowest average regular working hours per year among OECD countries, and government employees were paid 60 million hours of overtime (about 2½ weeks per employee per year). Some areas were overstaffed, including education (2½ percent of the population) and the security forces (about 1 percent of the population), and are above the average European levels. Portugal has also a powerful automatic progression system. It has translated into an early attainment of a high-level wage in most occupations, particularly for high-skilled workers, which can be detrimental to productivity. And it has resulted in a strong wage drift because of rapid increases in average wage

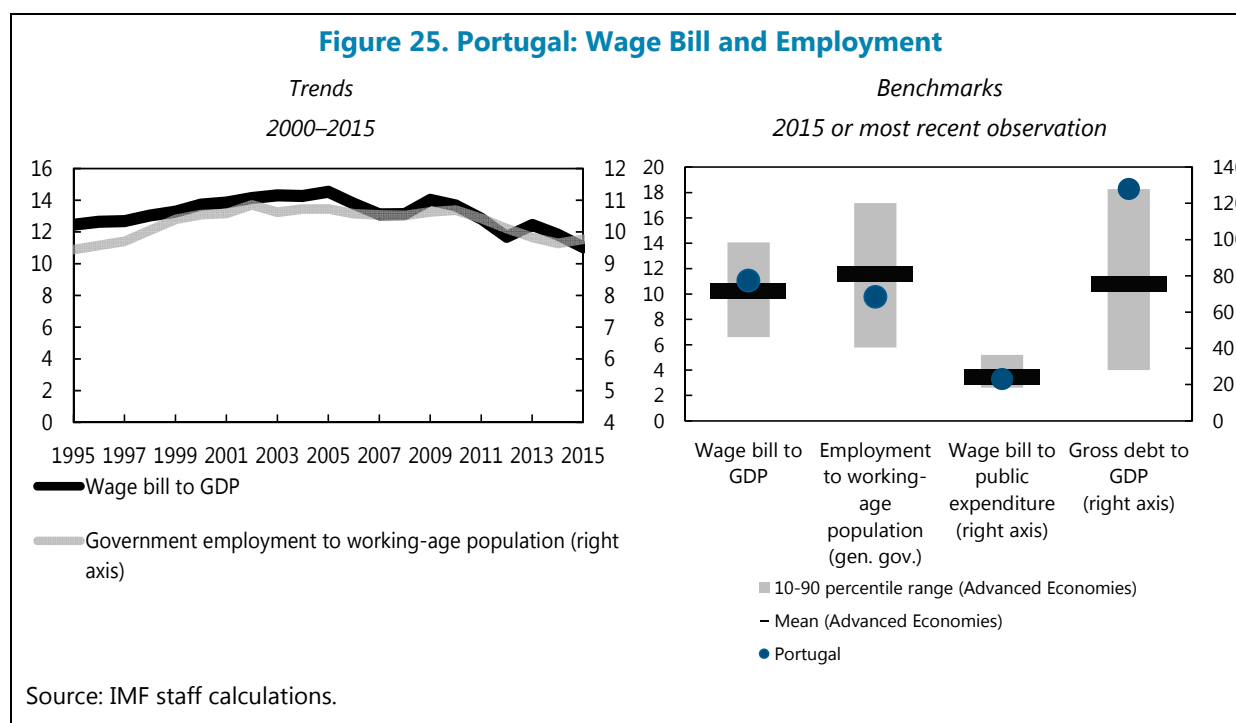
³⁵ These entities were reclassified into the general government with the move to the 2010 European System of Accounts (ESA 2010). This led to an increase in the general government of about 20 percent relative to the ESA1995 definition.

levels as the public sector workforce becomes more experienced, even in the absence of wage and employment increases.

The legal and institutional framework for managing the wage bill is relatively efficient in containing deviations. The Ministry of Finance (MOF) is responsible for wage setting and negotiations. There is a unified legal framework for wage setting and bargaining that covers central and local governments. Base wages are not indexed, and decisions on annual wage increases are made before the budget is finalized. The central government has a ceiling on the total wage bill, which is also broken down by program, but not on the number of employees. That said, the creation of new positions requires approval from the prime minister. Wage increases require legislative approval, and a reserve fund is used to cover over execution of the wage bill. Internal controls and audit are effective.

B. Trends and Issues

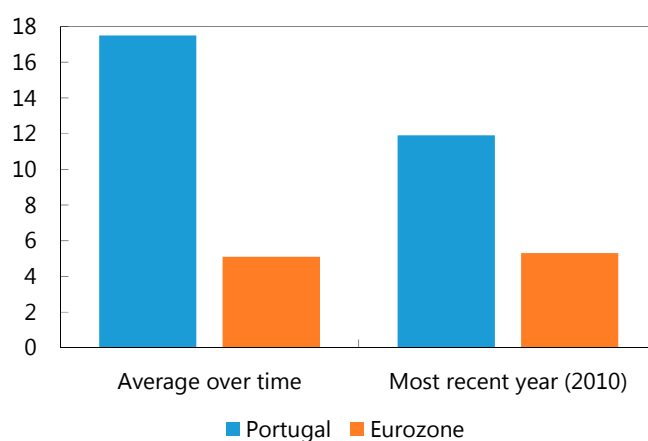
The wage bill was among the highest in the European Union (EU) before the financial crisis hit. In 1995–2005, the public wage bill increased from 12½ to 14½ percent of GDP, at the time the second highest in the EU after Denmark (Figure 25). Government employment expanded in Portugal during this time (9½ to 11 percent of the working-age population), while it improved significantly in terms of qualifications—an increase of 63 percent of staff with a bachelor’s degree or higher. In 2005–2008, Portugal managed to reduce its wage bill by 1½ percentage points of GDP, before it rose sharply in 2009 in the context of a severe recession. The wage bill and government employment have been gradually declining since 2010.



Even after recent adjustments, government pay remains relatively high compared to peers.

Estimated at 11 percent of GDP in 2015, the wage bill is about 1 percentage point higher than the average in advanced economies. Government employment, in contrast, is slightly below the advanced economy average. This suggests that a relatively high level of pay is the factor explaining the high wage bill. In fact, the public wage premium remains among the highest in Europe, after recent wage cuts, and controlling for several factors associated with earnings levels, like educational attainment, labor market experience, or managerial responsibilities (Figure 26). A positive public sector wage premium is observed at all levels of educational attainment, with the highest gaps for workers in lower professional categories (e.g., 47 percent in the case of plant workers).

Figure 26. Portugal: Public Sector Wage Premium
(Public-private wage differential as a percent of private wage)



Source: IMF staff estimates.

C. Reform Challenges and Lessons

A dire fiscal situation following the global financial crisis of 2009 required a sharp fiscal consolidation, including a sizeable wage adjustment. The fiscal path was anchored on a stabilization of debt through a sharp improvement in the primary balance, and a larger reduction of the fiscal deficit from 9 to 3 percent of GDP in 2010–2013. As part of this adjustment, reforms to the government wage bill were needed, reflecting its large share of the budget and its high level relative to peers.

To adjust the wage bill, priority was given to containing government employment and pay in the short term. To contain employment, the adjustment relied on across-the-board attrition (corresponding to an entry-to-exit ratio of 1:3), as well as a cut in the number of workers on temporary contracts. For local administrations, special provisions were introduced to reduce transfers in case of missed targets for employment reduction. To contain wages, successive progressive wage cuts were introduced, with higher reductions to higher salaries. These included a wage cut between 2.5 and 12 percent in 2011, the suspension of the 13th and 14th monthly salaries

in 2012, and an additional 3.5 to 10 percent reduction in 2014. In addition, promotions, performance bonuses, and mobility-related salary changes have been frozen since 2011.

The government also made structural changes to improve oversight, address inefficiencies, and increase flexibility in the management of human resources. One important step was the development of a comprehensive government employment and remuneration database (*Information System on the Organization of the State*) in 2011.³⁶ This enhanced oversight and transparency and became an important tool in identifying inefficiencies and potential areas for reforms. To enhance flexibility and address overstaffing issues and understaffing needs, a *special mobility pool* was created for people who are redundant as a result of reorganizations within the public administration. Several career-specific programs for separation through severance packages by *mutual agreement* were launched for less qualified workers, teachers, and senior experts in areas with over employment. Furthermore, to ensure service delivery while attrition measures were being taken (and to reduce overtime payments), the standard government workweek increased from 35 to 40 hours. To organize the government pay system, a new wage grid was adopted in 2014 that integrates all careers in a *Single Wage Scale* and replaces the existing arrangement of over 115 base wage levels and exceptions. A *Single Supplements Scale* was also adopted to significantly reduce the number of supplements. Finally, to better align the government compensation package with the private sector, the contribution rate to the civil servants' health care scheme was raised.

These reforms have been largely effective in containing the wage bill. In 2010–2014, the wage bill was reduced by 2 percentage points, and contributed to more than two-thirds of total expenditure consolidation (estimated at about 3 percentage points of GDP). In part due to these reforms, Portugal was able to maintain a structural primary surplus in 2012–2015.

The Portuguese authorities achieved a large reduction in public employment. General government employment declined from 14 to 11 percent of the working-age population—from 750,000 to about 660,000 thousand workers in 2010–2015. All levels of government contributed to these efforts, including subnational governments. Sectors that contributed the most were education (35 percent of total reduction in employment), and defense (9 percent).³⁷ Attrition was the main driver of employment rationalization, as the mobility pool and the termination scheme have resulted in fewer departures than expected. Going forward, the authorities project a stabilization in public employment over the medium term.

Wage cuts proved less successful in curtailing compensation spending, due to successive adverse Constitutional Court (CC) rulings and recent reform reversals. The suspension of the holiday and the Christmas allowances for civil servants was rejected by the courts. The second wave of wage cuts was also cancelled (with no retroactive effect) and will be fully reversed by 2016, at a

³⁶ The comprehensive database allows monitoring of the evolution of the stock and flows of public sector employees by different activities, professional categories, types of contract, and remuneration.

