Ensuring Fiscal Sustainability through Effective Wage Bill Management

February 12, 2015

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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
  o Pressures to raise productivity and contain cost of public administration
  o 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

The Wage Bill and the Crisis


<table>
<thead>
<tr>
<th>Nominal Wage Freeze</th>
<th>Nominal Wage Cuts</th>
<th>Hiring Freeze</th>
<th>Retrenchment / Rationalization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belarus</td>
<td>Bosnia (-18 %)</td>
<td>Croatia</td>
<td>Bulgaria (14 agencies were closed between Jul-2009 and Jul-2010, while staff reduction was 10.9%)</td>
</tr>
<tr>
<td>Croatia</td>
<td>Latvia (-12 %)</td>
<td>Georgia</td>
<td>Hungary (8% Cut in Employment)</td>
</tr>
<tr>
<td>Georgia</td>
<td>Lithuania (-12 %)</td>
<td>Bulgaria</td>
<td>Latvia (the government laid off almost 6,000 workers)</td>
</tr>
<tr>
<td>Hungary</td>
<td>Belarus (14 agencies were closed between Jul-2009 and Jul-2010, while staff reduction was 10.9%)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Latvia</td>
<td>Macedonia (excl.</td>
<td>Hungary</td>
<td></td>
</tr>
<tr>
<td>Moldova</td>
<td>Positions required for the EU integration)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Montenegro</td>
<td>Slovakia</td>
<td>Latvia</td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>Serbia (-10 %)</td>
<td>Moldova</td>
<td></td>
</tr>
<tr>
<td>Serbia</td>
<td>Romania (-25 %,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Slovakia</td>
<td>cuts in allowances)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ukraine</td>
<td>(real wage freeze)</td>
<td></td>
<td></td>
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<tr>
<td>Ukraine</td>
<td></td>
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</tbody>
</table>
Trends in Wage Bill Growth

Real Growth Index 2000-2008 (year 2000=100)

Real Growth Index 2008-2011 (year 2008=100)

Source: World Bank

Recent Empirical Findings

• Large wage bills do not imply unsustainable fiscal policy
  o 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
  o More pro-cyclical during bad times than during good times
  o Impacted by electoral cycles, with election years characterized by steep increases


• “Can Public Sector Wage Bills be Reduced?” – Pierre Cahuc and Stephane Carcillo (2012)
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?

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
Managing Tradeoffs…

- Higher Pay vs. More Staff
- Across the board pay increases vs. targeted increases
- Wage expenditures vs. other expenditures

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
## Role of Institutions in Policy Development

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

## 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:
  o What is the government achieving with its human resources? Is there good value for money?
  o Do current practices promote a flexible, performance-oriented public service?
  o Does the pay structure and broader human resource management system promote and reward individual performance?

Making the Link to Performance (2)

• Beyond performance-based pay
  o Difficult to do fairly/objectively in practice
  o Measurement challenges

• Does current staffing reflect government spending priorities and performance targets?
  o Strategic planning
  o Organizational and until level objectives
  o Budget priorities
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

Questions?
### Forecasting Model in Excel

#### Example #1

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

<table>
<thead>
<tr>
<th>Wage Bill to GDP ratio</th>
<th>Scenario</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baseline</td>
<td>10.99</td>
<td>9.66</td>
<td>8.55</td>
<td>7.57</td>
<td>6.69</td>
<td></td>
</tr>
<tr>
<td>Scenario</td>
<td>11.04</td>
<td>10.12</td>
<td>9.36</td>
<td>8.09</td>
<td>8.07</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Wage Bill to Domestic Revenues ratio</th>
<th>Scenario</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baseline</td>
<td>53.48</td>
<td>45.52</td>
<td>39.03</td>
<td>33.14</td>
<td>27.91</td>
<td></td>
</tr>
<tr>
<td>Scenario</td>
<td>53.70</td>
<td>47.68</td>
<td>42.75</td>
<td>38.05</td>
<td>33.67</td>
<td></td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Wage Bill to Public Expenditure ratio</th>
<th>Scenario</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baseline</td>
<td>37.42</td>
<td>33.44</td>
<td>29.64</td>
<td>26.23</td>
<td>23.21</td>
<td></td>
</tr>
<tr>
<td>Scenario</td>
<td>37.57</td>
<td>35.03</td>
<td>32.47</td>
<td>30.11</td>
<td>27.99</td>
<td></td>
</tr>
</tbody>
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Example #2

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

Wage Bill to Domestic Revenues

<table>
<thead>
<tr>
<th>Year</th>
<th>Baseline</th>
<th>Scenario</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2016</td>
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<tr>
<td>2017</td>
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<tr>
<td>2018</td>
<td></td>
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Baseline | Scenario