

WAGE BILL AND PAY REFORM: A FIRST GLANCE AND A LOOK FORWARD

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Reforming wage bills can significantly impact a country's fiscal outlook, public sector performance, the health of its labor market, and private sector development. The public sector represents an average 15 percent of total employment, and it accounts for a large chunk of formal sector employment in Sub-Saharan Africa, East and Central Asia, South Asia, East Asia and the Pacific, and Middle East and North Africa Regions of the World Bank.¹ The Bank began focusing on this topic several decades ago, and many of the issues then remain relevant today. This *Governance Note* offers answers to principal questions: What is the main motivation for the Bank's involvement? What does its basic package of policy solutions look like? What are the main policy trade-offs? How does the political economy of pay reform come into play? And what can be learned by World Bank staff from experience for future wage bill and pay reform projects?

WHAT IS THE WORLD BANK'S MAIN MOTIVATION?

The Bank's goals in wage bill reform are transparency, horizontal equity, and predictability of the wage bill. Most of all, it aims to improve a country's fiscal sustainability. The policy options that underpin these motivations will be discussed in more detail after examining the purpose of these goals.

Transparency is the basis for horizontal equity and predictability. Creating a simpler pay structure, reducing the number of allowances on top of public servants' base pay, and improving payroll management all lead to more transparency. Greater transparency then leads to the opportunity to achieve more horizontal equity — where public servants get the same pay for the same work, regardless of their respective organization. Better options also become available to monitor and improve public sector performance, and the wage bill for the next fiscal year becomes easier to predict. As a result, the government is better able to adjust the wage bill to better fit budgetary limits, detect waste and shortages, and improve its overall performance.

The Bank's most important motivation is the positive impact of wage bill reform on a country's fiscal situation. Fiscal sustainability is a key priority for developing countries. The total wage bill (salaries plus allowances) can add up to between 20 percent and 30 percent of government spending (IMF 2016). This simple fact shows that efficiency measures could significantly impact the total budget. Similarly, money saved on the wage bill can be spent on other, critical nonwage priorities.

WHAT IS THE BANK'S BASIC POLICY MENU?

Although interventions differ between countries based on administrative traditions, political context, level of development, and other factors, common threads are found among the policy options recommended by the World Bank. The most important ones are differentiated between technical and short - and medium - term options for wage bill reform.

TECHNICAL OPTIONS

To get a grip on the government's personnel expenses, the Bank often looks at payroll management first. Although not immediately leading to reductions in the wage bill, these steps form the fundamental basis for further action:

- Centralize and modernize payroll management
- Link the wage bill to the overall budget

A central agency or bureau in charge of the personnel register is needed to develop clarity and structure. Digitization of payroll management simplifies the process of analyzing and adapting the workforce and calculating overall costs. Once payroll management is centralized and modernized, it becomes much easier to link the wage bill to the overall budget. Often government budgets are finalized without knowing exactly the cost of the wage bill (World Bank 2009).

SHORT-TERM OPTIONS

Fiscal crises might require a government to implement short-term wage bill policies. Some of them include:

- Freezing wages across the board or linking wage increases to inflation only
- Allowing only current positions to be refilled or creating attrition by only replacing, for example, three out of every five people leaving the public sector
- Encouraging older employees to retire early, although this option might include extra costs in the form of pension payments

Often, when hiring freezes or attrition are introduced, the education and health services sector are excluded.

MEDIUM-TERM OPTIONS

Medium term policy changes tend to be more sustainable and

¹ World Wide Bureaucracy Indicators: [https://databank.worldbank.org/data/source/worldwide-bureaucracy-indicators-\(wwbi\)#](https://databank.worldbank.org/data/source/worldwide-bureaucracy-indicators-(wwbi)#).

have greater impact on the wage bill (Forni and Novta 2016). Four options often offered to the Bank's clients are summarized here.

Registering all employees. Finding out exactly who works where and for whom can be a massive challenge. This is, however, the start. One immediate benefit is that finding so-called "ghost workers" and redundant positions becomes a lot easier. Malawi, for example, got rid of 17,669 ghost workers (World Bank 2018a).