³⁷ Employment in public entities outside the general government also declined by 23 percent in 2012–2015.

total cost of 0.3 percent of GDP. Finally, the new government elected in October 2015 has decided to fully reverse the remaining wage cuts adopted under the adjustment program. Going forward, the CC implies that consolidation should take place through structural reform of public employment. This reinforces the need for a multiyear horizon, to better plan the wage bill and identify structural measures that could deliver lasting savings.

Some structural reforms are also expected to be reversed or halted and will not generate expected savings. The Single Wage Scale was initially expected to generate significant savings (of about 0.4 percent of GDP) by streamlining career paths and allowing a permanent reduction of the pay level. Savings (of about 0.1 percent of GDP) were also expected from the adoption of the Single Supplements Scale through a reduction in the number of supplements. However, the rolling out of these reforms has been postponed and will not generate savings in the short and medium term. In addition, the authorities announced that they would return to the 35-hour week in 2016, leading to an increase in overtime in some sectors, particularly health care.

Portugal succeeded in reducing public employment, but further across-the-board attrition may have an adverse impact on service provision in certain sectors. Increasing the rate of natural attrition would provide a gradual approach to rationalizing public employment, and would generate savings in both the short and medium terms. While a similar level of attrition across sectors would be easier to implement, it may have an adverse impact on service provision in certain sectors. The authorities should target overstuffed sectors to rebalance the structure of public employment. There is also considerable scope for rationalizing the public sector to reduce duplication and streamline public interventions. The authorities should prepare a comprehensive strategy to modernize the public sector, building on an in-depth assessment of the appropriate level of employment needed to deliver public services.

The main challenge remains to gradually improve skills in public administration, while reducing both public employment and the wage premium relative to the private sector. At present, lesser-qualified workers receive relatively high pay in the public sector compared to both peers in the private sector and more highly skilled civil servants. In addition, the wage grid is relatively flat and depends mostly on years of experience, rather than performance. This makes it difficult to attract highly qualified staff, because private sector opportunities (with lower entry salaries but steeper increases for performance) are considerably more attractive. In order to become more attractive, the civil service should identify specific jobs needed in the public sector (such as information technology experts) and revise the wage structure that is costly and impairs talent attraction in these areas.

ROMANIA

Romania's wage bill expanded rapidly in the second half of the 2000s and became unsustainable towards the end of that decade. In addition, the global crisis hurt revenue. To restore fiscal sustainability, the government implemented drastic measures, including nominal wage cuts and attrition-based employment reduction. However, as many of those measures were phased out or reversed, the wage bill rose slightly again. Romania's experience has shown that structural reforms of the public sector wage and employment system as well as consistency between policy measures are needed to reign in the wage bill over the medium and long term.

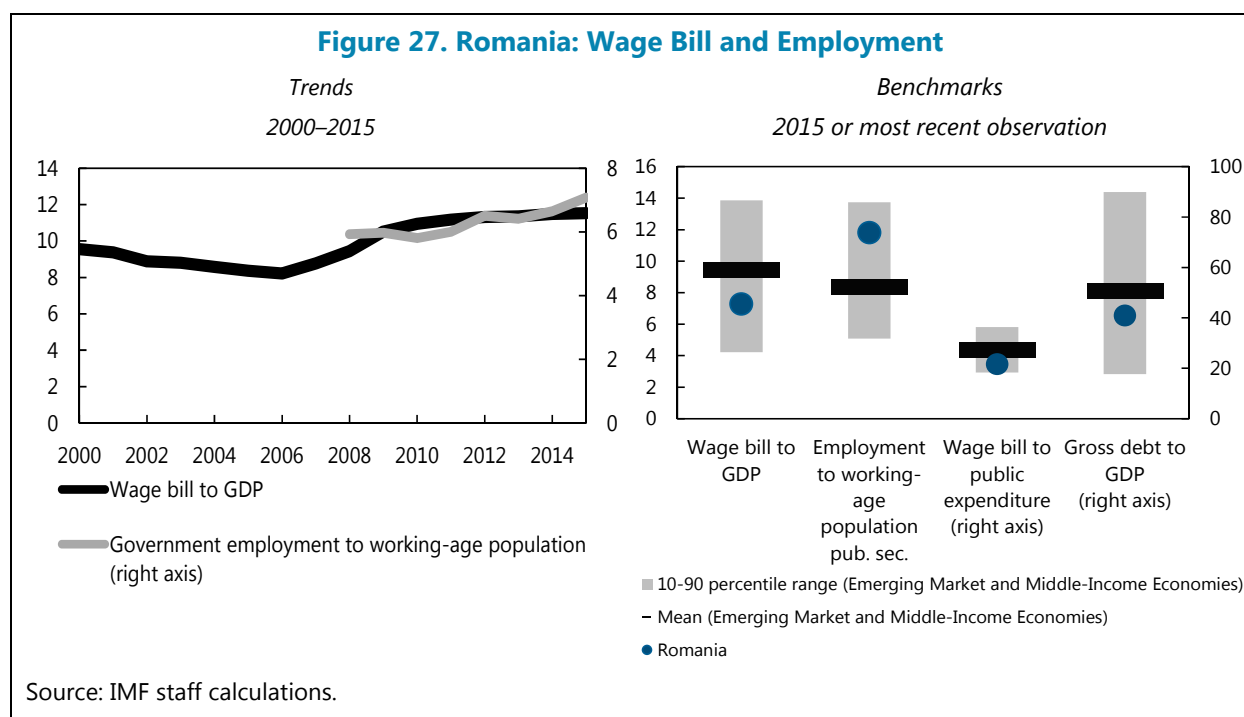
A. Institutional Background

Primary budget holders manage the compensation and employment for their respective public institution. The management of the government sector employment and compensation is highly fragmented. Despite some harmonization efforts, the hiring and compensation systems still differ across sectors.

A Social Dialogue Code was adopted, despite some initial controversies. It aimed at making the wage-setting process more flexible and allowing for a stronger link between wage growth and productivity developments, for both the private and public sectors. Key elements include abolishing collective bargaining at the national level and eliminating the automatic increases at the sectoral level.

B. Trends and Issues

The government wage bill expanded rapidly during the second half of the 2000s. Real wages grew more rapidly than productivity. The wage bill increased from 8 to 11 percent of GDP in 2009–2011 (Figure 27). This expansion, together with other fiscal loosening measures, led to a sharp deterioration of the fiscal deficit from 0.7 to 7.1 percent of GDP during the same period. The expansionary expenditure policy carried out during a period of strong economic growth could not be sustained when the crisis hit in 2009. The economy grew by an average of about 7 percent in 2005–08 and shrunk by 7 percent in 2009. The GDP decline, compounded with a drop in revenue collection, led to a sizable shortfall in resources to finance large expenditure. In 2009, the public sector wage bill and employment exceeded those in emerging economies. Government debt soared by 13 percentage points of GDP between 2005 and 2010.



The expanding public wage bill originated from both increases in wages and employment. The average wage in the public sector grew by 63 percent between 2005 and 2008. General government employment rose by about 15 percent, driven primarily by employment at the local government level, which accounted for about 65 percent of the total increase.

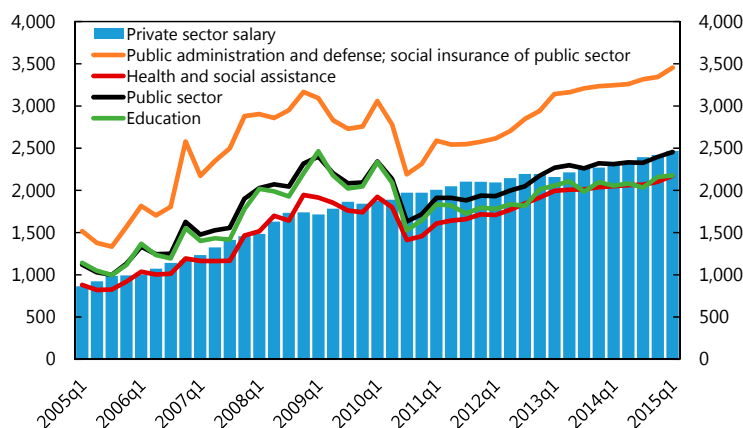
Moreover, the large increase in public sector wages widened the disparities between the average compensation in the public and private sectors. Whereas the nominal average wages in the public and private sectors were broadly similar in the mid-2000s, the former exceeded the latter by about RON 500 in early 2009, corresponding to about 30 percent of the average salary in the private sector (Figure 28). The disparities were even wider for some subsectors of public employment that receive preferential treatment.

C. Reform Challenges and Lessons

The Romanian authorities implemented a large package of measures to contain the public sector wage bill in 2009–2012. Urgent measures to reduce compensation costs were introduced, including furloughs (up to 10 days leave without pay in November–December 2009), nominal pay cuts (25 percent reduction in July 2010), and hiring restrictions (one hire per seven separations to reduce employment by attrition, 2010). More targeted measures to address shortcomings of the compensation system were also implemented, with a focus on rationalizing non-base pay. This included eliminating allowances related to work complexity, managerial responsibility, and meeting attendance in 2009; removing special salaries for doctors, policemen, and prison administration in 2010; capping non-wage pay to 30 percent of the base pay in 2011; discontinuing payments for overtime and work on weekends and holidays in 2012; and phasing out social coupons and the

13th month salary and holiday bonuses. For state-owned enterprises (SOEs), government control on budgeting and the wage-setting process were strengthened—SOEs with losses were not allowed to raise wages while others could do so only in line with inflation and productivity growth.

Figure 28. Romania: Average Monthly Wages
(RON per month)



Source: Haver Analytics and IMF staff calculations.

The design of the measures sought to explicitly limit the impact on the most vulnerable. In addition to earmarking funds for the Guaranteed Minimum Income scheme, the lowest-wage employees and poorest pensioners were protected from the cuts in government wages—for example, minimum public wage thresholds were unchanged. While implementing reforms to social transfers, better targeted programs were protected in response to concerns about the distributional impact of cuts in social transfers.

