

4. STRATEGIC ISSUES IN MANAGING THE PUBLIC ADMINISTRATION

A. INTRODUCTION

4.1. Strengthening the quality of public administration remains a key challenge as BH advances European integration. Effective administration is also an important enabling condition to many other policy reforms. While new functions and activities are added to the public administration to help meet EU standards, the authorities must find ways to lower the overall cost and improve effectiveness. Despite significant efforts over the past few years to reduce the burden of public employment on budgets, public wages and benefits relative to GDP remain high by international standards, while outcomes remain substandard. Moreover, some of the underlying systems and practices for managing the government's human resources undermine efforts to encourage a culture of performance and meritocracy within the public sector.

4.2. The share of public wages in GDP and in total expenditures is substantially larger than among comparator countries, an outcome largely due to higher relative wage rates. Wage rates are particularly out of line for lower grade employees at the level of the state and to a lesser extent in the FBH. By contrast, wage rates for higher and mid-level employees are unusually compressed. High comparative wage rates are accompanied by overall public employment that appears modest relative to the country's population but excessive relative to total employment in the economy. Given substantial excess employment in police, defense, the courts and education, as well as the duplication arising from the fragmented administrative structure, the size of the "core" public administration is very small, with negative consequences for the functioning of government and delivery of public services.

4.3. Reducing the cost of the public administration over the medium term will necessitate tight control of salary levels, even to the extent of reducing average wages in real terms. Because the bulk of public employment is at the lower levels, excessive pay levels for these positions can have a significant impact on the overall wage bill. At the state level in particular, further assessment should be carried out as to whether the planned but as yet unrealized reduction in salary levels for 2006 by 10 percent should not be augmented to reduce public sector employment costs. Moreover, without good coordination between the levels of government, there is a risk that fiscal costs will rise even further, as employees are shifted to the state level as state building advances. Even within the current entity structures, there is a need to avoid over-paying for positions that are less essential to the core functions of government.

4.4. Difficult trade-offs need to be made to reduce the levels of employment at some levels of government. The planned defense and police reforms will contribute to that, but will not go far enough by themselves to reduce public administration costs to sustainable levels. The overlapping governmental structures within BH imply that some degree of rationalization should be feasible, but the magnitude of possible savings is difficult to quantify without in-depth studies. Setting a clear, realistic budgetary target for savings is one strategy to compel a prioritization of functions and activities across the range of ministries at the entity and the sub-entity levels. Gradual declines in staffing levels over the medium term should be feasible, but their contribution to overall savings may be moderate because the core civil administration is relatively small. **Defense, public order (including the judiciary), and the education**

sectors together make up roughly 70 percent of the overall wage bill, meaning that any serious attempt at cost reduction must include these sectors.

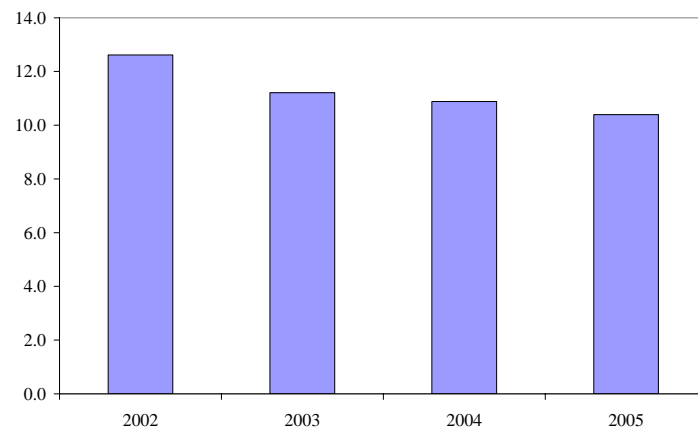
4.5. Incentives for performance must also be strengthened if there is to be any genuine improvement in the quality of public management. Though substantial progress has been made in introducing merit-based appointment into the civil service, the pay system remains largely unreformed. Pay scales remain highly compressed, and heavy reliance upon length-of-service in determining total pay contributes to a culture in which performance and responsibility are often not rewarded. Improving the incentive structure would have budgetary implications, but they need not be excessive if they are well targeted toward key skills. Policies for career management and advancement could also be refined to make the public sector more attractive to high-skilled individuals.

4.6. This chapter focuses on the high cost of the public administration and its key determinants. It outlines options for reducing the cost, based on the premise that policy actions should be well-targeted to specific sectors. It makes no attempt at specifying what ministries or functions should be cut back as these are the policy trade-offs that are the reserve of the authorities. The chapter also analyzes the current pay practices and how they contribute to or undermine performance management and equity within the public administration. Recommendations are made on enhancing incentives in the recruitment and retention of skilled staff and that would facilitate greater effectiveness. The overall thrust of the chapter is that resources could be much better allocated to improve public sector performance. Indeed, the over-reliance on achieving desired staffing levels to the neglect of basic operating funds has in some instances led to higher costs with questionable outcomes.

B. THE COST OF PUBLIC SECTOR EMPLOYMENT

4.7. The wage bill remains high despite substantial progress in reducing wage outlays over the past few years. The general government wage bill fell from 11.7 percent of adjusted GDP in 2000 to 10 percent in 2004 (Figure 4.1). Relative to official GDP, the decline was from 19.6 percent to 15.2 percent.¹ Including outlays by the extrabudgetary funds and wages for medical professionals, an adjustment that makes possible a more reliable comparison with other countries, the wage bill amounted to 12.7 percent of adjusted GDP in 2005. Relative to GDP, the government wage bill is larger than among all other CEE and SEE countries, and particularly oversized compared with faster growing emerging market economies (Figure 4.2).

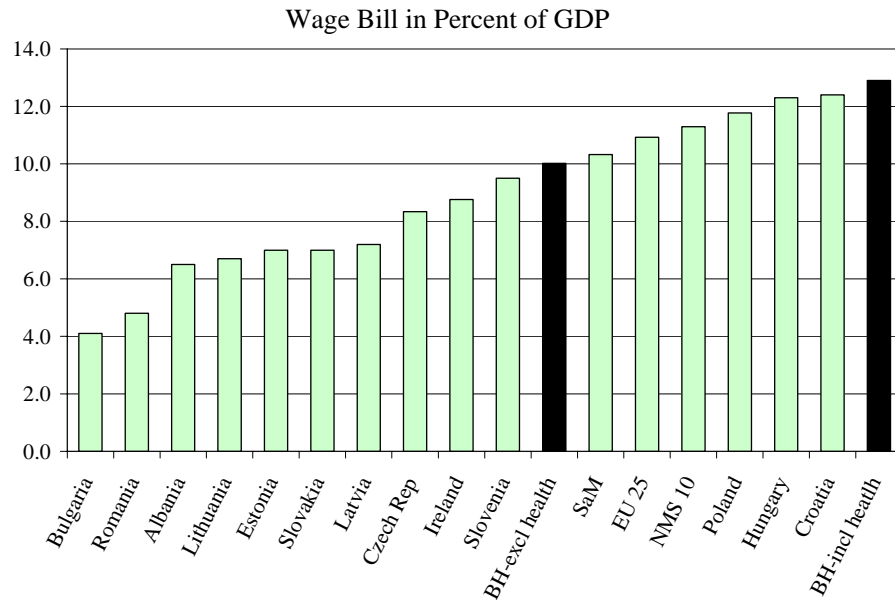
Figure 4.1. BH: General Government Wage Bill 1/
(In percent of adjusted GDP)



