

Wage Spending: Options for Reform

Fiscal Affairs Department

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Options for Reform:

The Challenge of Managing Wage Spending

- **Wages are not widgets:**
 - Prices (i.e., compensation) are not easily renegotiated
 - Quantities (i.e., employment) are mostly-fixed in the short term
- **Weaknesses in PFM/HR management can frustrate efforts to improve the efficacy and efficiency of wage spending**
- **Measures to contain wage spending have implications for the quality and quantity of public service delivery**



Options for Reform: The Importance of PFM/HR Systems

Effectively managing wage spending requires:

- ***Accurate and timely data***
- ***Budget planning processes*** to integrate decisions on compensation and employment into the planning process and incorporate medium-term projections into the planning cycle
- ***Budget execution rules*** to ensure the budget is implemented as planned
- ***Payroll controls*** to limit inappropriate discretion in compensation policies protect against malfeasance
- ***Employment controls*** to ensure employment-related decisions are consistent with staff development plans and budgetary constraints



Options for Reform: Compensation Must Be Competitive

Over the long-term, government compensation must be competitive with that of the private sector:

- Competitive pay does not require “pay parity”
- Can be evaluated with labor force surveys and occupational studies
- When compensation is non-competitive, good workers leave (adverse selection)
- Overly generous compensation is fiscally inefficient, often becomes unsustainable, and has high opportunity costs
- Maintaining the competitiveness of compensation requires flexibility in pay-setting which many governments lack
- Governments also need the flexibility to adjust the *composition* (as well as *level*) of compensation



Options for Reform:

“Right-Sizing” Government Employment

Inadequate government employment precludes or degrades public service delivery

Excessive government employment:

- Is fiscally inefficient
- Risks crowding-out investments in HR development
- Discourages the adoption of new technologies and business processes
- Results in inefficient spending on non-wage inputs

Can be difficult to measure: cross-country comparisons and inter-temporal analysis can help

Managing the size and composition of the workforce can be difficult when labor-protections are overly rigid



Options for Reform:

Lessons from International Experience

Crude measures (such wage and hiring freezes):

- Can provide meaningful short-term fiscal relief
- But can exacerbate weaknesses in wage and employment policies, degrade morale, and impair public service delivery
- Often unravel once existing fiscal pressure eases

Structural reforms:

- Take time to design and implement
- Initially have an inestimable fiscal impact
- But, in the long-term, are essential to improving the efficiency of wage spending and assuring its sustainability



Bending the Trajectory: Measures Addressing Compensation

- **Ad Hoc Adjustments**

- Nominal wages and salaries can be increased at less than the rate of inflation (i.e., cut in real terms)
- Common examples include across-the-board wage freezes and the suspension of longevity-related pay increases

- **Structural Pay Reforms**

- Pay tables can be revised to better align compensation with job requirements, performance levels, and private sector pay
- Examples include switching to a single pay spine (SPS), introducing performance-related pay (PRP), and rationalizing allowances and other nonwage compensation



Bending the Trajectory: Measures Addressing Employment (1/3)

- **Attrition-based employment reduction**
 - Only some vacated positions can be filled, resulting in a net reduction in employment
 - Under a typical attrition rule only “X out of Y” vacant positions are allowed to be filled
- **Targeted employment reduction**
 - Voluntary or involuntary separation; early retirement
 - Must consider lifetime employment costs
 - International experience has been mixed



Bending the Trajectory: Measures Addressing Employment (2/3)

Organizational restructuring

- Functional reviews of ministries, departments, and agencies to:
 - Identify areas of overlap or duplication; and
 - Clarify/codify organizational goals and responsibilities
- Functional reviews should be followed by mergers of units, outsourcing, and process reengineering to streamline staffing within units
- The goal is to “right-size” government employment



Bending the Trajectory:

Measures Addressing Employment (3/3)

- **Strengthening payroll management**
 - Human resource management can be strengthened, and – in some instances – centralized, to better track government workers and tighten payroll controls
 - Centralization works best in countries with limited human resource and/or weak PFM capacity
 - An employee census can be used to identify ghost and zombie workers