While these measures helped public finances in the short term, legal challenges and distortions in pay and employment made them less effective in the long term. The drastic ad hoc measures allowed an immediate correction of the large fiscal imbalances and brought about fiscal and macroeconomic stability. However, some of the more drastic measures were ruled unconstitutional, illustrating the legal risks surrounding pay and employment reforms—the Constitutional Court ordered the government to reverse the 25-percent wage cut and compensate teachers for the 50-percent increase. Beyond legal challenges, the reforms failed to address important distortions in the pay and employment system. For example, as the public sector average wage became lower than that in the private sector (by about 15 percent), it became challenging for the government to retain or hire skilled workers. Furthermore, the seven-to-one rule was not accompanied by a reallocation of employees between sectors. Thus, attrition failed to address overstaffing and understaffing issues.³⁸ This explains why the reduction in government staffing may

³⁸ Although a functional review was conducted with the assistance of the World Bank, its conclusions did not feed into the decision on employment reduction.

have been partly offset by the outsourcing of services—spending on goods and services by 0.6 percent of GDP between 2009 and 2013.

Attempts to introduce a new pay framework have stalled, reflecting its potentially high fiscal costs. Legislation approved in 2009 aims to unifying the pay scale across the government, reforming and capping bonuses; and reducing the wage bill to 7 percent of GDP by 2015. However, this law has not been implemented because its application implies a sizeable increase in compensation expenditure—up to 1–2 percentage points of GDP.³⁹ The higher cost of the new framework is associated with several factors. First, it relies on unfeasible cuts in public employment to reach the wage bill targets. Second, the reversal of past measures increases the point at which workers would be in the proposed grid, making it more costly than expected. Third, the law ties the entire pay scale to a single reference wage (envisaged to increase by 56 percent between 2010 and 2015). Fourth, increases in the minimum wage have raised the lower point of the scale. Maintaining the same compression (ratio of the highest to the lowest point of the scale), would require large increases to all points in the scale. And finally, the bonus reforms are more timid than expected.

The Romanian experience highlights the need for consistency across policy measures. The increase in the minimum wage exacerbated the distortions that the unified wage law intended to address. Moreover, due to the wage increase, the implementation of the revised unified wage law is becoming more challenging because the corresponding decompression would lead to an upward shift of the entire wage system. This would require a larger fiscal space.

Thus, although Romania made some important progress, the public sector compensation and employment system still shows some serious weaknesses. Romania succeeded in reducing the wage bill below peer countries. However, pressures are re-appearing as the consolidation measures were reversed. The public sector employment level seems to have declined below that in peer countries, but the employment structure does not seem to match the structure of public service needs. Finally, the wage structure does not provide sufficient incentives for skilled-labor to join and remain in the public sector. The inconsistency between the increase in the minimum wage and the unified wage law has exacerbated this distortion.

³⁹ A revision of the unified wage law is under preparation. This revision is based on the following principles: (i) it is unitary, i.e., the salary of all categories and sectors are regulated similarly; (ii) it follows the rule of law, i.e., all salary rights are established by legal standards; (iii) it is fair and consist, i.e., equal opportunities and equal pay for work of equal value; (iv) it promotes professional performance; (v) the pay system enables career development; and (vi) the pay system attains financial sustainability, i.e., in line with fiscal space.

SOUTH AFRICA

After a gradual decline in 2000–06, South Africa’s wage bill started to increase sharply from 2007 after the introduction of a new compensation framework, before levelling off in recent years. At 11½ percent of GDP in 2015, the wage bill seems unsustainable and stands out in a cross-country comparison, largely reflecting relatively high government pay. A remuneration commission was created in 2013 to examine the pay and working conditions of civil servants and make recommendations on the best practices. The reform momentum has gained steam recently, initially focused on containing employment. However, little has been done in containing pay increases, the root of the high wage bill. Political will and social dialogue are key for the success of the reforms.

A. Institutional Background

Our analysis focuses on wage expenditure covered by the general government budget, which includes both the national government and the provinces. With the education and health services being decentralized, the provinces are the largest public service employers with about 70 percent of the 1.3 million people in the public service work force as of March 2015. The remaining 30 percent are employed by the national government, with most working in the judicial and security sectors.

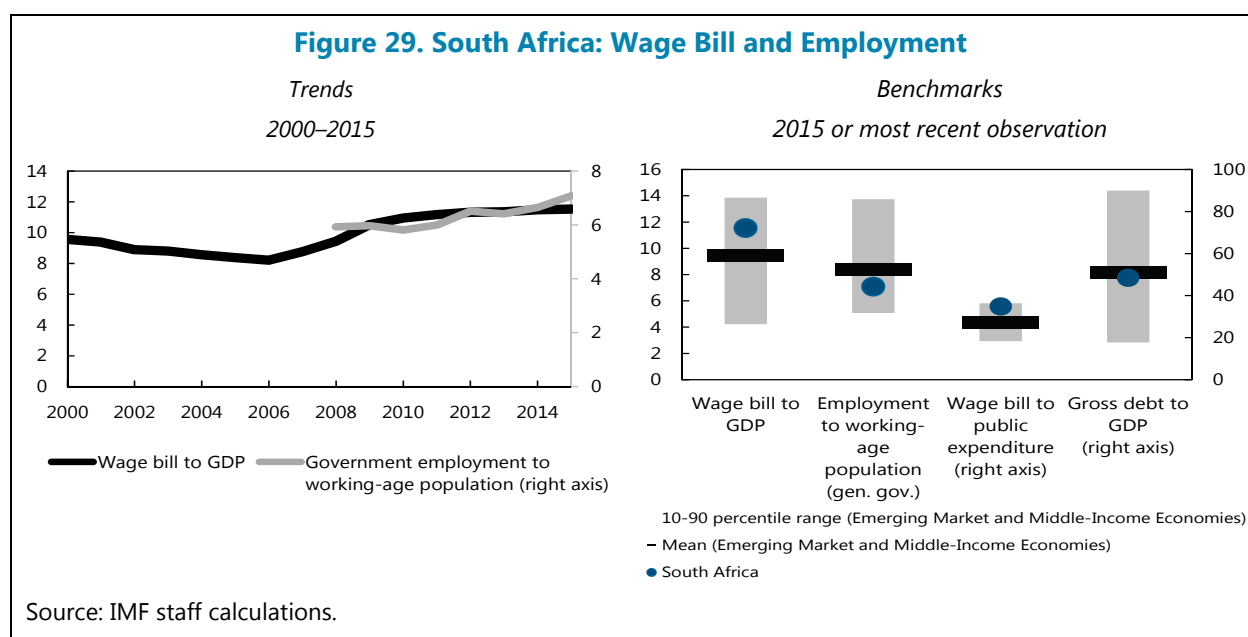
The wage bargaining process in the public service is centralized under the Public Service Coordinating Bargaining Council (PSCBC). The PSCBC—an independent institution comprising representatives of the main labor unions and the government—has the mandate to provide a forum for stakeholders to negotiate on public service matters, including wages and conditions of employment, and resolve disputes. There are also sector bargaining councils that deal with issues pertaining to a specific sector, but their capacity and power of decision making are limited. The pay increase is agreed at the PSCBC level and the process typically starts with labor unions submitting their proposal. In consultation with national departments, including the Ministry of Finance, the Department of Public Service and Administration—the representative of the government—prepares the government position paper with the costing of various scenarios. The negotiations, usually expected to take 3 weeks, can in practice last up to 6 months. The parties agree on a given increase in the base salary for a year or multiyear term, applicable to all civil servants except those in senior management whose salary adjustments are decided by their respective ministries.

A 3-year agreement with the labor unions in 1996 marked the beginning of deep civil service reforms aimed at streamlining and modernizing the structure of the public sector, rationalizing the wage bill, and improving service delivery. To rightsize the public sector, the government introduced a voluntary severance package, combined with attrition and redeployment, which helped achieve close to a 10 percent reduction in public employment by 1999. Further, pension benefits were restructured and a number of allowances were consolidated into the base salary. The salary scales were also simplified, in addition to reducing the wage drift from pay

progression by 0.5 to 1.5 percent. The consolidation of job categories into larger groups also brought some simplification to the new grading system.

B. Trends and Issues

After a gradual decline in 2000–06, the wage bill started to increase in 2007 following the introduction of a new compensation framework. The need for a lean, affordable, efficient, and competitive public sector has led to difficult public service reforms post-1994, including voluntary separation and a wave of privatization. This, combined with moderate wage increases, helped put the public wage bill on a downward trend until 2006 (Figure 29). However, the wage bill surged from 8.2 to 11 percent of GDP in 2006–2010, largely reflecting rapid increases in pay following the implementation of the Occupation Specific Dispensation (OSD)—a mechanism to harmonize salary scale and grades, and ensure attraction and retention of specific skills, while promoting performance based remuneration.⁴⁰ Further, wage settlements were consistently above inflation in 2008–10. The wage bill continued to increase since 2010, albeit at a slower pace, reflecting a slight increase in employment. The wage bill stands out in a cross-country comparison, whether measured as a ratio of GDP or expenditure. The wage bill is much higher than the average of emerging peers. The high wage bill crowds out other critical expenditure and jeopardizes fiscal sustainability. With employment under the emerging country average, relatively high pay seems to be the source of the high wage bill.



⁴⁰ OSD aimed to achieve the goal of equal pay for equal work, reduce wage compression to provide incentives for specific skills critical to the public sector, stimulate work performance and productivity, and simplify the remuneration framework to facilitate its administration and budgeting of its cost. The criteria for defining scarce skills have been developed, and the grading of positions and salary attached to them are determined centrally, as well as the minimum requirement for each position in terms of qualifications, skills, and experience. Despite some success, the OSD failed to be cost-effective because it contributed to reversing the fiscal gains from the late 1990s reforms.