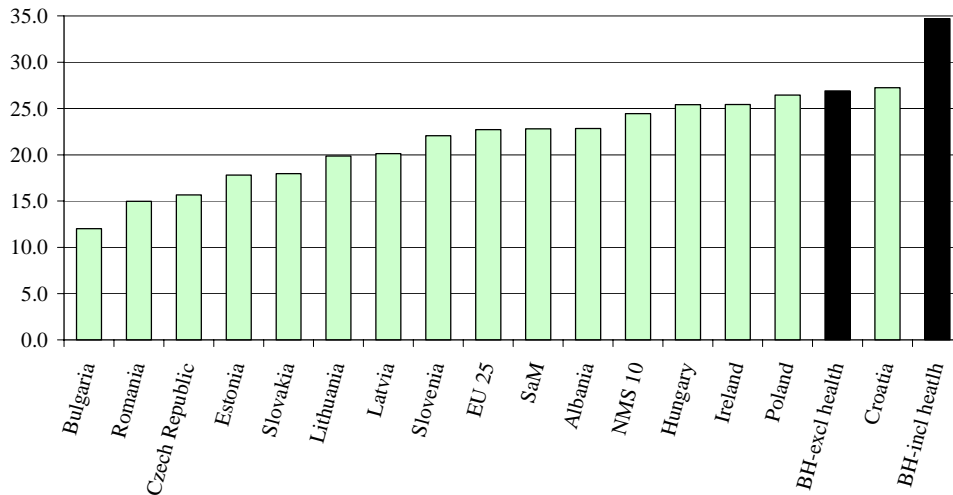
Sources: Ministries of finance and World Bank staff estimates.
1/ Excludes wages for health workers.

¹ No reliable wage data are available for the extrabudgetary funds. To enable comparisons with other countries, this estimate excludes wage outlays by the extrabudgetary funds. These outlays amounted to 0.4 percent of adjusted GDP in 2005. The BH wage bill in this example also does not include wages paid by medical facilities, as these are financed through lump sum transfers from the extrabudgetary funds. These wage outlays are likely to have amounted to KM400 million in 2004, or 2.3 percent of adjusted GDP.

Figure 4.2. Comparisons of the General Government Wage Bill, 2004 1/



Wage Bill in Percent of General Government Spending



Sources: Ministries of Finance; IMF; Eurostat and World Bank staff estimates.
1/ BH – relative to adjusted GDP in 2005; NMS – new member states of the EU.

4.8. Helped in part by army demobilization, the nominal wage bill was little changed from 2002 to 2004 before rising moderately in 2005 as a result of building new state institutions. Efforts have been made by entity ministries of finance to keep costs under control, and freezes in salary level for most public employees have been among the most prominent policy actions.²

² The ability of governments in BH to restrain wage levels reflects a contrast with other countries. Elsewhere in the region, collective agreements with public sector union have been known to put upward pressure on the public sector wage bill. In BH in contrast, the general collective agreement is problematic primarily because of the heavy burden it

4.9. The wage bill is high even when measured relative to total government expenditures. Including health wages, wage outlays amount to 35 percent of government spending in BH compared with 24 percent on average in the EU and 19 percent in the Baltic states. High wage outlays crowd out other spending, including operations and maintenance (O&M). In the judiciary, for example, salaries rose significantly from 2001 through 2004, while resources for basic equipment and operations virtually dried up and many courts accumulated debts to pay utilities and other ongoing costs. The High Judicial and Prosecutorial Council (HJPC) estimates that even in 2004 only about 18 percent of the total budget for the judiciary goes to O&M and only 2 percent for capital investment in facilities.

4.10. Both entities contribute to the high wage bill, but the situation is worse in the more decentralized FBH structure.³ Among the FBH cantons, the scope of activities tends to be dominated by education and policing functions, which are heavily labor-intensive. Only one canton, Sarajevo, had sufficient budgetary resources that it spent less than half of its budget on personnel costs. In 2 out of the 10 cantons, wages and salaries represent 70 percent or more of the total expenditures in 2004. The actual amount available for operations is actually much lower because transfer payments make up about another one-fifth of cantonal budgets. When all is said and done, cantons spend on average only about 14 percent of their budgets on goods and services to carry out their functions.

4.11. The following section examines public employment and the size of the public payroll according to three dimensions: (i) between civil servants and other public employees; (ii) the level of government in which people are working; and (iii) the functions or sectors in which they are engaged. The section concludes with observations on the overall size of public employment.

Civil Servants vs. Public Employees

4.12. The civil service generally carries out the main policy functions of the public administration, but there is in fact no consistent definition of civil servants across governments. The state and the two entities each have civil service laws that define differently the categories that make up the civil service. For example, at the state level, civil servants are limited to those employed in certain executive functions, and exclude the diplomatic corps and the uniformed police. Within the prescribed state functions, civil service positions are limited to those that require a university education. The FBH civil service has the same educational restrictions, but it includes staff working in the cantons and the municipalities who meet the educational criteria. In contrast, the RS civil service excludes those employed by the municipalities. Moreover, the RS criteria for inclusion in the civil service are more flexible with respect to educational qualifications.

4.13. No reliable data exists, but civil servants appear to make up only a small proportion of the total public employment. The state and entity governments are in the process of developing a registry of civil servants. Both the state and the RS have provided only data on the number of civil servants in each ministry. In contrast, the FBH Civil Service Agency (CSA) has impressive statistics available in its registry but for only a small portion of the total number because the data is dispersed across the different levels of the entity, the cantonal and the municipal governments.

has placed on the private sector. As noted in a recent World Bank report on the labor market in BH, many of the terms and conditions of work currently addressed in the general collective agreement could be more productively treated in separate branch agreements for the public and private sectors.

³ In this case, we mean the entity level government and any sub-entity governments (i.e., cantons and/or municipalities).

4.14. In total roughly 105,000 people are employed in the public administration, excluding those working for municipalities, and of that amount about 12 percent are probably civil servants (Table 4.1). No data is available from the municipalities, but based on their expenditure data one may estimate that they might account for an additional 16,000 employees, bringing the total public employment at all levels of government to over 121,000.

