

Civil Service Reform

High civil service costs, amounting to about 35% of national government expenditures, have constrained fiscal flexibility. Civil service management, professionalism, and morale have been sapped by an inadequate and opaque compensation structure and the lack of a meritocracy. While the political economy challenges associated with civil service reform are substantial, a reform program could begin with actions to control and reduce the fiscal weight of the wage bill by designing an affordable compensation modernization and rightsizing program, and modernizing the legal framework for the civil service to strengthen its professionalism and integrity.

Background

Three major issues have long confronted Philippine policy makers in their quest for an affordable, professional, and skilled civil service that can effectively provide policy advice, implement policy decisions, and deliver public services.

First, *high civil service costs have constrained fiscal flexibility*. Since 1997, falling revenues and rising debt-servicing demands have squeezed the amount of public resources available for poverty-reducing developmental programs. In addition, very high levels of personal services (PS) expenditures have exacerbated this compression of discretionary expenditures, especially poverty-reducing investment and maintenance and other operating expenditures (MOOE) in key sectors such as education, health, social protection and infrastructure. Unless the revenue-to-GDP ratio recovers to 1997 levels, PS expenditures will need to be rapidly and effectively controlled for fiscal sustainability.

Second, *civil service management, professionalism, and morale have been sapped* by an inadequate legal and institutional framework for managing civil service policy and excessive politicization (the latter exemplified by the substantial role of the presidency in making appointments to “positions of confidence”, i.e., political or “elective” appointments).¹

¹ This is through appointment of non-Career Executive Service (CES) personnel to CES positions.

Third, *past reform efforts have not been very successful*. There have been several attempts since 1985 to pass legislation on restructuring the executive and re-engineering the bureaucracy—all of them unsuccessful. Policy makers are now reluctant to confront this long-term, politically challenging, and complex reform agenda.

Nevertheless, fiscal constraints and a new Government provide an opportunity to initiate a civil service reform process that is politically feasible, administratively doable, and fiscally sustainable.

Issues

Controlling civil service costs

The cost of the civil service is a significant part of the heavy fiscal burden. Civil service PS expenditures are about 35 percent of national government expenditures annually. The PS share has been even higher in some key sectors, for example, rising to 90 percent in 2001 in the Department of Education budget. The same trend is also evident at the local government level. In addition, the last few years have seen substantial salary increases for different categories of civil servants (e.g., armed forces, police, teachers). In 2003 and 2004, the Government had to defer payments to suppliers to keep within its deficit targets for the first half-year. And, as in 2003, this may lead to an expansion of monthly budget deficits in the second half of the year.

Overall, the broad government strategy to control the wage bill through incremental measures is not working. The strategy has been to minimize contractual positions, contain the growth of permanent positions, and control local government unit and government owned and controlled corporation (GOCC) expenditures on personal services.

Weak establishment controls contribute to the Government's inability to control its wage bill. The Government has instituted measures to control recruitment and impose selective hiring freezes. But these have not been as effective as anticipated because: (i) reliable information on the number of filled and unfilled permanent positions, and on the number of temporary employees, does not exist; (ii) the Department of Budget and Management (DBM), the Civil Service Commission (CSC), and the Government Service Insurance System currently maintain their own personnel information databases, but these are not integrated with each other and are not up to date; and (iii) each department maintains its own personnel registry—since these are not cross-checked, the possibility of the same person being appointed to multiple positions in different agencies is very real.

Employment levels are bloated. Almost 1.07 million permanent employees are paid from the national budget. Adding about 350,000 local government employees and about 90,000 GOCC employees, total public employment comes to 1.5 million. This constitutes almost 2 percent of the population—higher than, for example, 0.1 percent in China and 0.3 percent in Vietnam. At the national level, the five largest employers of permanent staff are the Department of Education, state universities and colleges, the Department of Health, the court system, and the Department of Environment and Natural Resources. Ironically, however, amid the general overstaffing, staff shortages are emerging in key professional categories (such as auditors, lawyers, and information technology professionals). In addition, an

inappropriate skills mix (too many lower-level staff generally, and not enough technical staff in specific sectors) constrains the Government's ability to carry out critical development tasks effectively.

Long-standing technical constraints are a key factor in the failure to control personnel costs. These include: (i) lack of information systems on the basis of which the CSC and DBM can exercise effective control over the approved positions (*plantilla*) and the payroll; (ii) establishment controls in national government agencies, with agencies largely free to make staffing arrangements most suitable for their purposes; and (iii) only a token relationship between the *plantilla* and the payroll, facilitating a widespread practice of employing staff on a casual or temporary basis without reference to authorized (*plantilla*-based) positions.

Progress in controlling the wage bill through incremental measures is slow, and the fiscal impact minimal. The effort to control the wage bill has been led by the Presidential Commission on Effective Governance (PCEG), DBM, and CSC. In 2001, the PCEG began an effort to streamline the executive. Scores of contractual positions in the Office of the President were abolished in early 2002. But this effort did not continue, robbing it of impact. The President also issued orders directing GOCCs and government financial institutions (GFIs) exempted from the Salary Standardization Law to standardize their pay practices and make senior officers' compensation comparable with counterpart positions in national agencies. The fiscal impact of these measures has been minimal, and further negated by salary increases granted to almost all categories of employees during 2002–2004.

