

# Ensuring Fiscal Sustainability through Effective Wage Bill Management

February 12, 2015

Zachary Mills

Public Finance Specialist  
Governance Global Practice  
zmills@worldbank.org

PEMIPAL Europe and Central Asia Region



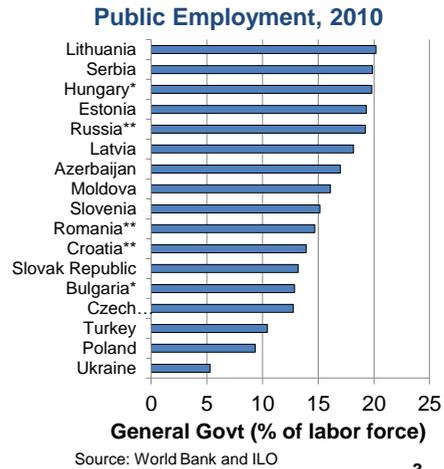
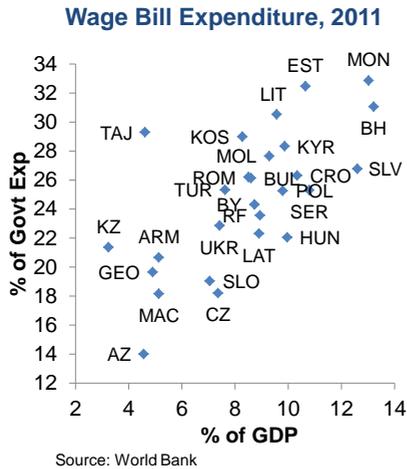
## Why Look at the Wage Bill?

- Largest or second largest expenditure item in the budget
- One of the first items to be cut during fiscal consolidation
  - Pressures to raise productivity and contain cost of public administration
  - But wage bill adjustments are particularly difficult
- Implications for service delivery
- Proactive management



## How Big is the Wage Bill?

- Data Challenges (classification practices, GDP base, etc.)
- Significant variation across countries



3

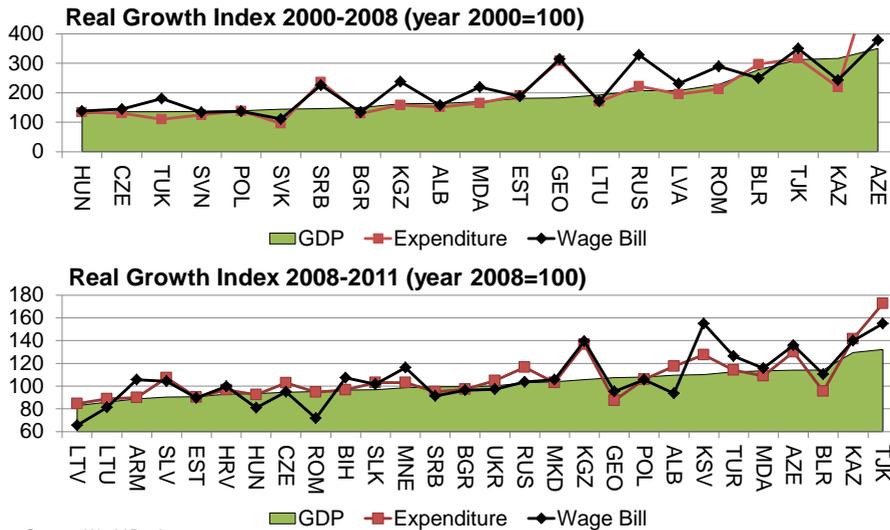
## The Wage Bill and the Crisis

- Measures Implemented in 2008/2009

Nominal Wage Freeze	Nominal Wage Cuts	Hiring Freeze	Retrenchment / Rationalization
<b>Belarus</b> <b>Croatia</b> <b>Georgia</b> <b>Hungary</b> <b>Macedonia</b> <b>Montenegro</b> <b>Russia</b> <b>Serbia</b> <b>Slovakia</b> <b>Ukraine</b> (real wage freeze)	<b>Bosnia</b> <b>Latvia</b> (-18 %) <b>Lithuania</b> (-12 %reduction, excluded teachers, police, medical workers) additional -10 % cut to high paid employees ) <b>Serbia</b> (-10 %) <b>Romania</b> (-25 %, cuts in allowances)	<b>Croatia</b> <b>Georgia</b> <b>Bulgaria</b> <b>Hungary</b> <b>Latvia</b> <b>Macedonia</b> (excl. Positions required for the EU integration) <b>Moldova</b> <b>Montenegro</b> <b>Serbia</b> <b>Ukraine</b>	<b>Bulgaria</b> (14 agencies were closed between Jul-2009 and Jul-2010, while staff reduction was 10.9%) <b>Hungary</b> (8% Cut in Employment) <b>Latvia</b> (the government laid off almost 6,000 workers) <b>Moldova</b> (4,000 vacant positions) <b>Slovakia</b> <b>Romania</b> (all vacant positions)