Table 4.1. Public Employment and Wages by Level of Government, 2005

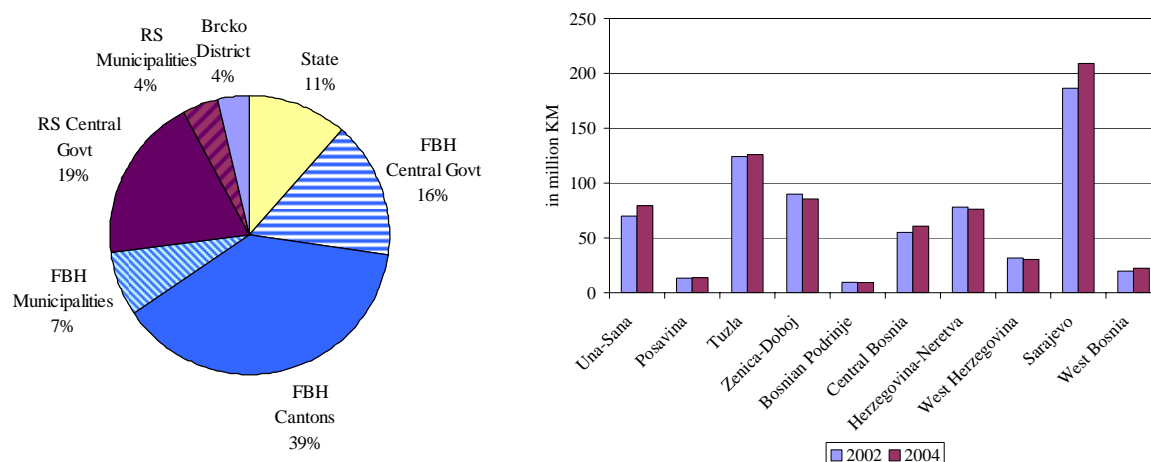
	Civil Servants	Other Public Employees	Total Public Employment	Total Payroll (In millions of KM)
State	823	6,310	7,133	214
FBH				
Entity Government	n/a	n/a	15,041	297
Cantons	n/a	n/a	46,100	715
Municipalities	n/a	n/a	n/a	138
RS				
Entity Government	4,006	30,357	34,363	362
Municipalities	...	...	n.a.	78
Brcko District	...	...	2,900	66
All	...	...	105,537	1,870

Sources: MoFs; Civil Service Agencies; the EU Systems Review; IMF; and World Bank staff estimates.

Employment by Level of Government

4.15. The responsibility for management of wages and related costs is distributed across multiple governments. The FBH, the cantons and the municipalities account for 61 percent of all BH wage outlays, and the RS for about 23 percent (Figure 4.3). The entity governments provide an overall coordination for much of the spending, but they are directly responsible for only one-third of the overall wage bill. The cantons are responsible for the single biggest part of the wage bill, almost two-fifths. The state's share has

Figure 4.3. BH: Composition of the Overall and Cantonal Wage Bills, 2005



grown significantly in recent years, but still accounts for only one-tenth of total costs. If there are to be significant cuts in the wage bill, reductions should necessarily be carried out at the cantonal and possibly at the municipal level. At the entity level, some rationalization of ministries and functions has already occurred in the RS but not in the FBH.

4.16. Among the cantons, spending capacity varies substantially and a few account for most of the outlays. The Sarajevo and Tuzla cantons account for almost one-third of the total cantonal wage expenditures. Together with the cantons of Una-Sana, Zenica-Doboj, and West Herzegovina, the five largest cantons make up about 80 percent of the overall cantonal wage bill.

Payroll by Function and Sector

4.17. The majority of public employees are concentrated in three areas—defense, public order, and education. These three functions together represent two-thirds of the overall wage bill, equivalent to about 9 percent of official GDP or 6.9 percent of adjusted GDP (Table 4.2).⁴ The remaining one-third of the wage bill reflects the “core” civil administration: it includes all the other functions and ministries of government. Moreover, about one-half of the latter amount is spent by the municipalities and the Brcko district. Thus the majority of functions within the cantons, the entities, and the state are funded with the equivalent of 2 percent of GDP. Of that amount, about one-quarter goes for tax and customs-related work. Whether the balance is an appropriate amount for BH is difficult to say in isolation, but the orders of magnitude involved seem generally in line with international practice.

Table 4.2. Estimated Functional Allocation of the 2005 Wage Bill 1/

	In millions of KM	In percent of the wage bill	In percent of GDP
Defense	198	11	1.4
Police/Security	304	16	2.1
Judiciary	118	6	0.8
Education	630	34	4.4
Other Civil Administration	620	33	4.3
Municipalities & Brcko	282	15	2.0
State, Entity, Cantons	338	18	2.4
Total	1870	100	13.0

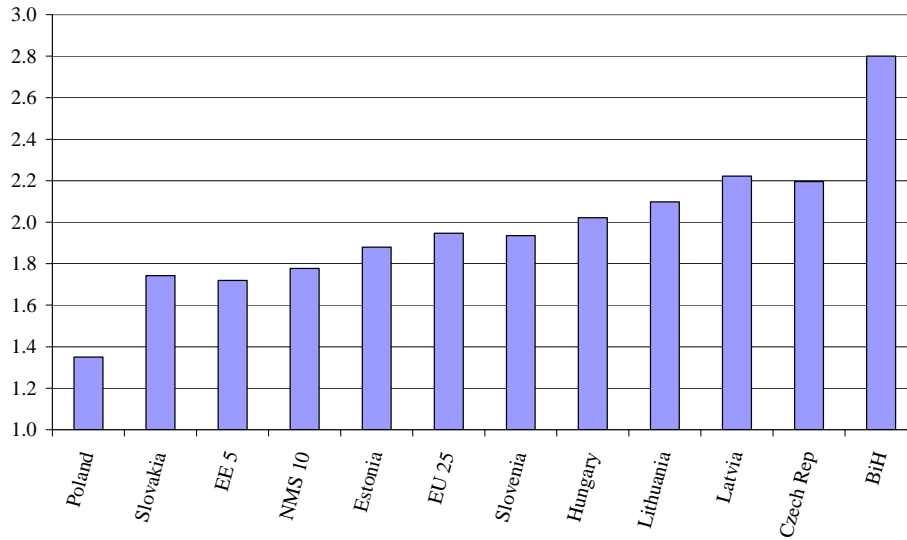
Sources: Ministries of Finance; IMF; and World Bank staff estimates.

1/ Wages of medical professionals are not included.

4.18. Demobilization efforts in recent years have helped lower outlays on defense, but overall spending on defense and public order still stands out as particularly large compared to other countries in Europe. Wage outlays related to these two categories amount to 2.8 percent of adjusted GDP compared with less than 2 percent on average in the EU. Results are similar when outlays relative to total spending are compared. About 37 percent of the wage bill in BH is on defense and public order, compared with about 19 percent in the EU and 17 percent among the NMS (Figure 4.4). Despite the relatively high rate of spending already on defense and public order, the share could increase further if defense and police reforms are not implemented carefully (Chapter 3).