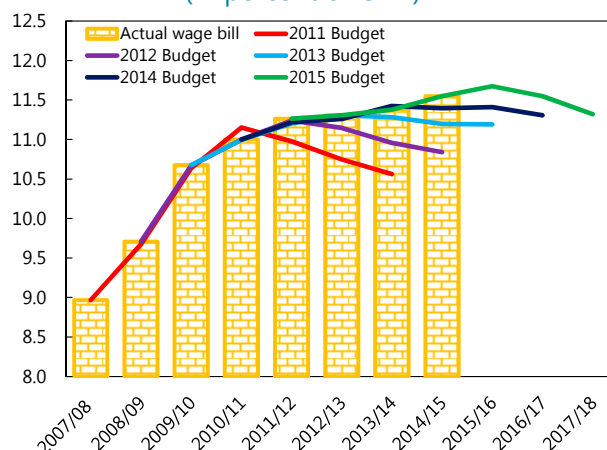
While the OSD provides a framework to harmonize job contents and ensure that the public sector remains attractive to specific skills, the fiscal cost has been sizeable. The implementation of the OSD was separated from the outcomes of the collective bargaining process, allowing public workers to enjoy a higher salary on the OSD pay scale coupled with a generous across-the-board pay increase. In addition, the OSD has led to a proliferation of salary scales, coexisting with those applicable to the general public service. Also, multiple allowances subsisted with the OSD, although the idea was to streamline allowances under the OSD. Further, implementation challenges led to some employees being placed on a more generous scale, without the state being able to recover the overpayments. Finally, the OSD has put a strain on public finances not only because of its cost, but also because its implementation coincided with the global financial crisis.

The public wage premium, already large, is thought to have widened following the introduction of the OSD. Bosch (2006) estimates that the average compensation in the public sector was 35 percent higher than in the private sector using 2005 data. Since then, the gap may have worsened with the rapid increase in public wages, potentially with adverse effects on the competitiveness of the private sector if there were spillover effects on private wages—average government wages have steadily increased in real terms, in particular in the health sector, as civil servants moved onto the OSD pay scale with a higher salary, combined with generous across-the-board wage increases resulting from the wage negotiations between the unions and the government. Automatic progression, along with promotions and allowances also added to the rising wage bill. A recent report from the Ministry of Finance notes that allowances are numerous and complex, some duplicative in nature and often not well targeted, making it difficult to ensure they are used effectively and efficiently. An example is the housing allowance that was intended to promote home ownership but became a general allowance; thus benefiting all employees, including those who already occupied heavily subsidized official housing. Nevertheless, anecdotal evidence suggests there is some heterogeneity among public workers, with the wage premium being substantially higher at low-qualified positions, which might threaten the ability to attract or retain highly skilled workers.

Medium-term wage bill projections were consistently outpaced by wage bill outturns. Wage settlements are generally above the planned fiscal envelope (Figure 30). While social pressure has played a role, another factor is the lack of coordination between the budget process and the collective bargaining, which often is completed after the budget was approved. This complicates budget management as additional resources have to be found to finance the extra spending associated with the wage agreement. For instance, the 2015 wage agreement resulted in an additional cost of R63.9 billion (1.5 percent of 2015/16 GDP) over the fiscal envelope of the Medium Term Expenditure Framework (MTEF). Reflecting the authorities' strict adherence to the MTEF spending limits, they announced that the wage cost overrun will be accommodated through savings, reallocation and draw downs on contingency reserves. Another complicating factor that undermines wage bill projections is that the elements of the remuneration package are not discussed as a whole. The fragmented system whereby the cost-of-living adjustment is negotiated separately from

allowances and other benefits creates uncertainty on the ultimate fiscal cost of the collective bargaining.

Figure 30. South Africa: Medium-Term Wage Bill Projections and Outturns
(In percent of GDP)



Sources: National Treasury and IMF staff.

A recently signed agreement is likely to add pressures on the wage bill going forward.

Although there is no formal inflation indexation of wages, wage agreements have been generally linked to inflation. The 2015 agreement covers 3 years and entails a 7 percent increase in salary in 2015/16 (against an average inflation rate of 4.5 percent in 2015), and for 2016/17 and 2017/18 an increase by inflation rate plus 1 percentage point.⁴¹ Benefits such as housing allowance and employer's contribution to medical insurance will also be adjusted upward as part of the agreement. The cost of the wage agreement will be further increased by progressions, promotions, and adjustments in allowances negotiated at the sector level. In addition, the rollout of the OSD is not completed yet, heightening risks of wage bill slippages. Overall, it is expected that public workers' salaries including benefits will grow by 10.1 percent in 2015/16, followed by an increase that will be at least two percentage points higher than consumer inflation in the next two years. Although multiyear agreements offer predictability on the cost of public wages, they come at a considerable cost and limit the ability of the government to take wage measures when a crisis hits.

C. Reform Challenges and Lessons

Against a backdrop of low growth, the government has placed fiscal consolidation at the center of its strategy to safeguard fiscal sustainability. Persistently weak growth has created challenges for the authorities in their aim to stabilize public debt. With little room for raising revenue, expenditure restraint is critical to achieve the needed consolidation. In this regard, the authorities have introduced nominal expenditure ceilings since the 2012 budget. However, this has

⁴¹ The 2015/16 fiscal year runs from April 2015 to March 2016.

not been sufficient to contain public debt, which increased by over 10 percentage points in 2011–2015, suggesting that a tighter fiscal stance is desirable in the short-term while implementing structural reforms to unlock growth potential.

With the wage bill approaching unsustainable levels, the reform momentum has gained steam recently. While broad consultations are still ongoing to pave the way for more structural reforms, the government has taken some urgent measures to contain the wage bill. In the 2015/16 budget speech, the Minister of Finance announced a freeze in public employment for 2015/16 and 2016/17, and a review of funded vacancies to withdraw funding for those that have not been filled for a long period. New recruitment will be funded through existing allocations as well as space created by natural attrition. A remuneration commission was created in 2013 to examine the pay and working conditions of civil servants and make recommendations on the best practices. The commission, which has launched a wide consultation of various stakeholders, is tasked with specifically look at ways to make the public service more effective and efficient, ensure the sustainability of the wage bill and improve service delivery.

Across-the-board employment restrictions could yield some savings in the short-term, but they are not efficient. Untargeted employment freeze is easier to implement and probably more acceptable to stakeholders as everyone is sharing the pain more or less equally. The fiscal gain can also be quickly realized. However, it does not address pockets of overstaffing and thus, does not generate much efficiency gain. Moreover, it can affect service delivery because critical sectors such as education and health may suffer from the lack of personnel as demand increases with demographics.

Structural reforms, such as pay policy reform, deliver more lasting results, but they need to be carefully designed, properly costed, and embedded in the fiscal framework to reduce risks of slippages. The implementation of the OSD was hampered by the lack of comprehensive personal data records, the lack of a clear definition of eligible skills, and capacity constraints of departments. This underlines the importance of a strong payroll and personnel management system as a prerequisite for pay policy reform. The database should be cleaned to eliminate ghost workers and employees' information should be regularly updated. To limit fiscal risks, it is important to develop alternative pay policy scenarios and conduct careful modeling to determine the appropriate solution, within what is affordable. Also, a pay reform should be entrenched in the MTEF and guided by key budget parameters, and since its implementation can take several years, the expected impact on wages should be integrated in the regular wage bargaining process. To take full advantage of a pay policy reform, the implementation should be comprehensive in the sense that the reform components simplifying remuneration structure—for instance by streamlining allowances— and linking pay to performance should not be left out.

Achieving a rapid and sustainable reduction in the wage bill requires a combination of wage and employment measures. While South Africa has managed to stabilize public employment, little has been done to contain wage increases, the root of the high wage bill. Without tackling the level of wages, the wage bill will continue its upward trend as there is a limit to how much decline in

public employment could be achieved through employment freezes and natural attrition. In light of the high unemployment rate, public service retrenchment is not a likely option, leaving wage control as the only remaining tool. The creation of the Presidential Remuneration Review Commission (PRRC) to look at public service remuneration and provide recommendations is a welcome step.

Political will and social dialogue are important for the success of the reforms. Although the government has demonstrated a commitment to fiscal consolidation by setting and meeting hard overall expenditure ceilings, the outcome of collective bargaining consistently exceeded budget allocations for wages. This suggests that there is a need to build a high-level commitment to the government's medium-term wage bill ceilings and make the latter binding for the government. South Africa has a long tradition of social dialogue, partly due to a heavily unionized public sector, but this dialogue could be strengthened. Continuous engagement with the labor unions—as opposed to ad hoc consultations at the time of wage negotiations—is needed to build a consensus in society that wage bill reforms could be one of the least painful routes to achieving a necessary fiscal adjustment. This would require building a strong evidence base on the need to reduce the public wage bill, for instance by highlighting public/private wage differentials, the trade-off between employment level and wages, and potential difficult measures if wage reforms are not undertaken. The government negotiation strategy might also need to be strengthened, notably by developing a set of longer-term employment reforms to bargain for in negotiations, adopting a holistic approach on the remuneration package during negotiations, and potentially reforming the government's negotiating bodies to give an enhanced role to the Ministry of Finance. To further enhance the social dialogue, consideration could be given to an independent pay review body as an intermediary between government and unions. However, social dialogue to build reform consensus takes time and might be possible only if fiscal space allows.

TUNISIA

The wage bill has been rising reaching about 13½ percent of GDP in 2015. In part, this has reflected the reliance on public sector employment to maintain social cohesion during the country's political transition. Nevertheless, this relatively high level of expenditure in the wage bill raises concerns about the sustainability of public finances.

A. Institutional Background

The focus of this case study is the central government wage bill. This is set by the legislature as part of the overall budget process, and comprises wage spending by central administrative units, executive agencies, and other agencies that are fully or partially funded by the budget. It excludes wage spending by local governments and any budget contribution to the financing of the wages of state owned enterprises through budgetary transfers.

