GET Note: Options for Restraining the Wage Bill
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Options for Restraining the Wage Bill
(while preserving essential service delivery)

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General principle

Nearly every personnel and pay system has some slack in it, either fiscal excess or staff positions (vacant or otherwise) that are not essential. The key is to look for targeted measures that produce savings and reduce the wage bill, without adversely affecting service delivery.

Measures (the following are not mutually exclusive)

1. **Retain savings from vacant positions**. Some countries allocate to line ministries at the beginning of the year the full budget amount for approved staff positions. If the average vacancy rate in ministries is 10 percent over the course of a fiscal year, then potential savings worth 10 percent of the ministry wage bill are possible without any reduction in staffing. Central payroll processing, where the treasury cuts the checks for each employee centrally, effectively retains the vacant position salaries with treasury until such time as a position is filled and the ministry adds a staff person to their regular pay-roll report to treasury.

   While seemingly painless, there may be strong resistance to this option by line ministries. In some countries, ministries retain the salaries for vacant positions and reallocate these funds as salary top-ups or bonuses for on-board staff. Removing the funding for vacant positions from ministries is therefore effectively a pay or bonus cut. If faced with the choice between staff lay-offs and reduced *ad hoc* bonuses, ministries may choose the loss of bonuses. However, the loss of bonuses will likely generate pressure for pay reform from civil servants, where base compensation is often significantly lower than the private sector.

   Central retention of the funding for vacant positions until the position is filled also generates pressure in ministries to fill the vacant position. A related reform option might be to cancel all positions left vacant for more than 12 months, on the grounds that the position/staff were in fact not needed, and permanently take the savings from these posts.

2. **Furloughs**. Instead of formal lay-offs (permanent reduction in force), some countries have used forced leave-without-pay for a few days or weeks to reduce wage expenditure in the current year. This is a one-off measure but may need to be repeated in future years if spending pressures remain a problem. (e.g. Maryland, USA, 2008-09)

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3. **Contracting-out or out-sourcing**. It may be possible to contract-out some basic service delivery functions that still remain in the public sector, reducing the wage bill. Examples include many local or municipal functions (garbage collection, snow removal, health services). Osborne and Gaebler in *Reinventing Government* make much of these options, but it can take some years to amend public sector laws and regulations to enable out-sourcing. Careful cost-benefit analysis is required, as out-sourcing may reduce total costs for service delivery and improve service delivery in the process; but such results are not always achieved. Governments frequently out-source IT services, but mainly to enable paying higher wages to these scarce skills and improve internal services. In these cases, total costs generally rise (though in return for better services). In heavily unionized public sectors, policies of out-sourcing can engender large-scale opposition.

   Some countries have moved away from filling government positions through the civil service, preferring short- or long-term contract employees. Contract employees can be let-go more easily and at lower cost, but this approach can lead to dual personnel systems, with special management challenges (e.g. Peru). In some countries, a dramatic shift to contract employment has been a formal approach to over-all "civil service" reform, such as in Switzerland, where the majority (90%+) of federal public sector employees work under contract.

4. **Wage reduction of current employees**. Reducing the wages and benefits of current public sector employees is always difficult, and in some countries may be prohibited by the constitution. But in some cases, countries or even ministries have reduced public sector pay rates to maintain employment and reduce the wage bill (e.g. Ukraine 2008).

5. **Downsizing and voluntary retirement**. In any discussion around these thorny topics, it is always worth keeping in mind that major downsizing exercises have a pretty poor track record (because of the design complexities and the obvious anguish that they create). If explicit downsizing is chosen as part of the strategy, then any Voluntary Retirement Scheme should be designed to pay only the minimum required (see Martin Rama's work)[1] and, to minimize harm to service delivery, should guard against the well-known but very hard to avoid problem of adverse selection (where the public sector loses its best and brightest). Many countries have statutory provisions for separation benefits (severance payments, retraining, etc.), and it is important to note that formal downsizing can actually increase personnel-related expenditures in the year of the downsizing itself. It may take up to 2 years or more before the net savings of formal downsizing exceed the immediate costs (even assuming that the government refrains from (re)hiring employees in the interim—as short-term consultants or otherwise).[2]

   Many approaches might be taken to identify areas for downsizing (for example, see #9 below), including

[1] Martin Rama's work on a Voluntary Retirement Scheme in Two Nepal Public Sector Banks is available from: http://www1.worldbank.org/publicsector/civilservice/rightsizing/coursepack.htm

[2] On a cash basis. Under accrual accounting, staff separation costs might be treated as 'other expenses' or 'extraordinary items' and brought to account after the operating statement result.