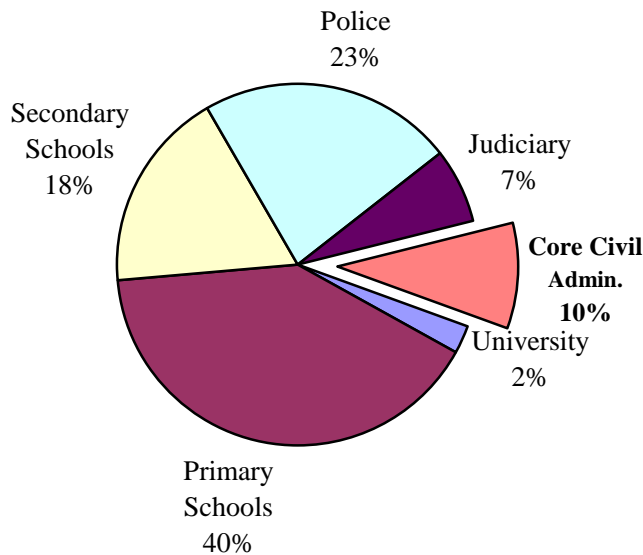
⁴ The data to derive the functional allocation is very imprecise, so that the figures presented in Table 4.2 are at best rough approximations.

Figure 4.4. Wage Outlays for Defense and Public Order, 2004 1/
(In percent of GDP)



Sources: Ministries of Finance, Eurostat and World Bank staff estimates.

Figure 4.5. Distribution of Employment by Functions in the Cantons, 2004



4.19. Most cantons have relatively little capacity outside of education and policing, limiting scope for savings under the existing constitutional structure.

Only 10 percent of cantonal employees work in the core civil administration, 60 percent in the education sector and the rest in policing or justice (Figure 4.5). Moreover, the capacity of cantons to staff the core civil administration varies widely across cantons. Thus, any across-the-board cut would have a disproportionate impact on some cantons. Among the eight cantons that provided staffing data, Una-Sana, Tuzla, and Herzegovina-Neretva have much leaner civil administrations. The size of the canton's budget is not necessarily an indicator, however, as Tuzla has one of the larger overall wage bills but one of the smallest civil administrations. Further assessment is needed on whether cantons with larger civil administrations provide proportionately more functions or services that would justify the higher cost.

The Size of Public Employment

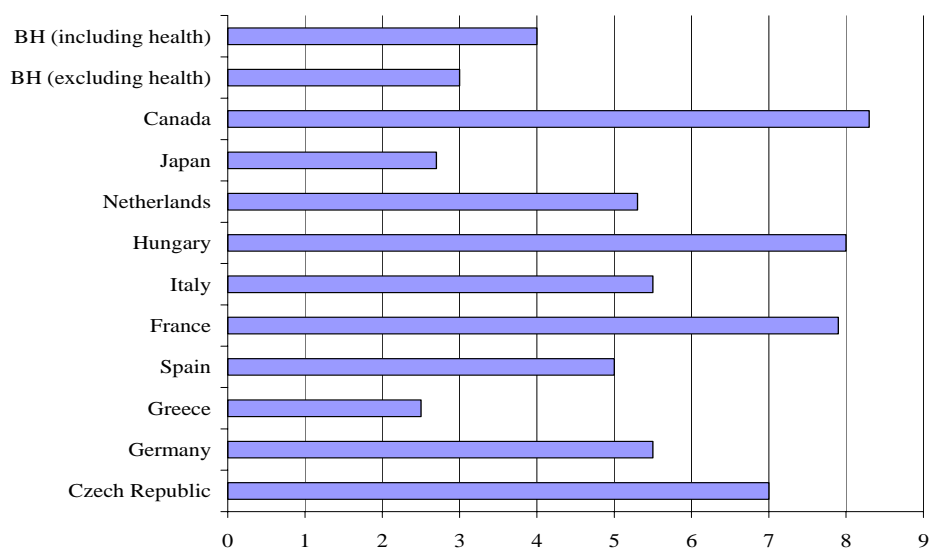
4.20. Overall, public administration employment to the population does not

appear to be excessive compared to other countries. For the ten OECD countries where data is available, general government employment ranges from 2.5 percent of the population for Greece to 8.3 percent for Canada (Figure 4.6). In BH, public employment including the local governments amounts to about 3 percent of the population, putting it on the lower end. If health workers were included in the BH estimate, the level of public employment would rise to about 4.0 percent—still on the lower end. As a share of

formal sector employment, however, public employment is an outsized 23 percent. These comparisons need to be made with care since definitions may not be similar across all countries.

4.21. The key issue for BH may not be the overall number of people employed in the public sector, but whether they are employed in productive functions and activities. Apart from the few major categories discussed above (defense, public order, and education), the data does not permit an assessment of how many people are engaged in the various activities of government, or whether the value of the services provided justifies the additional administrative costs. For example, it is unclear how many people are engaged in what GFS classifies as “general public services” and in particular, for the executive and legislative organs that exist across all levels of government. Nor can we specify the cost of carrying out common administrative and support functions at the various levels of government. These areas could be significantly over-staffed, even while areas within the “economic affairs” or “environmental protection” domains are very understaffed, or vice versa. The EU integration process will bring to light areas where additional staffing is needed, but it will not necessarily address areas with bloated public administration.

Figure 4.6. General Government Employment, 2004
(In percent of population)



Source: World Bank staff estimates from the OECD/Puma data.

C. THE IMPACT OF CURRENT PAY PRACTICES

4.22. Pay practices in BH are costly and do not provide incentives for performance in the public administration. The characteristics of the BH pay system are not unlike those found in other former Yugoslav republics. Yet, while others are beginning to make progress in reforming their systems to meet European and OECD standards, BH has been slower to adapt. Salary ranges in BH remain highly compressed, and an excessive portion of total compensation is still based on allowances and seniority.

4.23. Reforming the pay system will require hard choices between competing interests and a greater level of national coordination. The following section compares pay rates in the BH public sector with those in the private sector and those in other countries. Next, it examines the level of consistency in pay practices across the different governments in BH and reviews the overall system structure and its likely impact on work performance.

External Competitiveness of Public Sector Salaries

4.24. Pay rates vary significantly across government levels, but at the state level—where most future growth in staffing is expected—salaries are already very competitive and often excessive relative to the private sector. A recent survey shows that net total compensation approaches or exceeds the private sector median for three out of six public service posts.⁵ Only the two highest positions surveyed—“head of function” and “senior professional”—trailed significantly behind the private sector median and approximated the 25th percentile.⁶ Of the four positions that are competitive with the median, two are classified as civil service posts (Table 4.3).⁷

Table 4.3. Net Compensation in the Private Sector Compared to the State and the FBH, 2004
(In KM per month)

Job Title	Private Sector Median	State	FBH
Head of function / middle mgt	2,050	1,402	997
Senior Professional	1,621	1,162	955
Experienced Professional	1,166	1,090	945
Basic Professional	950	1,018	924
Administrative Clerk	791	874	664
Manual worker	685	730	664

Source: PriceWaterhouseCoopers, Final Report for DfID, October 2005.