A collective wage bargaining process between the government and the unions is used to negotiate salaries in the public sector. The Union Générale Tunisienne du Travail—the largest labor union in Tunisia—undertakes wage negotiations on behalf of all public employees, typically over a three-year period. Additional sector-specific wage negotiations are also decided separately between the government and different labor unions in their respective sectors. Nevertheless, the recent period has been characterized by a less predictable process, starting with an exceptional salary increase granted in 2011 by the government.

Civil service recruitment is governed by competitive procedures and set on the basis of budget constraints. The Statute of the Public Service mandates competitive recruitment (*concours*) for entry into the public service (Assemblée Nationale, 1998). However, several exceptional provisions were approved after 2011, which allowed for direct recruitments, effectively bypassing competitive recruitment processes. New recruits are hired on a permanent basis, after an initial internship of one year (new graduates and contractual workers) or two years for all other civil servants. Overall, processes for determining the staffing structure of governmental entities do not follow a systematic evaluation process assessing actual needs and tend to be vulnerable to ad hoc requests for staff increases.

The current administrative and legal framework does not adequately support redeployment nor encourage mobility. A law authorizing redeployment was passed in 2014, but the implementing regulations have met with significant resistance from unions.

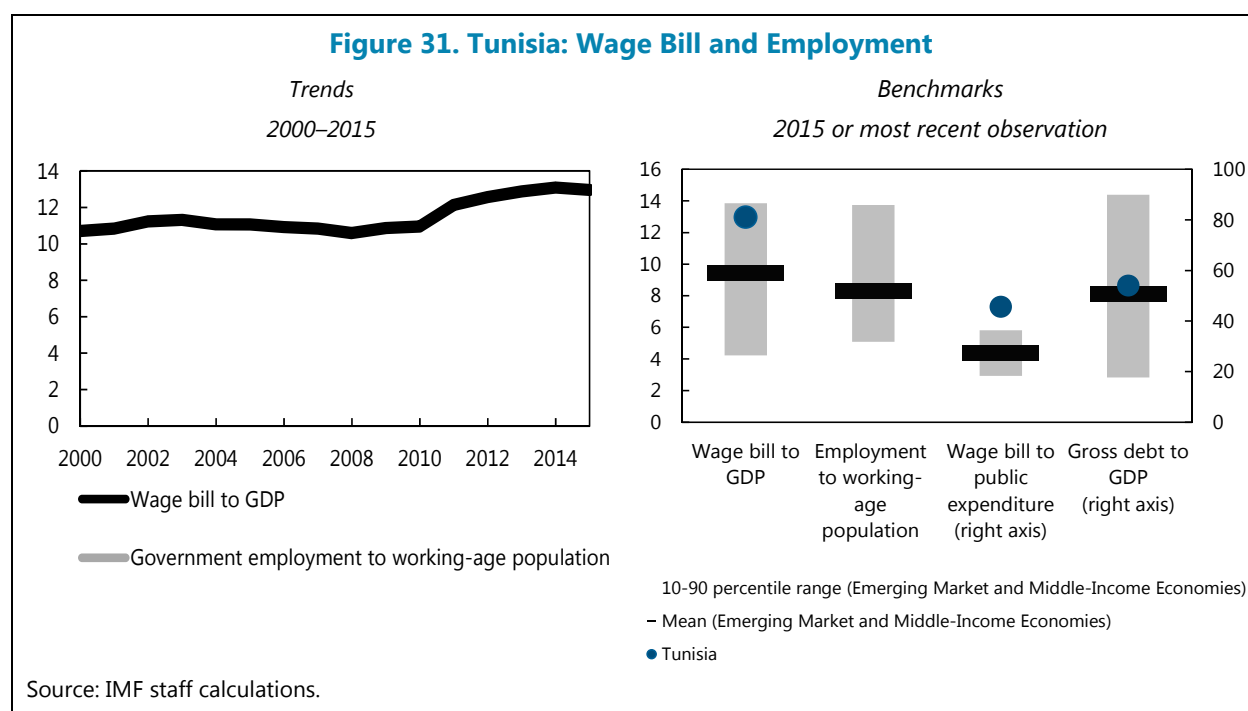
Tunisia's public sector compensation system is complex. It combines a base salary with numerous allowances that can vary according to an employee's professional group, category or unit, and rank. Specific allowances for various professional groups are set by decree and by particular statutes for each group. Special allowances are limited to certain professional groups or special

situations. Finally, all public servants receive common allowances, such as the mileage allowance, the family allowance, and the performance bonus.

Promotions are largely awarded based on seniority and have become largely automatic in some ministries. Public employees automatically advance within their grade from one level (echelon) to the next, based on a timetable defined for each professional group (usually 1–2 years). Overall, the annual professional rating lacks transparency and objectivity, with the grading of conduct largely depending on the subjective assessment of a supervisor.

B. Trends and Issues

The wage bill has been rising since 2011, reaching potentially unsustainable levels. The wage bill increased by 2½ percentage points of GDP in 2010–2015, crowding out spending on priority infrastructure spending (Figure 31). In part, this reflects the government’s reliance on public sector employment policies for managing the country’s political transition. Although this has contributed to social cohesion, the fiscal burden of the central government wage bill is becoming unsustainable—at 13½ percent of GDP, Tunisia’s government wage bill is high relative compared to the emerging economies (Figure 31). Moreover, it ranks very high as a share of government expenditure, raising concerns about wage bill sustainability.

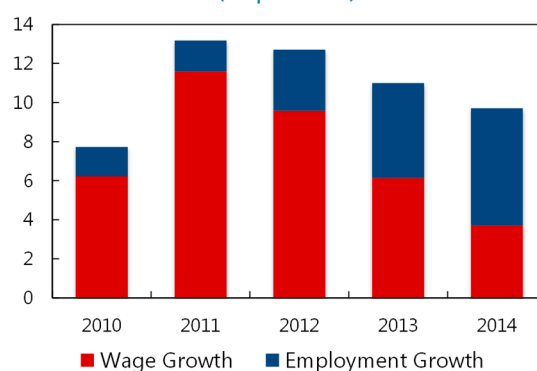


Increases in pay have been the main drivers behind the increase in wage bill spending, but more recently the contribution of employment has also picked up. On average, 68 percent of the growth in the wage bill was due to rising pay in 2011–2014, largely reflecting the introduction of new allowances (Figure 32). Nevertheless, the contribution of employment growth to the rising wage

bill spending has notably increased in recent years. The number of civil service employees increased by about 15 percent in 2010–2015 to about 631,000 workers.

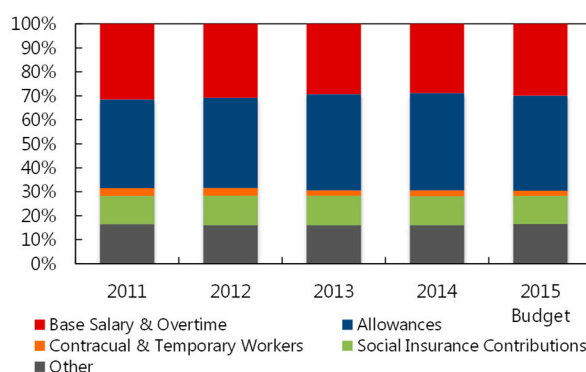
Allowances constitute the largest and increasing component of civil service compensation. In 2014, allowances amounted to about 60 percent of total compensation (Figure 33). Their incidence in the pay structure is relatively large by international standards, and well above the level of allowances typically found in OECD economies (about 10 percent). Moreover, the ratio of average allowances to average basic salary has increased markedly from around 120 percent in 2011 to around 143 percent in 2014.

Figure 32. Tunisia: Relative Contributions of Wages and Employment to Wage Bill Growth, 2010–2014
(In percent)



Source: IMF staff calculations.

Figure 33. Tunisia: Central Government Wage Bill by Component
(In percent of total)



Source: IMF staff calculations.

Public employees appear to receive a wage premium over their private sector counterparts.

After accounting for differences in socioeconomic characteristics of workers such as age, education, and experience, the premium is 18.2 percent for public sector workers. Given that the government is an important employer in Tunisia, higher compensation of public sector workers is likely to introduce wage distortions in the economy and crowd out private sector employment, with negative implications on competitiveness.

C. Reform Challenges and Lessons

Pressures on compensation spending could arise following the recent wage agreement. An agreement was reached in April 2015, stipulating an increase in base salary and specific allowances for all public sector employees. For central government employees, base salary is set to increase by 55 Tunisian dinars a month, on average, in 2016 and 2017. The increase in allowances averages about 43 dinar a month, taking effect in July 2016, with automatic renewals in April 2017 and in April 2018.

The authorities' medium-term consolidation plan aims to reduce the wage bill as a share of GDP to 12 percent by 2020. To mitigate pressures from rising compensation, the government has introduced a temporary hiring freeze starting in 2016, except for the health, defense, and security ministries. In addition, the government will not authorize any new recruitment, including replacing retiring workers. Importantly, the authorities, with assistance from donors, are developing a civil service reform strategy involving redeployment, organizational audit, review of the structure of compensation, and career mobility.

UNITED KINGDOM

The United Kingdom's (U.K.'s) government wage bill increased rapidly in the 2000s. The recession in 2008–09 worsened the government's fiscal position with rising public sector debt, leading to an urgent need to address the growing deficit. The government introduced short-term controls and long-term reforms to manage the size of the wage bill. Short-term controls included pay and recruitment freezes, while long-term reforms have included revaluing pension provisions, changing employee contracts to modernize terms and conditions, and reforming automatic progression pay. These reforms have led to a reduced wage bill. There is scope for further reforms to address the ageing population with increased pension liabilities, growing demand for health care services, and low labor productivity.

A. Institutional Background

Wage setting in the U.K. is a mix of centralized policy setting and guidance and decentralized implementation. Individual departments manage employment and salary decisions for their respective workforces within an overall budget constraint as well as pay award policies and specific workforce rules set by the central government through periodic 'spending round' processes. The central government also sets rules and guidance policies on other aspects of pay, including senior pay controls and off-pay roll rules that both central and local government employers are expected to adhere to.