4

## Trends in Wage Bill Growth



5

## Recent Empirical Findings

- **Large wage bills do not imply unsustainable fiscal policy**
  - Across countries there is no correlation between the size of the wage bill and fiscal health
- **But within countries, wage bill expansions associated with deteriorating fiscal positions**
  - More pro-cyclical during bad times than during good times
  - Impacted by electoral cycles, with election years characterized by steep increases
- “What Goes Up Must Come Down – Cyclicalities in Public Wage Bill Spending” – Sebastian Eckardt and Zachary Mills (2013)
- “Can Public Sector Wage Bills be Reduced?” – Pierre Cahuc and Stephane Carcillo (2012)

6

## Implications for Fiscal Management

- **Proactive management of wage bill growth**

- Wage bill forecasting models
- Importance of policy analysis to inform decision-making



- **Role of institutions in wage bill management**

- How are pay and establishment policies developed and implemented?



7

## Why Model the Wage Bill?

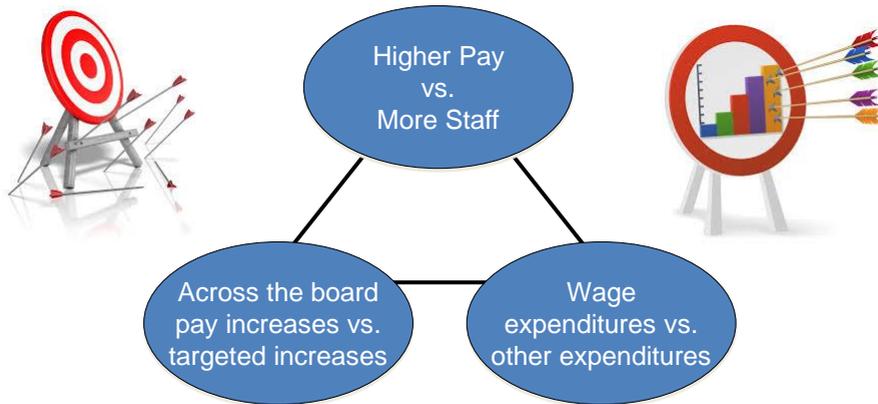
**Allow policymakers to understand the fiscal impact of changes in pay policy and staffing numbers**

- Ensuring an affordable wage bill
- Attracting and retaining needed human capital
- Identify likely winners and losers in any given pay reform scenarios



8

## Managing Tradeoffs...



9

## Customized Forecasting Models

- **World Bank has recently partnered with several countries to develop customized wage bill forecasting models**
  - Microsoft Excel based
  - Uses detailed payroll data
- **How does it work?**
  - Fiscal implications of policy changes in pay/employment
  - 5 year projections
  - Incorporates different pay structures
  - Forecasts attrition and individual pay progression
  - Allows manipulation of many different parameters

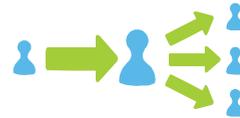


10

## Role of Institutions in Policy Development

	Russia	Kyrgyz	Serbia	Romania	Poland
Decentralized vs. Centralized Pay Policy	Formally centralized pay grid for civil service, but de facto decentralized through numerous adjustment coefficients	Traditionally no centralized pay grid. In 2011 introduced separate pay grids for selected professions, including teachers and health care personnel. New civil service pay grid is being introduced.	Centralized grid for civil service (5% of general Government); Decentralized for other types of public employees	Traditionally, decentralized pay setting; recent move toward unified pay grid under major pay reform	Decentralized pay setting at the level of ministries and agencies
Annual Adjustment in Pay	Ad hoc decision by President, including in year adjustments	Ad hoc decision by the Government; no in year adjustments	Currently, indexation formula which is given twice every 6 months	Ad hoc decision by Government, including in year adjustments	Officially, tripartite commission, but in recent years Government decision
Performance Based Pay	Some performance based pay components exist, but appraisal systems are weak	Performance pay exist in in health and education organizations and in development in civil service. Appraisal systems are weak	No performance based pay	No performance based pay	One off performance bonuses, but appraisal systems are weak
Establishment Control	The number of funded are endorsed through staff ceilings, approved by the President and the Government for subordinated ministries and agencies; the actual level of staffing within the ceilings are within the authorities of ministers and heads of agencies	The number of funded positions is approved by the Government; the actual level of staffing within the ceilings are within the authorities of ministers and heads of agencies.	No centralized establishment control; delegated to line ministries and agencies	No centralized establishment control; delegated to line ministries and agencies	No centralized establishment control; delegated to line ministries and agencies

## Pay Policy Issues to Consider



### Transparency and Fairness

- Equal pay for equal work
- Extent, magnitudes and discretionary additions to basic salary

### Competitiveness

- Pay levels set at an appropriate level to attract and retain staff
- Competition with private sector

### Career Growth

- Vertical compression ratios
- Pay increments without promotion (amount and number)
- Cost-of-living adjustments

## Making the Link to Performance

- Wage bill policies and practices should not be considered in isolation from:
  - What is the government achieving with its human resources? Is there good value for money?
  - Do current practices promote a flexible, performance-oriented public service?
  - Does the pay structure and broader human resource management system promote and reward individual performance?