4.25. FBH wages are consistently lower than those at the state level for the same category of post. According to the survey, the FBH pay levels are closest to the state for the entry level civil service positions (such as “associate”) and much less for the senior posts such as “secretary general” and “assistant minister.” Data provided for the survey by the RS is unreliable, but showed that RS wage rates vary relative to those in the FBH. Net total compensation in the FBH is slightly lower than the private sector median for the four job categories between manual workers through “experienced professional.” For “senior professional” and “head of function” jobs, the FBH pay levels are below the 25th percentile, however.

4.26. Salaries at both the state and the FBH levels are very high compared with other countries in the immediate region, especially for lower and mid-level positions. Cross-country comparisons of pay levels must be interpreted with caution, not least because of differences in purchasing power. The above quoted study presents analysis of pay practices in Croatia and SaM for six levels of jobs, from “clerk” up to “secretary general.” BH state level compensation rates appear roughly similar to those in Croatia for the lower four positions and substantially lower for the top two. In contrast, pay rates are much higher than in SaM for the lower four categories, and equal for the top positions (Table 4.4). When the salary data is adjusted for purchasing power parity (PPP), the high rate of compensation in BH stands out more dramatically.⁸ BH state compensation is almost double that of Croatia for all but the top two positions.⁹ In the FBH, where salary levels are lower than for the state, on a PPP basis they would still be moderately higher than in Croatia for the bottom four positions. FBH pay would be comparable to SaM for the top two positions, but substantially higher for the remaining middle and entry level posts.

⁵ “BH: Support for the Determination of the Pay and Grading System at State Level,” October 2005, prepared by PriceWaterhouseCoopers LLP on behalf of the DfID. The survey is primarily for civil service posts. For police and the military, RS salaries tend to be significantly lower than those in the FBH.

⁶ Salary rates for these positions were higher than only 25 percent of the private sector equivalents.

⁷ Moreover, the PWC data is affected by the presence of international firms in the sample. Wages among such firms are typically 50 percent higher than in national firms, but they are also likely to require higher skill levels.

⁸ Analysis of pay practice adjusted for PPP were not included in the final version of the PWC study.

⁹ The difference in wage rates between Croatia and BH is also reflected in the fact that the aggregate wage bill relative to GDP is comparable in the two countries, but Croatia’s public service is substantially larger than BH’s.

Table 4.4. Comparison of Total Net Compensation with Neighboring Countries
(In KM per month and in US dollars PPP)

Job Title	BH/State	FBH	Croatia	SaM	BH/State	FBH	Croatia	SaM
	In KM per month				In US dollars PPP			
Secretary General	1,690	1,049	3,098	1,664	3,588	2,227	2,963	2,192
Assistant Minister	1,402	997	3,098	1,664	2,977	2,117	2,963	2,192
Senior advisor	1,162	955	1,438	503	2,467	2,027	1,376	663
Senior associate	1,090	945	1,230	359	2,314	2,006	1,176	473
Associate	1,018	924	1,133	350	2,161	1,962	1,083	461
Clerk	874	664	889	312	1,856	1,410	851	411

Sources: PriceWaterhouseCoopers, Final Report, October 2005, for DFID and PWC draft reports.

4.27. Notwithstanding the analysis above, pay levels for some categories of jobs exceed those found in the core civil service. For example, police officers at the state level receive on average a 30 percent bonus on top of their regular pay, and judges have had special pay scales rates that can be more than double those in the civil service. Data from the survey demonstrates that police in SaM are paid substantially less (one-third to one-half) than those in BH.

4.28. A steady supply of labor to the public sector suggests that the salary offered for most positions is probably quite attractive compared to alternative job opportunities. Data on turnover is not available, but conversely anecdotal evidence suggests that the public sector has not lost significant numbers of people to the private sector. Officials in the entities are more apt to cite examples of losing staff to other governments, including new state institutions and some municipalities. The lack of alternative employment options in the private sector is likely to be a major reason why people remain in the public sector despite stagnant wages over the past several years. The more significant question may be whether the civil service is drawing the caliber of civil servants that it needs. Officials acknowledged that the best university graduates tend to pursue other opportunities and are not attracted to public sector employment.¹⁰

Internal Equity and Consistency in Pay Practices

4.29. The linkage between job responsibility and pay is not as strong as it should be to support internal equity. Jobs with very different levels of responsibility have virtually the same pay; conversely, jobs with similar responsibility sometimes have wide variance in pay. Good human resource management practice is to set pay levels based on the relative job content. However, in BH, job titles define the pay grades and those are based on educational qualifications and years of experience – a system fairly common in the former Yugoslav republics. While there is some correlation between job titles and the level of responsibility, the correlation is weak. A “head of function” for example, is not necessarily the same across all ministries or departments. Some pay systems in other countries might be able to address the differences in responsibility through broad salary bands, but these are not used in BH.

4.30. Large unexplained variations exist among positions with the same title working within the same level of government. This stands out both for the state and the RS. A review of the state’s payroll data for April 2005 shows several posts where the differences in salaries across individuals are wider than would normally be explained by the salary and allowance structure.¹¹ The biggest differences, however, are

¹⁰ The public sector pay may not adequately take into account the market premium that the skills of the most qualified graduates command among international private sector firms. Other factors, including concerns about career advancement, training, and the level of responsibility may also contribute to a reluctance to work in the public sector.

¹¹ For example, there is a 100 percent spread in net salaries for people holding the title of “expert advisor,” and all with the same level of educational qualification. There is about a 70 percent difference in salaries for “head of department”

within the newly created ITA, where the highest salary is four times higher than the lowest salary for the same position title. A variety of explanations are possible. For example, wage arrears may have been included in the data, or managers could have used their perceived flexibility to attract, retain or reward better performers. It is also conceivable that the wide differences reflect some degree of favoritism or poor controls. Al told, the magnitude of differences is quite large and suggests that a more transparent structure is needed, with a clear set of rules and procedures for salary decisions. Further, the authorities would benefit from stronger payroll accounting procedures that clearly delineate the components of total pay.

4.31. The attempt by a government working group to draft a state-level wage law confirms that there are bad practices that risk becoming entrenched. Special allowances were proposed for the security services, the army, those holding jobs of “special importance,” and those who have taken on temporary duties because of a vacancy in their institution. The criteria for most of these allowances are vague, with allowances set to represent 25-50 percent of the net salary. The allowance for temporary duties is subject to abuse and distorts the budget process. Currently, ministries propose their own organizational structure, including the number of posts they will have (subject to approval by the Council of Ministers). Since vacant posts create opportunities for individuals to receive an allowance for accepting “additional” duties, ministries have an incentive to keep some posts vacant.

4.32. Salary practices in the RS are very inconsistent as well, as each ministry appears to have the flexibility to compensate as it sees fit. Data obtained by PWC from the MoF and the Ministry of Labor and Veterans Affairs (MoLVA) indicates that the same position could have very different pay levels. The smallest difference is 34 percent for the Associate position, and the largest is 81 percent for the “secretary general.” While differences in pay might be justified based on some differences in job content or responsibility, there does not seem to be a formal system in which that is evaluated. Even more unusual is the fact that within the same ministry, a lower level position could be paid more than higher ones. If these data are reasonably reliable, they suggest the need for new guidelines or procedures to assure that the compensation practices are transparent and are genuinely linked to differences in performance.