The process of determining wage increases differs between the civil service, central government workforces, and local governments:

- For the civil service, the central government issues annual civil service pay guidance which sets out the annual pay award policy as well as any other pay/workforce rules and requests for data.⁴² The departments then liaise with their unions and staff to determine individual pay increases, bonuses and allowances, and employment decisions within an overall budget envelope and the pay award policy;
- For the central government workforces the pay award is determined through an annual pay round process that involves the government receiving recommendations from independent Pay Review Bodies consisting of academics and workforce experts who make their recommendation after considering labour market evidence from individual departments, unions, and their own research (Office of Manpower Economics, 2016).
- For local government workforces pay policy is delegated to the local government level, and individual councils/bodies make pay/workforce decisions within their overall available funds.

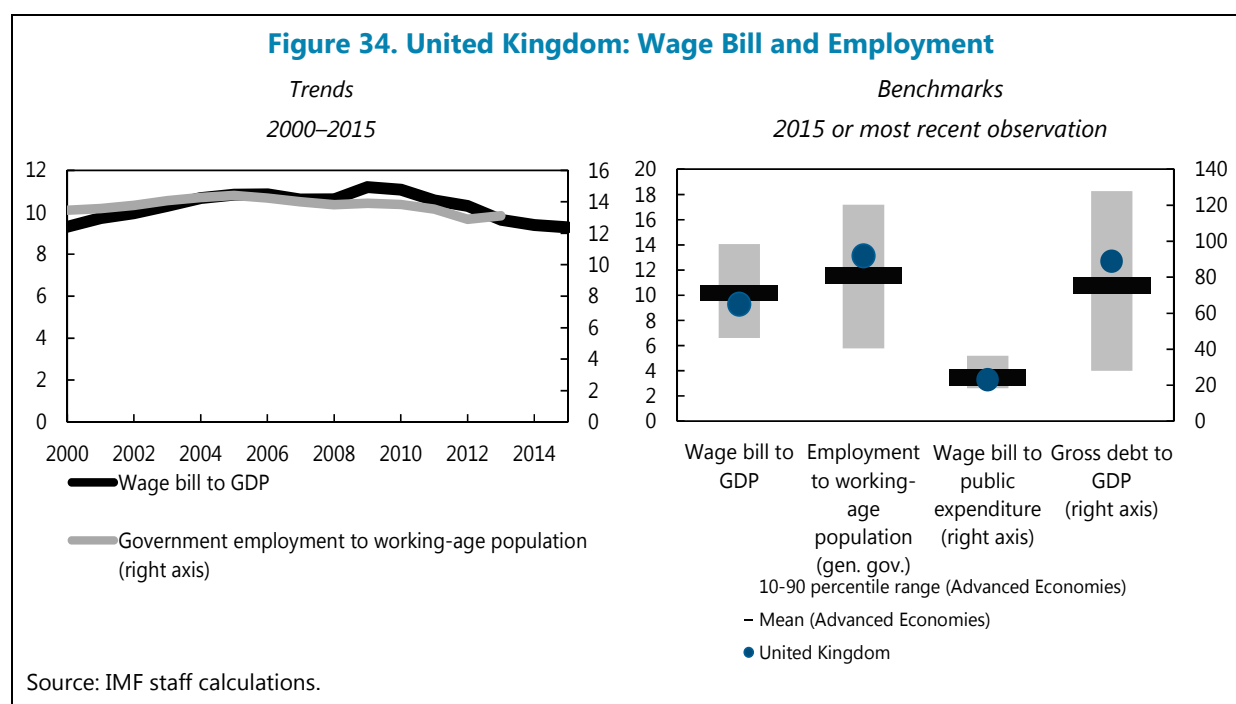
Other aspects of wage bill management also differ across the public sector. Pension contributions and payments, allowances, sickness benefits, redundancy payments, progression pay, and annual leave provisions differ across different workforces and different levels of government.

⁴² For example, average increase in base pay.

Recent reforms have however harmonised the basic principles by which pension payments are valued across the different workforces, and the government is currently consulting on options to reform redundancy payments.

B. Trends and Issues

The public sector wage bill expanded steadily during the 2000s along with overall increases in public spending. The U.K. wage bill increased from 9.3 percent of GDP in 2000 to approximately 10.6 percent of GDP at the end of 2008, despite a small reduction in the percentage of government employees to the working-age population (Figure 35).⁴³ With the additional stress from the financial crisis, the wage bill increased to 11 percent of GDP. Post-crisis reforms, described in more detail below, have resulted in a decrease in the wage bill from 2009 onwards. The U.K. wage bill is now roughly at the mean for advanced economies.



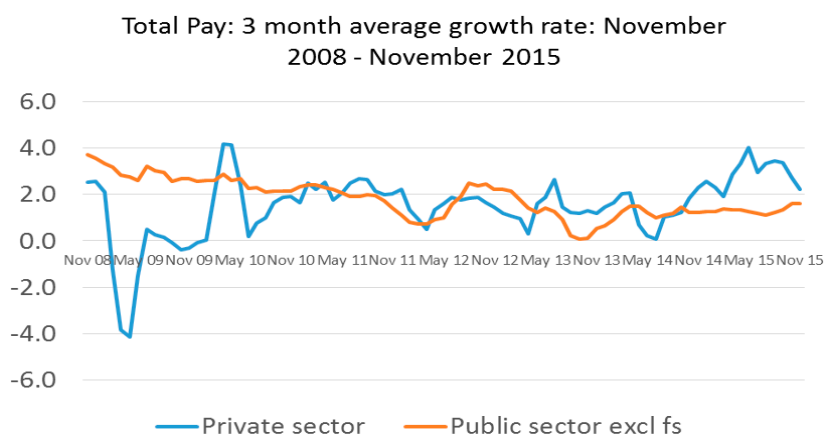
Like in other countries, the expansionary expenditure policy carried out in U.K. during a period of strong economic growth could not be sustained after the crisis hit in 2009. In 2010, when the new coalition Government came into power, the U.K.'s debt position stood at more than 70 percent of GDP, and the fiscal deficit at approximately 11 percent of GDP. In the 2010 Emergency Budget the government therefore announced its plan to embark upon fiscal consolidation as its key priority. Employing over 22 percent of the total U.K. working population, and comprising about a quarter of total public spending, the wage bill represented a significant area of government spending at the time of the financial crisis and would be a key area of consolidation (Box 1).

⁴³ Some of the reduction has been owing to reclassification of certain parts of the government sector into the private sector.

Box 1. United Kingdom: Public and Private Sector Wage Developments Compared

As private sector wages crashed in the aftermath of the crisis, and tax revenues deteriorated, there was an urgent need to put the government's wage bill on a more sustainable footing. Whereas the nominal average weekly wage growth in the private sector exceeded the weekly wage growth in the public sector before the recession, Private wage growth fell sharply post the 2008–09 recession, while sector wages on the other hand adjusted with a time lag, moving from about 4 percent average annual growth in the pre-recession years to about 1–2 percent growth post 2011 (Box Figure). This widened the disparity between average compensation in the public and private sectors.

The public-private pay differential is now back to its pre-recession level, with small scale recruitment and retention issues beginning to appear across specific specialist areas in the public sector. Public sector pay remains, on average, comparable to private sector pay, and public sector defined benefit pensions are amongst the best available. HM Treasury analysis, as well as independent studies, show public sector pay at a premium for most of the last Parliament (2010–2015), and at a significant continued premium when pensions are taken into account.



The coalition government implemented a large package of measures to control the growth of the wage bill. The package included both short-term and structural measures.

Immediate, short-term measures included:

- A pay freeze for two years (with protections for the low paid) followed by a 1 percent annual average pay award policy for central government workers (i.e., including the civil service and wider workforces including health, education, police, judiciary, and armed forces). The 1 percent pay award was an average that applied to each department but not to each individual. Thus departments were free to distribute the award among staff based on their own requirements;
- A temporary recruitment freeze in the civil service (the U.K. civil service is now at its smallest since the second World War); and
- Reduction in departmental budgets that led to a reduction in the workforce size across large parts of the public sector including the police, the civil service, and local government services. Health and education budgets were protected to ensure continued delivery of frontline public services. These protections have now been extended to armed forces as well.

Longer-term, structural reforms included:

- Legislation to undertake public sector pension reforms, including (i) moving from final salary to career average pension schemes; (ii) moving from RPI to CPI indexation; (iii) an automatic link between the pension age for public sector schemes and the state pension age (except for firefighters, police, and armed forces); and (iv) a rebalancing of contributions between scheme members and the taxpayer. These pension reforms increased employee contribution rates by 3.2 percent on average and aimed at saving £2.8bn by 2014–15.
- Introduction in April 2015 of a cap on the overall cost of new pension schemes to ensure the long-term sustainability of the schemes.
- Removal of automatic time served progression pay across the civil service.
- Civil service workforce reforms to introduce a number of central controls on allowances, bonuses, and the use of interim staff in the civil service; and modernizing employee terms and conditions by changing contracts (work hours, sick pay, annual leave provision, etc.) for all new staff and promotes.
- Stricter monitoring and control of approval for salaries above that of the Prime Minister, and off-pay roll staff.

Containing the wage bill also involved a number of policy challenges that had to be addressed. These included (i) negotiating changes to legal contracts for public sector workers to reform terms and conditions of employment, and pension provisions; (ii) devising a pay award policy that would balance the need for fiscal consolidation against the need to keep morale up and prevent recruitment and retention issues; (iii) addressing issues such as automatic time served progression pay that varied widely across departments and had been a historic feature of public sector contracts; and (iv) working with departments to incentivise better long-term strategic planning and workforce management.

The government is currently consulting on a number of additional reforms. These include reforming redundancy pay for public sector workers, and negotiating contract reforms with doctors and nurses to increase workforce productivity in this sector and deliver seven-day health services. Recent additional reforms have included giving head teachers the flexibility to set their own pay awards within a set maxima and minima approved by the government; specific reforms for the police forces; and a new employment model for the armed forces to simplify the number of pay scales and allowances.