- consolidation of ministries and departments
- Functional Reviews of ministries and reorganization
- elimination/merging of single-issue ministries and associated overhead costs
- reducing mid-level management ranks through reorganization and broadening spans of control

6. **Administrative function consolidation**. Identify common administrative tasks across agencies/ministries, and try to consolidate the functions in central services units, downsizing in the process. In 2008 Finland started to implement such measures, creating central, government-wide service units for human resource management, procurement, etc.

7. **Taking gains from automation and modernization**. As countries have modernized their public sector—particularly public financial management—the roles and responsibilities of some entities have changed, but the staffing has not been reduced commensurately. For example, as treasury systems have been automated and modernized, the role of accountants in the public sector has changed. In Latin America, in particular, accountants no longer have a control function, and the demand for their services under automated general ledger systems is greatly reduced. Nevertheless, there remain large numbers of accountants on staff at ministries of finance and within line ministries.

   Similar approaches can be followed for other sectoral ministries, as well, though the necessary analysis, business processes re-engineering, and re-staffing would likely require some investment up front, and significant lead time would be needed to implement the reform. For example, some countries organize front-line health services delivery to require multiple doctors to staff even a small clinic or health center. In remote areas, these may not be affordable. Alternate service delivery mechanisms would require training doctors differently (to enable one doctor per clinic), allowing new health professions to exist and be trained (physician assistants or nurse practitioners), and perhaps changing normative rules for unique circumstances (two nurses and one physician, instead of three doctors and three nurses). Changing the labor inputs to reflect new technology and production arrangements can yield substantial savings over time. However, as the example suggests, changing medical labor laws, creating new professions, training and certifying, and then deploying these new staff will take years. Even so, given potential improvements to service delivery and reduced costs, a current wage bill crisis can be the perfect lever to initiate these changes and reduce wage bills over time.

8. **Recruitment freeze**. These have had a bad press and raise the obvious problem of uneven vacancies; but attrition (retirement, resignation, death) is generally around 3-5% per year, which represents a significant saving and attracts less public attention than formal retrenchment strategies. A partial freeze might also be possible, allowing limited re-filling of vacant positions (e.g. essential services). For example, in the U.S. during the 1990s, a partial freeze was put in place for the Federal Government, allowing re-filling of 2 out of every 5 vacant posts.

   Transforming the <u>methods</u> for service delivery can reduce staff needs and thus enable staff reductions that do not harm service delivery. This includes process

simplification/reengineering, IT investments, and citizen service centers (see also #7 above). But these are medium- to longer-term strategies that are unlikely to produce quick savings.

9. **Retire over-age staff** (working pensioners). This may have some impact on service delivery, but is likely to be minimal.

10. **Review/rationalize allowances**. It is here where many of the *de facto* and potentially unwarranted salary increases will be found.

11. **Review/rationalize lower grade/support staff**. It is often at this level where: (i) there are unnecessary staff hired for patronage reasons; and (ii) remuneration tends to be above private sector comparators. Look particularly in the large employing sectors (e.g., health, education, and the civilian defense establishment) rather than in the core ministries.

12. **Remove ghosts and double-dippers** (occupying more than one post). By definition this has no impact on service delivery. However, this will require work on establishment control and payroll management, as there is likely to be collusion from payroll staff.

13. **Remove fraudulently appointed staff or staff with forged qualifications**. Again, this will have minimal impact on service delivery, as these employees most likely were not appointed for their skills or competence.