4.33. Wide differences in pay practice exist also among individual cantons. Some of the differences across the cantons may be a result of differences in the composition of jobs, others may reflect differences in pay policy (Table 4.5). The range between the highest and lowest paying cantons is striking; for police

Table 4.5. Comparison of Average Net Pay in Selected Cantons, 2004
(In KM per month unless indicated otherwise)

Canton	Canton No.	University	Primary Schools	Secondary Schools	Police	Judiciary	Core Civil Administration
Una-Sana	1	706	485	539	561	1,065	970
Posavina	2	-	613	740	604	1,138	728
Tuzla	3	767	454	515	546	972	623
Zenica-Doboj	4	793	412	540	481	990	682
Bosnian Podrinje	5	-	412	523	478	1,011	462
Central BH	6						
Herzegovina-Neretva	7	-	564	591	672	1,076	945
West Herzegovina	8						
Sarajevo	9	-	615	663	788	1,080	688
West BH	10	-	493	556	559	1,125	616
Spread (Min to Max, percent)			49	44	65	17	110

Sources: Ministries of Finance and World Bank staff estimates.

or “head of function,” and double that if the donor-assisted High Judicial and Prosecutorial Council is included.

positions, for example, the spread is 65 percent. For positions within the civil administration, one canton pays twice as much on average as another canton.

4.34. Differences in pay can also be quite significant across functions or sectors. For example, because of influence from the international community, salaries for judges and prosecutors rose steadily over the last four years and now tend to be about double those of senior public officials. While the justification for this policy may appear sound, it has generated significant imbalances. Even some common civil service positions that work with the judiciary through the HJPC now benefit from much higher salaries than similar positions in other sectors. Those working in the judiciary are not the only ones to benefit from higher pay; at the state level, the police and security workers enjoy higher average salaries in part because of a 30 percent bonus.

The Pay System's Potential Impact on Performance

4.35. Several features of the current pay system design, both at the state and at the entity levels, have a negative impact on the performance of the public administration. Some of the practices have a long tradition and are thus entrenched, requiring substantial reform effort to bring the system in conformity with European public administration standards. Ideally, reforms should be enacted before there are additional transfers of responsibility to state level institutions. Without stronger incentives in the pay system for career advancement and performance, the government risks maintaining high levels of expenditure without reaping the desired economic benefits.

4.36. The first step should be to decompress the current salary structure, which by international standards is highly compressed. Comparing total net compensation in the civil administration,¹² the ratio between the highest and the lowest paid position is about 2.3 in the FBH¹³ and about 2.8 at the state.¹⁴ (The RS has not provided sufficient data to calculate this ratio, but it is likely to be within the same range.) In contrast, the compression ratio in SaM has already been increased to about 4.9, and many OECD countries have a compression ratio around 7 to 9. The U.S. federal government has a compression ratio of about 10.

4.37. Allowances play a large part in the BH pay system and contribute to the low compression ratio. The most common allowances are for meals, transport, and holiday pay. For a “non-qualified worker” employed by the FBH, the allowances can amount to as much as or more than the base pay. As the allowances are expressed as an absolute amount rather than as a percent of the base pay, more skilled public servants receive a proportionately lower benefit. There are other allowances, such as those for temporary duties and for work on commissions that are awarded selectively to a few individuals and are open to possible abuse. In general, the allowances have too large a role in determining total net pay and most should be eliminated with the proceeds used to enhance base salaries. The differential tax treatment that now exists within the FBH between base salaries and allowances would need to be addressed in order to implement this policy.

4.38. The little difference in total net pay between grades is a significant impediment to performance (Table 4.6). A person who enters the civil service as an associate can expect her net base pay to rise by no more than 20 percent after three promotions. Consequently, strong performers would have little incentive to take on additional responsibilities. Nor is the “threat” of career stagnation much of an instrument to induce efforts from those who prefer to be idle. The lack of career growth is assuredly one of

Monthly salaries for “secretaries,” one of the most senior posts, range from KM1,500 to KM2,600.

¹² Police and judiciary have their own separate scales.

¹³ Assuming total net pay of about KM1,150 for a Secretary General vs. about KM500 for a non-qualified worker.

¹⁴ For the state, assuming total net pay of KM1,690 for Secretary General vs. KM610 for an unqualified worker.

Table 4.6. Compensation within the Core Civil Administration, 2004 1/

Level of Government	Title	Pay Coefficient	Pay Ratio
State	Assistant Minister, Advisor	4.8	1.50
	Head of Department	4.2	1.31
	Expert Advisor	3.8	1.19
	Senior Expert associate	3.5	1.09
	Expert Associate	3.2	1.00
FBH	General Secretary	7.2	1.20
	Assistant Minister	6.7	1.12
	Head of Department	6.4	1.07
	Expert Associate	6.0	1.00

Sources: BH governments and World Bank staff estimates.

1/ Based on civil servant posts at the state and the FBH level.

the obstacles to attracting and retaining younger highly-skilled staff into the public sector. Data from the state CSA indicates that only about 4 percent of the state civil servants are under the age of 30.¹⁵

4.39. Decompression of the salary structure would have budgetary implications, but the costs would be limited if salary adjustments are targeted and implemented gradually. To illustrate, salaries could be increased

by an average of 50 percent over five years for the three highest levels of civil servants within the FBH civil administration at an annual cost of KM7 million, or 0.04 percent of GDP. In the cantons, in the RS entity government and at the state level, decompression could also be focused on the core civil service administration and positions equivalent to “head of department” or above, which represent only a small share of total public sector payroll. Continued control by the authorities over nominal salaries for “public employees” and lower level civil servants would help to limit the overall fiscal impact of decompression. If the authorities choose to adopt a substantial decompression strategy, it would also be appropriate to tighten performance requirements so that only those with satisfactory performance benefit.

4.40. A second major reason the pay system discourages performance is that it gives disproportionate weight to a person’s length of service in determining total pay. Length of service is a legitimate factor in pay awards, and many governments give automatic annual increases, at least in part because of the challenge of evaluating performance through means other than length of experience. However, the way it is implemented in BH leads to highly inequitable outcomes and discourages performance. Annual increments should occur within a specific job category or grade, but in BH it functions as an additional allowance tied permanently to the individual and not to the job. Even if a person is new to the job, they carry their higher pay level with them to the new job and may surpass those who have higher performance in that particular job. Because the salary grades are so compressed, the years of service make a big difference in the total pay. A better approach would be to have salary ranges for each grade, with a defined minimum and maximum and allow increments within that range. How one moves through the range could be based on seniority and/or performance, but the relevance of seniority would be primarily linked to a specific job.