Creating a single-pay structure. After cataloging all employees, a wage grid with equal positions linked to equal wages could inform the levels of equity and transparency. Much like modernizing payroll management, this approach is intended to enhance the government's options and ability to control the wage bill. However, single-pay structures must take into account different career paths in different parts of the public sector. Similarly, a balance needs to be found between horizontal equity between similar positions in different organizations and the need for wage flexibility to award outstanding employees or attract personnel to hard-to-fill positions. An interesting example is found in Ghana (Cavalcanti 2009).

Decreasing allowances and increasing the wage percentage taken up by base pay. Allowances form a large part of the lack of transparency and insight in the exact size of an upcoming wage bill (Reid and Orac 2007). A significant number of discretionary non-pay benefits are often unaccounted and mostly handed out in a decentralized nontransparent manner. Decreasing the number of allowances and increasing the percentage of base pay in the wage will increase transparency and the government's ability to control the wage bill.

Comparing public and private sector wages. Properly and regularly comparing public sector wages with their equivalents in the private sector can enable the public sector to set its wages more efficiently and competitively (Gindling et al. 2019).

It can be difficult to figure out which of these options are most relevant, effective, and achievable. The World Bank Bureaucracy Lab is working in many countries (e.g., Bosnia-Herzegovina, Brazil, Honduras) to discover which policies are best applicable and most pertinent for each client country. The Lab works mainly through the analysis of microlevel personnel and payroll data shared by government.²

WHAT ARE THE MAIN TRADE-OFFS?

Many policy decisions come with possible trade-offs and often unexpected outcomes. Four of the most notable ones are described here. A few general issues are considered first.

Public servants do not just represent a cost, they are crucial for service delivery. Finding a balance between cost savings and inherent impacts on service delivery is key. In developing countries, improving public services can often mean increasing staff.

Research and experience show that support among stakeholders and the political elite, plus clear communication and expectations from management, are crucial in pay reform

(Forni and Novta 2016; Bregn 2008). This facet tends to be underrepresented in many World Bank documents. Closely related is the importance of the political economy of pay reform — a key bottleneck issue that often determines what types of reforms are feasible. Changes in people's pay are inherently political. Campaign promises, looming strikes, union actions, or upcoming elections can be decisive (Barma and Orac 2014; Eckardt and Mills 2014). In Chad, cuts in allowances were reversed after fierce pressure from striking public servants (World Bank 2018b).

When the public sector employs a great number of people (sometimes up to 35 percent of the working age population), large, across-the-board wage cuts or firings could lead to social unrest — an issue addressed in the pay bill strategy for Swaziland (World Bank 2010). Countries like Egypt and Tunisia are two other examples where public sector jobs had, previous to the Arab Spring, been used consistently to ease social tensions.

Previous evaluations find a tendency to take too much of a technocratic, one-size-fits-all approach to wage reform (World Bank 1999, 2008a). What exactly constitutes too large a wage bill is partly nationally, culturally, and historically determined. In certain countries the government is generally expected to deliver more services than in others. Simply comparing percentages over different countries might not be enough to reach a solid conclusion.

Unintended consequences and trade-offs of short-term solutions. The unintended consequences of policy advice can be seen in Cameroon. Strict wage limits were quickly followed by a recovery of wage losses through the proliferation of discretionary non-pay allowances. The wage freeze led to a far less transparent system rather than a smaller wage bill (World Bank 2018c). Downsizing is equally problematic. An evaluation by the Independent Evaluation Group concludes, "Downsizing and capacity building initiatives failed to produce permanent reductions in civil service size and to overcome capacity constraints in economic management and service delivery" (World Bank 1999, ii). At the same time, encouraging employees to retire early could lead to a hike in pension payments, might not lead to quick wins, and are more likely to produce quick losses.

Notable trade-offs and consequences in the medium term. Decompressing wage structures, or creating a single-wage grid, can lead to short term wage hikes. When changes are made, no one wants to make less money. As a result, up is the only movement wages will make. Although the long-term effects of a simplified and decompressed pay structure might be positive and significant, the wage bill might go up in the short term. In Ghana, the government expected at least a 50 percent increase in its base pay wage bill if its single-pay spine was introduced (Cavalcanti 2009).

Winner and losers when decompressing and reorganizing wage structures or moving allowances into base pay. Political economy teaches us that changes to nonwage compensation is a strong and effective mobilizer, as seen in the case of Chad (World Bank 2018c). Opposition parties, unions, and affected members of the

² World Bank Bureaucracy Lab: <http://www.worldbank.org/en/research/dime/brief/Bureaucracy-Lab>.

public service can be formidable opponents to pay reform and delay or block the process (Kiragu and Mukandala 2003). In Latvia (World Bank 2005), reforming the pay system in the public sector became a highly politically charged issue that encountered strong resistance from high level civil servants, leading to little progress.