C. Reform Challenges and Lessons

The public sector pay and pension reforms have helped curtail the rising public sector wage bill, but consolidation efforts are ongoing. For example, the public sector pay freeze and the 1 percent pay award policy helped save approximately 8 billion pounds in the last parliament and are expected to save another 5 billion pounds in the next five years. Similarly, the pension reforms will have saved approximately 430 billion pounds by 2060 and are an important structural reform to

reduce long-term pension liabilities. In the latest spending round, the government continued to reduce departmental budgets to meet its fiscal consolidation plan; however, the overall pace and size of cuts set for the next five years is one-third smaller on average than the cuts in 2010–2015 (Office for Budget Responsibility, 2015). The Office of Budget Responsibility has estimated that while approximately more than half a million public sector jobs were lost in the last parliament, the next five years will see a reduction of less than a hundred thousand jobs.

Overall the recent public sector wage bill reforms have been largely successful in controlling the wage bill without risking business delivery. It is still early to evaluate specific workforce reforms, for example in schools, where automatic progression has been replaced by performance-based pay, or the reforms currently being implemented in the armed forces and police. There is likely to be increased pressure to reverse some of the short-term ad hoc measures including the cap on the pay award at 1 percent, as private sector wages begin to increase. On the long-term reforms, there is likely to be less pressure to reverse these as many of these reforms have involved changes to employee contracts via legislation and after securing agreement from all key stakeholders.

In its Summer Budget 2015, the government announced it would continue to examine pay reforms and modernize the terms and conditions for public sector workers, including a renewed focus on reforming progression pay. The government is also continuing to look at other areas for long-term reforms, including redundancy pay and sick pay to move to a more modern and productive public sector. Finally, the government is reviewing the use of expensive interim staff that departments tend to use as a short-term fix when making employment cuts, and this will continue to be a challenging area.

Some key lessons from the U.K. experience include:

- Having a clear policy goals helps reforms. In the case of the United Kingdom, the coalition government that came into power in 2010 set a clear road map to achieve fiscal consolidation, which helped policymakers drive forward wage bill reforms.
- The Pay Review bodies provide independent advice to government and serve as a useful intermediary in the wage bargaining process between the government and the unions.
- It is still early to evaluate workforce specific reforms to modernise pay and terms and conditions across education, police, and armed forces. Short-term measures including pay freeze and pay award control have worked so far, but could be difficult to sustain once the private sector labour market picks up pace.
- Further long-term workforce planning and structural reforms are required to improve labor productivity in the public sector and prevent short-term decision making that might have repercussions on the wage bill.⁴⁴

⁴⁴ For example, the increased use of more expensive agency nurses in the National Health System to substitute for permanent staff.

ZIMBABWE

Since 2009, the wage bill in Zimbabwe has grown rapidly, reflecting the need to restore public service wages after the hyperinflation of the 2000s, expansions in service delivery and a general increase in the state's role in the economy. At about 55 percent of total spending, the wage bill is substantially larger than in other low-income developing countries. Current measures to contain the wage bill include an announced freeze on the size of the civil service, no nominal wage growth since 2014, and a number of direct interventions based on salary and employment audits. While these measures are important, the government should develop a medium term strategy of wage bill management that is directly linked to fiscal objectives and includes management of the salary bill, as well as broader budget, accountability, and management reforms.

A. Institutional Background

The wage bill covers the central government (including police and armed forces). Transfers to local government and subvented agencies for wage purposes have grown in recent years. Civil servants paid by externally financed projects are not included in the wage bill.

The management of government compensation and employment is by service commissions/boards with the concurrence of the Minister of Finance. The Public Service Commission, judicial and uniformed service commissions, and the Health Services Board approve wage levels, and hiring and promotion decisions. Their approval requires the concurrence of the Minister of Finance.

Zimbabwe has a career based employment system. Political affiliation is not a prerequisite for any position within the civil service and recruitment is on open competition and assessment of merit. Pay is grouped into six grades from A (lowest—unskilled) to F (highest—top professionals and senior managers). The bulk of staff, such as trained teachers and nurses, are in the middle grades of C and D. There appears to be a high degree of compression between salary scales within each grade, and between the base pay of the lowest and highest grades. Allowances paid to higher grades effectively decompress total remuneration. Efforts are made to ensure internal pay harmonization across different service categories within the total public service.

Pay progression is linked to a positive performance assessment. There is no guaranteed pay progression, though in practice almost all staff receive positive assessments. The 13th check not subject to a performance assessment, and includes allowances in addition to base pay. This remains universal, though is not mandated by law for civil servants.

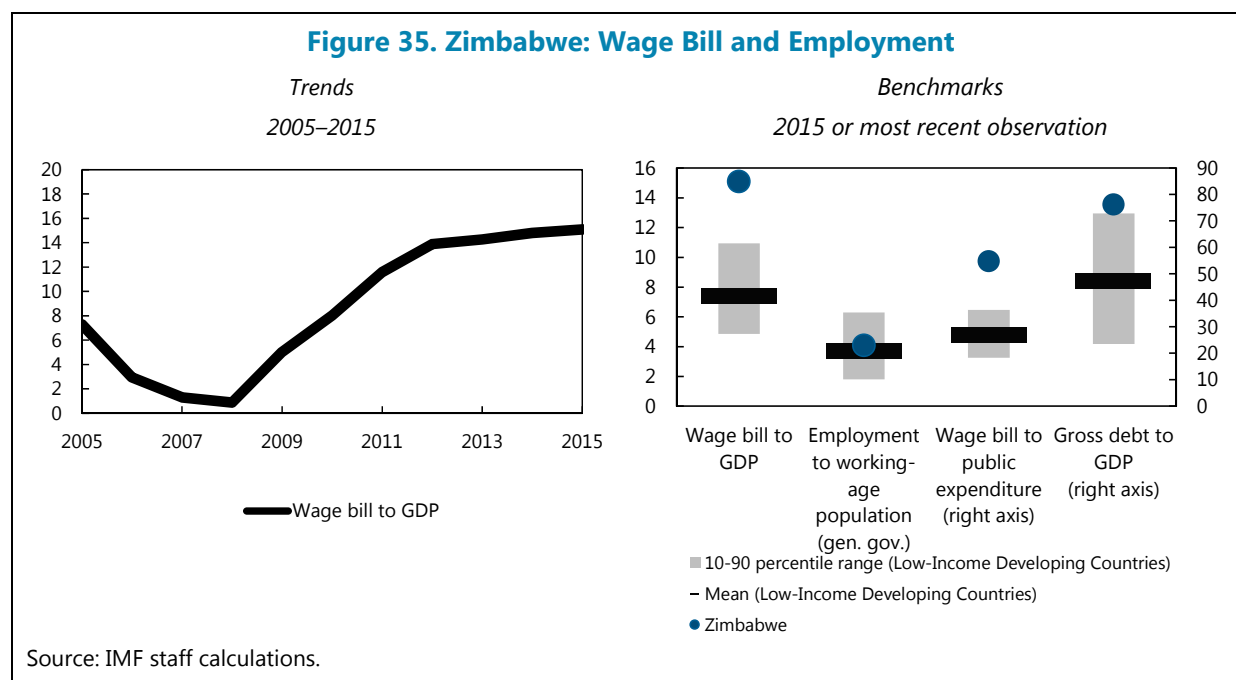
Allowances are extensive (over 40 percent of the wage bill), and guaranteed. Civil servants receive a housing and transport allowance. Management positions also qualify for additional allowances, and sector specific allowances are also paid (for example, overtime and scarce skills). Generally, allowances have become a form of base pay and are not targeted to address a specific market failure or incentivize better public policy outcomes.

Workers are free to join unions (subject to minor restrictions) and there is evidence of a public sector wage premium. Traditionally, pay scales and allowances have been adjusted annually, after negotiations with public service unions. However, there have been no pay negotiations since early 2014. Zimbabwe competes for scarce technical and professional skills in regional labor markets and experiences inability to recruit in some critical areas. Overall, there appears to be a public sector wage premium over the local private sector

The government is an important player in the labor market. The central and local governments provide almost a quarter of all jobs. In part, this reflects relatively low employment in the private sector—the employment to working-age population is 28 percent, reflecting low labor market participation rates (only 40 percent are economically active) and high unemployment rates (about 30 percent of the active are unemployed).

B. Trends and Issues

The wage bill in Zimbabwe is out of line with other countries. Both as a percent of GDP and expenditure, the size of Zimbabwe's wage bill is significantly larger than other low-income developing countries (Figure 35). At 55 percent of government spending (2015), employment costs can undermine fiscal sustainability, potentially placing a significant financing burden on the economy and crowding out other productive expenditures. If total employment costs are considered (including pension costs and transfers for wage purposes) the total public service wage bill would rise to over 65 percent of expenditure.



The wage bill growth has been very strong since 2009. The growth in employment costs has been the result of both higher wages and employment growth. Wage growth has mainly been driven by the need to restore public service real wages that were eroded by hyperinflation during the 2000s. At the same time, the increase in employment numbers was the result of an expansion in service delivery (for example, introduction of an early childhood development program), and a generalized expansion of the state in the economy. Between 2010 and 2013, the expansion in employment costs was underpinned by expectations of continued economic growth, and the unanticipated slowdown in growth and inflation has served to exacerbate the problem.

Despite a freeze on new hiring announced in 2011, numbers of employees have continued to grow. The freeze in positions has not been successful in containing growth in the civil service, and the numbers of employees have continued to grow as service delivery priorities (mainly in health and education) have overridden the commitment not to increase staff numbers. The freeze in new hiring, nonetheless, remains an official policy of government, and the FY2016 budgets have been prepared on that basis.