Other Human Resource Practices and their Impact on Performance

4.41. The state and entity CSAs appear to be performing their roles very well in ensuring that entry into the civil service is based on merit. Interviews with government officials and findings from the EU’s System Review suggest that civil service recruitment is well-structured and progressing without significant backlogs. Balancing of ethnic representation within the civil service is still a consideration in the recruitment process. However, its impact may decline in the future, as the composition of the selection committees has been changed to give greater weight to CSA personnel who would, hopefully, work to

¹⁵ Insufficient data were available from the FBH and the RS to determine the age distribution of their civil servants. However, data for a sample of about 1000 civil servants throughout the FBH indicates that the proportion of younger workers in the civil service roughly mirrors that found at the state level.

appoint the most qualified candidate. Civil service protections may need to be strengthened, however, to assure that senior civil servants are not arbitrarily removed with changes in government.

4.42. How the public administration manages promotion and career advancement has a substantial impact on the quality of the staff attracted and retained. To the extent that the process is perceived as too slow, too inflexible, or based on factors other than merit, the most-talented and ambitious civil servants or candidates will find alternative employment. The challenge for BH's public administration is to create an environment in which performance and talent are recognized. Higher pay cannot be the only tool in facilitating that. The current career system itself needs to be flexible enough so that as new, highly skilled staff enter the civil service, they can assume additional responsibilities quickly and gain the recognition that goes with it. In the UK, a formal program termed "fast track" was created with a separate, more demanding application process to identify talent and then to give them exposure to career-enriching assignments. A less structured program could be applied in BH, such as the one proposed by the EU System Review, which would reduce the amount of work experience required for university graduates to enter the civil service. One of the most significant features is that graduate studies would count toward experience required and that those who complete graduate-level studies could enter at a higher level than currently possible. Special bonuses and career tracks could also be created to attract individuals educated abroad and who possess high-demand skills. Not all of these people could be expected to devote their full career to the public sector, but it is incumbent upon the public sector to make full use of their skills for the period of time (perhaps 3-5 years) that they are there. To complement the managerial career path that already exists, high level technical/advisory positions could be introduced or expanded that would require less extensive knowledge of the public sector.

4.43. Regardless of how the specifications are set for each civil service level, it is vital that processes for promotion be as objective and merit-based as the process for initial entry into the civil service. Compliance with merit-based recruitment is assured by the civil service agency, but no such oversight exists for the internal recruitment of staff or the promotion of staff. Instead, each line ministry determines its own policies and practices to promote staff. Although not explicitly addressed in this study, steps should be taken to review procedures for the internal competition for posts, and more broadly how career advancement is managed across the civil service.

D. MANAGING THE COST OF THE PUBLIC ADMINISTRATION

4.44. The need to establish new institutions and functions at the state level has put upward pressure on the BH wage bill without offsetting savings or improvements in efficiency. To meet the challenges of state building over the medium-term, the authorities will need to curb costs at the state level and reduce costs at the sub-national level. Where given functions are transferred from the entity to the state, for example, the transfer should be cost-neutral. However, were costs to rise in the process, then offsetting savings would need to be found elsewhere (See Chapter 3 for details).

4.45. This section focuses on approaches to capturing savings in the public administration. It assumes that specific activities within a given function will be gradually expanded at the state level, and that this will in turn reduce the need to have people carrying out the activity at the entity and sub-entity level. The functions still need to be performed, but they can be done equally well and possibly more efficiently at a more centralized level. Further, not all savings need to come as a result of efficiency gains. It is also appropriate to encourage a reduction in functions and activities. Faced with budgetary constraints, policy makers may choose some activities that would be desirable but not essential.

4.46. The options presented below are for the core civil administration, excluding sectors such as police, judiciary, defense, and education. The first three sectors have reform programs already underway. The education sector is addressed in Chapter 5. The civil administration that is left accounts for KM545 million, or one-third of the total wage bill. **The rest of the chapter explores a range of scenarios**

(numbered 1 through 4) on how this amount could be reduced. Since municipal governments are granted autonomy under the Law on Local Self-Government, they are addressed as a separate scenario. All estimates of savings are rough approximations given the fragmented nature of data reporting in BH. For the purposes of this analysis, we assume a five-year implementation period, 2006-2010 (Table 4.7).

Table 4.7. Estimated Savings in Wage Bill from Different Policy Options 1/

Description	Spending in 2005		Spending in 2010		
	In KM	In percent of GDP	In KM, no policy change	In KM, with policy change	In percent of GDP
1a Hard-freeze on recruitment with 2.5 percent annual decline	207	1.5	229	199	1.0
1b Soft-freeze on recruitment with 1.5 percent annual decline	207	1.5	229	211	1.1
2a Targeted reduction of 15 percent over five years	207	1.5	229	194	1.0
2b Targeted reduction of 5 percent over five years	207	1.5	229	217	1.1
2c Targeted reduction of 5 percent for municipalities and Brcko district	242	1.7	267	254	1.3
3a Limit aggregate salary growth to 1 percent annually, including decompression	207	1.5	229	217	1.1
3b Aggregate salary growth in Education sector limited to 1 percent annually	630	4.4	696	660	3.4
3c Aggregate salary growth in municipalities and Brcko limited to 1 percent annually	242	1.7	267	254	1.3
4 Average wage rate declines by 5 percent in nominal terms	207	1.5	229	197	1.0

Sources: BiH governments and World Bank staff calculations.

1/ Applies to civil administration functions within Entity central governments and cantons unless noted otherwise. Civil Administration is defined as excluding Defense, Judiciary, Police/Security, and Education. Scenarios 1 and 2 assume salaries remain constant in real terms. Scenarios 3 and 4 assume employment remains constant.

Option 1: Reducing Costs through Attrition

4.47. One path requiring a low level of administrative effort or central policy guidance would be to implement a hiring freeze and to rely on attrition to reduce staffing. The number of people who might leave is uncertain, but it has the benefit of being voluntary with minimal conflict. Since some positions must be re-filled, the recruitment process would be only internal to the public service. No data is available on public sector turnover, but it is assumed to be 2.5 percent per year. An alternative approach is to allow some external recruitment to take place, so that there is a modest inflow of new employees into the public administration. Scenario 1A would entail a hard freeze – i.e., no external hiring whatsoever. Within the entity governments and the cantonal civil administration, such a measure would save KM8 million, less than 0.1 percent of GDP a year (assuming wage rates remain constant in real terms). Total staffing levels would fall by about 13 percent. Scenario 1B assumes a partial hiring freeze, with ministries allowed to recruit two out of five positions externally. Though employment would decline by only 1.5 percent per year, the savings would be about the same as under scenario 1A.

Option 2: Targeted Reduction of Functions and Activities

4.48. A disadvantage of attrition-driven reductions is that all budgetary users bear the same burden. This can be problematic because neither all units have the same workload, nor do they have the same strategic importance. An alternative approach would be to establish a process by which policymakers rebalance the relative staffing levels of all ministries to fit with strategic priorities. Faced with an upper resource limit within which to work, prioritization becomes a necessity. Some ministries or departments might remain unchanged or increase while others would shrink.