Difficulties in comparing wages. Comparing public with private sector wages is only a seemingly evident step in pay reform and is infamously difficult. These sectors don't have one-on-one comparable functions. Monetary allowances in the public sector might not be included in pay information, making comparisons flawed. People might decide to work for the public sector for nonmonetary reasons such as status, networking, public service motivation, and job security (Gindling et al. 2019).

Payroll management issues. Finally, even the more technocratic issue of payroll management often brings considerable budgetary and information technology issues along with it. Tech projects are notoriously difficult to manage and can lead to significant delays if not handled properly. Examples include making improvements to payroll management in Tajikistan and Tanzania (World Bank 2006, 2008b). Budgetary constraints became the main obstacle in Madagascar when the Ministry of Civil Service was unable to secure financing to update the civil servants' roster (World Bank 2017).

A LOOK AHEAD: LESSONS LEARNED

Three key lessons learned are identified and summarized: make interventions context specific and underpinned by diagnostic work on civil services and political contexts; make payroll management both the basis and the minimum for more comprehensive reforms; and be cognizant of unintended consequences.

Policy interventions on pay and wage bill reform should be context specific. Different countries have different public services, administrative cultures, and expectations of public service delivery. Thorough knowledge of these issues is a prerequisite for effective policy interventions. An example is the difference between administrations with a francophone or anglophone tradition, which possess different public sector features, including pay structures and reforms (Kiragu and Mukandala 2003). Reforms are best underpinned by diagnostic work on civil services (e.g., tradition, culture) and more diagnostics on specific political contexts (World Bank 2008a). Whereas short-term policies have policy risks such as low sustainability and diminished public service delivery, the risks of medium-term policies are more political in nature. The political economy surrounding wages and benefits is complicated and politically dangerous (e.g., World Bank 2005, 2018b). Political economic or stakeholder analyses are rarely carried out by World Bank teams before implementing or advising policies, even though, for example, the simple observation on whether unions are expected to strongly oppose the reforms can greatly inform policy options.

Payroll management is both the basis and the minimum for more comprehensive reforms. Apart from improving fiscal controls, a centralized payroll system provides the vital data to

inform the design of pay and employment policies and monitor policy implementation. Since it is rather technocratic, chances of full implementation are reasonable. The data generated by these systems provide objective facts, such as quantifying pay inequity across public sector workers, that can help relax the political economy constraints to reform. More generally, the Bank's engagement in wage bill and pay reform should be grounded in solid empirical analysis given the importance of local context and the lack of silver bullets to solve complex problems. An example of the empirical data necessary for such analysis is given by the Worldwide Bureaucracy Indicators.³ These cross-national benchmarks need to be supplemented by analysis of micro-data (e.g., number, location, and cost of all civil servants), to identify where the problems are located and provide client governments with suitable policy solutions to address them.

Finally, cognizance is needed around unintended consequences. Short-term reforms, like wage freezes and hiring contractual employees, can create long-term distortions. At a minimum, there needs to be fiscal modeling of different reform options and self-awareness of possible perverse effects given local political economy realities. Although short-term reforms are sometimes necessary, they are never sufficient. Research and experience show them to be unsustainable. More often than not, they don't lead to structural reforms.

CONCLUSION

Wage bill and hiring policies can have an enormous impact on a country's fiscal situation. Reforming them could have a large return on investment. If done properly, reforms could strengthen both the public sector, the private sector labor market, and the fiscal sustainability of the government. After considering general yet foremost factors, opportunities can be found at a technical level, and policy options are possible for both the short and medium term. However, if done incorrectly, attempts at reform can have a hugely detrimental effect on service delivery and a country's development. This *Governance Note* provides an introduction and overview and aims to generate interest in requests for more information.

For the convenience of World Bank staff who want to explore issues further, a list of relevant literature and World Bank cases by Region is available upon request. To obtain it as well as more cases, reports, working papers, or answers to essential questions, contact wvanacker@worldbank.org.

³ The Worldwide Bureaucracy Indicators can be accessed at <https://datacatalog.worldbank.org/dataset/worldwide-bureaucracy-indicators>.

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