The government has highlighted the need to manage the wage bill to reduce pressure on the public finances. The consolidation strategy focuses on direct interventions based on employment and payroll audits, while maintaining (and making more effective) the pay and hiring freezes. The Civil Service Human Resource and Payroll Systems Audit undertaken by the Public Service Commission identified potential wage bill savings of US\$170 million a year.⁴⁵ These interventions were announced in the 2016 Budget Statement and are in the process of being implemented. The service commissions/boards for the judiciary, health sector, and uniformed services are undertaking similar audits and are expected to announce specific savings interventions later in 2016. Looking forward, employment and salary freeze are expected to remain in place for the next three years and a review of allowances is planned to identify areas of potential savings and efficiency gains.

C. Reform Challenges and Lessons

In the short term, one important challenge is to contain the wage bill while ensuring service delivery. This requires establishing a clear target consistent with service delivery needs, and managing recruitment and remuneration policies in a manner consistent with achieving the target. Implementing payroll audits, in civil service, health, and uniformed services and reviewing the composition of compensation would help identify areas for savings and efficiency gains. In addition, a strategy to ensure the equitable retrenchment of workers in overstaffed functions and entities would be helpful, including redeployment to priority areas with understaffing.

Better coordination could enhance the administrative and financial management of human resources. Currently, line ministries and departments apply to the Ministry of Finance for their non-

⁴⁵ The Public Service Commission covers all civil servants except for health workers. The judiciary and uniformed services have their own commissions. The health sector has a Health Services Board. While they set pay independently, efforts reportedly are made to ensure pay scales for the different services are harmonized, and the concurrence of the Ministry of Finance and the approval of the Cabinet are needed before new pay arrangements can be implemented.

wage and capital budgets, and the service commissions/boards for approval of new positions, with funding of existing staff an automatic decision. The result is budgeting in silos, with little incentive for MDAs to rebalance their budgets between the wage bill, other running costs, and capital for greater service delivery effectiveness. Better coordination could help control the various drivers of spending such as recruitment needs, retirement projections, promotion policies, and compensation structure and dynamics. Over time, line ministries and departments could be provided more flexibility to manage their resources, and so better balance their inputs, within a clear framework of fiscal and HR management, and regular reporting and oversight.

A medium-term strategy could improve wage bill management. This means a clear and credible wage bill target that is anchored in fiscal objectives. Remuneration and employment levels could be managed in a manner that is consistent with the target. Further, systemic reform in budgeting, pay policy, reporting and accountability, and human resources (HR) management would improve the prospects for wage bill consolidation and improve the allocation and use of scarce public funds between the wage bill, other running costs, and capital investment. Medium term measures can also include giving early guidance to MDA's on budget ceilings, and improve the incentive to reprioritize funds in support of efficiency and effectiveness; further developing Program Based Budgeting, and reviewing and strengthening MTEF processes to shift budget culture from needs to availabilities over the medium term. It seems also crucial to conduct functional reviews in critical ministries, and reviews pay policies, including pensions.

References

- Assemblée Nationale, 1998, "Tunisie: Décret n° 98-834 du 13 avril 1998, fixant le statut particulier au corps administratif commun des administrations publiques," *Journal officiel de la République Tunisienne*, No. 32, pp. 816–22.
- Bonherbe, Jerome, Bruno Imbert, and Benoit Taiclet, "Management of Government Payroll Expenditure in Benin, Côte d'Ivoire and Mauritania," Forthcoming IMF Draft Working Paper (Washington: International Monetary Fund).
- Bosch, Adél, 2006, "Determinants of Public and Private-Sector Wages in South Africa," Research Department, South African Reserve Bank (Pretoria).
- Callen, Tim, Brian Nolan, and John Walsh, 2010, "The Economic Crisis, Public Sector Pay, and the Income Distribution" (Dublin: Institute for the Study of Labor).
- Centeno, Mario, and Manuel Coutinho Pereira, 2005, "Wage Determination in General Government in Portugal," Bank of Portugal Economic Bulletin (Lisbon).
- Clements, Benedict, Sanjeev Gupta, Shamsuddin Tareq, and Izabela Karpowicz, 2010, "Evaluating Government Employment and Compensation," IMF Technical Notes and Manuals 10/15 (Washington: International Monetary Fund).
- Conseil d'Orientation des Retraites, 2012, *Retraites: perspectives 2020, 2040 et 2060* (Paris).
- Côte d'Ivoire, Republic of, 2014, "Communication du Conseil des Ministres sur la stratégie de maîtrise de la masse salariale."
- Cour des comptes, 2009, *Les effectifs de l'Etat 1980–2008 : Un Etat des lieux (Synthèse du rapport public thématique)* (Paris).
- , 2012a, *La situation et les perspectives des finances publiques* (Paris).
- , 2015b, *La masse salariale de l'Etat, enjeux et leviers* (Paris).
- , 2015c, *La situation et les perspectives des finances publiques* (Paris).
- Curristine, Teresa, Mary Betley, Robert Clifton, and Jonathan Sell, 2015, "Malaysia: Strengthening Outcome Based Budgeting," IMF Country Report No. 15/266 (Washington: International Monetary Fund).
- De Castro, Francisco, Matteo Salto, and Hugo Steiner, 2013, "The Gap between Public and Private Wages: New Evidence for the EU," *European Economy, Economic Papers* 508.

Department of Budget and Management, 2016, "Staffing Summary 2016," Accessed March 28, 2016, http://www.dbm.gov.ph/?page_id=13365.

Department of Education, 2016, "K to 12 General Information," Accessed March 28, 2016, <http://www.deped.gov.ph/k-to-12/faq>.

Department of Public Expenditure and Reform, 2015, Statement by the Minister for Public Expenditure and Reform on the Outcome of Discussions Between the Government and the Public Service Unions, <http://www.per.gov.ie/en/statement-by-the-minister-for-public-expenditure-and-reform-brendan-howlin-t-d-on-the-outcome-of-discussions-between-the-government-and-the-public-service-unions/>.

Department of Public Service and Administration (DPSA), 2006, "Personnel Expenditure Review" (Pretoria).

———, 2011, "Personnel Expenditure Review" (Pretoria).

Directorate General of Administration and Public Employment, 2009, "The Decade: Public Employment in Figures, 1996–2005" (Lisbon).

European Commission, 2014, "The Economic Adjustment Program for Portugal 2011–2014," Occasional Papers 202.

Fair Wages and Salaries Commission, 2009, Government White Paper on the Single Spine Pay Policy, Working Paper No. 1/2009, <http://bit.ly/1JUZwQF>.

Government of Ghana, 2016, "Workshop on Comprehensive Public Sector Reform Strategy Document Held," Accessed March 28, 2016, <http://bit.ly/1RjAtM8>.

International Monetary Fund, 2013, "Rethinking the State—Selected Expenditure Reform Options," Country Report No. 13/6 (Washington).

———, 2014, "South Africa: 2014 Article IV Consultation Staff Report," IMF Country Report No. 14/338 (Washington).

———, 2016, "Ireland: Fourth Post-Program Monitoring Discussions," Staff Country Report No. 1618 (Washington).

———, "From Crisis to Convergence: Charting a Course for Portugal," Forthcoming IMF European Departmental Paper (Washington).

Kelly, Elish, Seamus McGuinness, and Philip J. O'Connell, 2009, "Benchmarking, Social Partnership and Higher Remuneration: Wage Settling Institutions and the Public-Private Sector Wage Gap in Ireland," Economic and Social Research Institute Working Paper (Dublin).

- Kenya Institute for Public Policy Research and Analysis (KIPPRA), 2013, "A Comparative Study on Public-Private Sector Wage Differentials in Kenya," Policy Paper No. 5 (Nairobi).
- Labour Relations Commission, 2010, "The Public Service Agreement 2010-14, The Croke Park Agreement" (Dublin).
- , 2013, "The Public Sector Stability Agreement 2103-16: The Haddington Road Agreement" (Dublin).
- , 2015, "The Public Service Stability Agreement 2013-18: The Lansdowne Road Agreement" (Dublin).
- Manuel Campos, Maria, and Mario Centeno, 2012, "Public-Private Wage Gaps in the Period prior to the Adoption of the Euro: An Application based on Longitudinal Data," Bank of Portugal Working Paper (Lisbon).
- Ministère de la décentralisation et de la fonction publique, 2015, *Rapport annuel sur l'état de la fonction publique* (Paris: Ministère de la décentralisation et de la fonction publique).
- Mishra, Prachi, 2006. "Emigration and Brain Drain: Evidence from the Caribbean," IMF Working Paper No. 06/25 (Washington).
- Mizala Alejandra and others, 2010, "Public-Private Wage Gap in Latin America (1999–2007): A Matching Approach," Documentos de Trabajo 268, Centro de Economía Aplicada, Universidad de Chile.
- Moldova, Republic of, 2005, "Law No. 355-XVI of 23 December 2005 on the Wage System in the Public Sector," Accessed August 24, 2015.
- Moldova, Republic of, 2012, "Law No. 48 of 22 March 2012 on the System of the Pay of Civil Servants," Accessed August 24, 2015.
- Office for Budget Responsibility, 2015, "Economic and Fiscal Outlook—November 2015" (London), <http://budgetresponsibility.org.uk/economic-fiscal-outlook-november-2015-3/>.
- Office of Manpower Economics, 2016, "About Us: What We Do," Accessed March 28, 2016, <https://www.gov.uk/government/organisations/office-of-manpower-economics/about>.
- Organisation for Economic Co-operation Development (OECD), 2008, "Ireland: Towards and Integrated Public Service" (Paris).
- , 2012, Public Sector Compensation in Times of Austerity (Paris: OECD Publishing), <http://dx.doi.org/10.1787/9789264177758-en>.
- Public Service Benchmarking Body, 2002, "Report of the Public Service Benchmarking Body" (Dublin).

- World Bank, 2014, *Pay Flexibility and Government Performance: A Multicountry Study* (Washington), <http://documents.worldbank.org/curated/en/2014/06/19630016/pay-flexibility-government-performance-multicountry-study>.
- , 2015, "Measuring the Impact of School Optimization Reform in Moldova" (Washington), <http://siteresources.worldbank.org/EXTSOCIALDEVELOPMENT/Resources/244362-1350667212030/Anna-Olefir-Education-Moldova.pdf>.