13

## Making the Link to Performance (2)

- **Beyond performance-based pay**
  - Difficult to do fairly/objectively in practice
  - Measurement challenges
- **Does current staffing reflect government spending priorities and performance targets?**
  - Strategic planning
  - Organizational and unit level objectives
  - Budget priorities



14

## Concluding Messages

- **Emphasis on fiscal management**

- Wage bill = people x wages
- Different tools available



- **Role of institutions in policy development**

- HRM practices / Management / etc.

- **Focus on Government performance**

- Denmark (wage bill 22% of GDP)
- Happiest country in the world
- High quality delivery of public services



15

## Questions?



16

# Forecasting Model in Excel

		2014	2015	2016	2017	2018
	Consumer Price Index	7.0	6.0	5.2	5.0	5.0
	Nominal GDP Growth	15.0	13.8	13.0	13.0	13.0
	Real GDP Growth	7.3	7.5	7.6	7.6	7.7
Pay Regime	Number of Staff					
PMEC TOTAL	177,659					
NON-PMEC Aggregated Gross Payroll	N/A					
Single Pay Spine	152,840					
A	15,461	Housing Allowance A-N	20%	20%	20%	20%
B	4,342	Housing Allowance ACC	30%	30%	30%	30%
C	2,018	Housing Allowance 100%	100%	100%	100%	100%
D	5,118	Housing Allowance 60%	60%	60%	60%	60%
E	2,349	Housing Allowance 40%	40%	40%	40%	40%
F	14,553	Housing Allowance 28%	28%	28%	28%	28%
G	12,303	Housing Allowance 80%	80%	80%	80%	80%
H	74,722	Commuted Night Duty Allowance	7%	7%	7%	7%
I	10,390	Double Class Allowance	20%	20%	20%	20%
J	9,156	Health Shift Allowance	15%	15%	15%	15%
K	1,719	Remote Hardship Allowance	25%	25%	25%	25%
L	711	Rural Hardship Allowance	20%	20%	20%	20%
M	439	Dependent Allowance	20%	20%	20%	20%
N	236					
O	53					
P	4					
Q	3					
R	1					

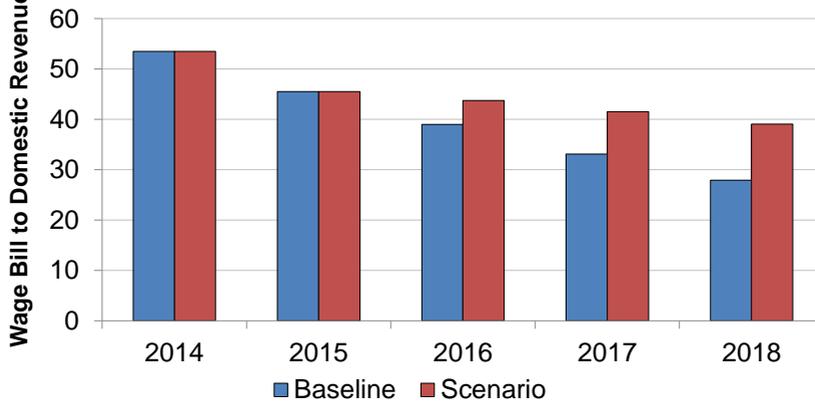
  

	Scenario	2014	2015	2016	2017	2018
Wage Bill to GDP ratio	Baseline	10.99	9.66	8.55	7.57	6.69
	Scenario	11.04	10.12	9.36	8.69	8.07
Wage Bill to Domestic Revenues ratio	Baseline	53.48	45.52	39.03	33.14	27.91
	Scenario	53.70	47.68	42.75	38.05	33.67
Wage Bill to Public Expenditure ratio	Baseline	37.42	33.44	29.64	26.23	23.21
	Scenario	37.57	35.03	32.47	30.11	27.99

17

# Example #1

10% Pay Increases in 2016, 2017, 2018  
No Changes in Staffing Levels



18

# Example #2

**5% Pay Increase 2016-2018**  
**Additional 10% Pay Increase to Grades F-G-H**  
**15,000 New Staff in Grade H**