4.49. For each ministry, an employment ceiling could be set for five years, and the ministries would have the choice of how to reach that goal. Some may do so by eliminating functions or departments, together with staff, others by using attrition, offering a voluntary departure package, or some combination of programs. To reduce hardship, those workers who have been retrenched would be given preferential treatment in applying for other posts that become vacant. Ministries would be expected to recruit most of their positions internally before looking externally for candidates. To keep the best people from leaving the civil service, the measures could be limited to certain functions or public employees who are not civil servants (or to some other defined subset).

4.50. The FBH Department of Joint Services could be among the ministries that bear a larger share of the costs. The department employed about 450 people in 2004, but only about 5 percent could be qualified as civil servants and most of the remainder have secondary education or less. Though further analysis would be required, it appears that this could be cut back substantially without significant impact on public services. If many of the services provided by Joint Services could be provided commercially, the MoF could create incentives for competition.¹⁶ This option would be more challenging to implement than option 1. Under the current constitutional set-up, implementation of any downsizing would necessitate either a strengthened central authority to provide specific policy guidance or a broad consensus among the entity governments to make budgetary concessions on their own. Scenario 2A assumes a total reduction in employment of 15 percent at the end of five years (and constant value wage rates), the wage bill for the entity and canton civil administration would be about KM 194 million or 1 percent of GDP, a drop of about 0.5 percent of GDP. Scenario 2B assumes a more moderate rate of downsizing or 5 percent. This would generate a savings of 0.3 percent of GDP. Scenario 2C would extend the downsizing to municipal governments, requiring them to cut staffing by 5 percent. This adds an additional 0.4 percent of GDP savings on top of what might be achieved at other levels.

Option 3: Restraining Salary Growth

4.51. A third option is to freeze most salaries in nominal terms. Given low inflation, thus far it has been possible for governments to keep salaries virtually unchanged. As noted above, however, the salary structure is highly compressed, and some decompression is needed to improve incentives for performance. This option assumes that 1 percent per year of the overall civil administration payroll is set aside for improving the salaries of the middle and upper-level civil service positions. The impact can be much greater than 1 percent if the resources are highly targeted. Assuming average inflation of 2 percent, the net effect would still be a 1 percent reduction of the average payroll.

4.52. Scenario 3A assumes that pay for the civil administration grows by 1 percent per year, while employment levels remain unchanged. Savings would amount to KM10 million a year, or 0.3 percent of GDP. Scenario 3B extends the same control on wage rates to the education sector, resulting in savings of KM30 million or 1 percent of GDP. Scenario 3C applies it to the municipalities, with savings of about 0.4 percent of GDP. Together these scenarios would offer up to 1.7 percent of GDP in savings.

¹⁶ It is not always the case that the private sector can provide the services cheaper, and governments are well-advised not to blindly contract out for “common services.”

Option 4: Reducing Nominal Wage Rates

4.53. Reducing nominal wages is an ambitious undertaking that would require substantial political will to implement. The state government proposed a 10 percent reduction in state-levels wages to be enacted in 2006, but as of mid-2006 this has yet to be accomplished. The authorities would be well advised to consider nominal cuts at the level of the state and the FBH for lower-grade employees. As discussed above, those employees appear substantially better remunerated than their peers in the region and their outsized salaries boost the overall wage bill. Pressure on private sector wages is also substantial, especially given the large size of government employment in overall formal sector employment.

E. RECOMMENDATIONS

4.54. The authorities will be well advised to keep perspective on two complementary objectives as they advance state building. The first is to create a pay system for the public administration that embodies transparency and accountability. Reform of the salary system is essential for all levels of government because the current practices do not reward performance or support the building of meritocracy within the public administration. To this end, new wage laws need to be drafted, in line with the authorities' commitments under the Economic Management Structural Adjustment Credit (EMSAC). Further, a more coordinated effort is needed across all levels of government.

4.55. The second goal should be to prioritize the functions that are to be undertaken by the public administration so that they are put on a path of fiscal sustainability. The key issue is to assure that resources are productively used and that the allocations across sectors and functions reflect the country's genuine needs. Reducing possible duplication within the civil administration is a starting point, especially with respect to overlaps between the state, the entities and the sub-entity level of government. Yet, it should also be acknowledged that some of the biggest parts of the wage bill are devoted to defense and public order – far greater shares than is generally the case elsewhere in Europe. Without a significant effort to lower costs in these sectors, deeper cuts will be needed in other vital areas, such as economic affairs or in front-line service delivery functions such as education.

4.56. In summary, the authorities should consider the following actions to create a foundation for effective state-building over the next several years:

Salary Policy and Pay Systems

- **Progressively decompress the salary structure by targeting future salary increases toward middle and upper level civil service posts in the core civil administration. Freeze (cut) the total nominal gross compensation for lower level civil service posts and all non-civil service posts.**

- **Eliminate and/or consolidate most allowances into the base salary and assure that cumulative allowances a person may receive rarely exceed more than 20 percent of net base pay.** Reduce the amount of discretion that individual ministries have in awarding allowances and bonuses, including allowances for taking on temporary duties or serving on commissions.

- **Revise salary laws to create salary ranges for each grade level and permit incremental increases for tenure only within the salary range.** Reduce the impact of length of service on total pay and create clear institutional arrangements and procedures for the use of discretion by managers, such as guidelines to allow faster movement for high performers.

- **Establish greater consistency between the laws on salaries for the state, the entities and the cantons.** In drafting new laws, assure that the salary regimes that are applied to each sector are compatible

(i.e. they facilitate comparison of jobs with like qualifications across sectors or job families) and they reflect a consistent strategy in terms of relative pay competitiveness.

Civil Service Management and Planning

- **Work toward greater consistency in the definition of a civil servant across governments** (with a preference toward narrow definitions) and establish common procedures that can facilitate the transfer of civil servants across governments.
- **Develop consolidated personnel databases** to enable the governments to know the size and cost of public employment. Reporting systems should include civil servants as well as other public employees, regardless of the level of government.
- **Increase oversight of the processes for promotion and career advancement** within ministries to assure that they are carried out transparently and according to merit.
- **Refine the criteria for entry into the civil service**, especially as concerns the experience required and how advance degrees are counted. Create more flexible career tracks for those with special skills, giving greater emphasis to performance over seniority in determining pay grades.

Rationalizing the Size and Scope of the Public Administration

- **Establish a realistic target for reducing the size of public employment across governments.** Follow this with a strategic review that (i) reduces areas of likely duplication across levels of government, and (ii) prioritizes remaining functions/activities at the entity and the cantonal level in order to strengthen those that are understaffed and significantly scale back those that are less critical.
- **Implement a partial hiring freeze into the public administration**, with preference for recruitment given to civil service posts engaged in functions and activities that are categorized as priority.
- **Follow through with significant reforms in defense, judiciary and security** to bring the aggregate costs of these sectors in line with levels in other European countries.