Proliferation of agencies, functional duplication, and overlaps among agencies and within and between departments compound the problem of high personnel costs. Some agencies seem to be overstaffed, while some are also overlaid, with too much middle management. There are staff surpluses in

many functions and staffing shortages in others. Equitable distribution of staff across regions and provinces is an issue. Overlap and duplication of functions also adds to numbers.

Configuring civil service policy and management to achieve greater public sector efficiency comprises the next set of challenges confronting the new Government. Two issues are key: (i) compensation and incentives, and (ii) merit-based recruitment and appointments.

Strengthening civil service incentives, meritocracy, and management

Compensation levels are inadequate for attracting, retaining, and motivating civil servants in critical jobs. The single civil service salary schedule, with 33 grades each with eight steps, is coming under increasing pressure. Many GOCCs and GFIs have already broken away, fuelling pressures. Fiscal pressures have led to numerous entities being granted exemptions from salary standardization on the basis of their revenue-generating capacity. These exemptions have created a special class of civil servants whose compensation has increased disproportionately to those covered by the Salary Standardization Law. This debasement of the salary standardization principle enunciated in the Constitution has demoralized civil servants, and constitutes part of the reason why national government agencies completely dependent on the budget are finding it difficult to attract, recruit, or retain personnel for technical and managerial positions. Pay surveys suggest that salaries for senior civil servants may be as little as 20 percent of private sector equivalents, and salaries for senior executives and for professionals in the middle pay groups lag well behind equivalent private sector salaries.

Low wages potentially also pose governance risks to the extent that they may be associated with absenteeism and corrupt practices. Civil service salaries are also compressed—they hardly allow room for reward and

significant milestones. At the same time, civil servants in benchmark positions in lower grades tend to be somewhat overpaid compared to private sector equivalents.

The compensation structure is opaque, complicated, and outmoded. There is a growing abundance of increasingly perverse and nontransparent “allowances”, especially in GOCCs and GFIs. Pressure to contain the defined benefit pension bill has resulted in growth of unconsolidated “allowances” rather than increased basic salary. In addition, productivity and performance pay has degenerated into merely another allowance, paid at a flat rate to almost all employees. Its original intention has been lost. On the other hand, geographic differences in pay and allowances have been abolished. But this has led to an unintended consequence: national government staff in regional offices are now better off in real terms than their Metro Manila counterparts, and experienced staff are now reluctant to move to the national capital area from regional offices. The result is an inefficient system, cumbersome to administer and vulnerable to abuse.

Lack of meritocracy in the civil service, especially at higher levels, has lowered civil service morale and capability. Political influence and the spoils system still hold sway in appointments to senior and other career positions. Open selection for career executive positions continues to be eroded by political influence. This is exacerbated by the fact that the President appoints no less than 11,000 personnel comprising 3,000 constitutional positions, 6,000 CES positions, 1,650 prosecutors, and 500 other positions created by special laws.² As a result, the Philippines has the greatest depth of political appointments, going all the way down from secretary, undersecretary and assistant secretary to bureau directors, regional directors and

² Judicial interpretations have also perpetuated the discretionary nature of the power of appointment by defining appointment as a “political question involving considerations of wisdom which only the appointing authority can decide.”

service directors. In contrast, most East Asian countries make such appointments only to the top two tiers. At present there are numerous positions of confidence, while the practice of offering ‘courtesy resignations’ with changes of administration creates the potential for high turnover of senior officials.

Effective management of the civil service and costs have been hindered by overlapping CSC and DBM mandates. The CSC and DBM currently deals with civil service employment and compensation issues. The CSC is the independent constitutional body vested with the authority to formulate and oversee implementation of all aspects of civil service policy, including compensation policy and personnel management. The CSC is slowly building up its capacity to effectively perform its constitutionally mandated role of formulating and overseeing implementation of all aspects of civil service policy, including compensation and personnel issues. At the same time, the DBM also deals with budgetary pay and employment issues. Such overlapping responsibilities and turf battles at the working levels have, in the past, diminished the effectiveness of both agencies, despite the intention of the leadership of each agency to contain civil service employment and costs.

An outmoded and ineffective legal and integrity framework is a major constraint in moving toward a modern and professional civil service. The CSC has prepared an updated draft of the new Civil Service Code, which is currently under legislative review. The Code seeks to promote efficiency and professionalism through merit-based recruitment, performance evaluation, and promotion; make compensation more competitive and performance-linked within fiscal constraints; protect upright civil servants in the discharge of their functions; and give stronger accountability and integrity mechanisms. In addition, the PCEG has formulated an integrated anti-corruption strategy for the Government aiming, among other things, to strengthen integrity in the civil service.

Addressing political economy challenges

The political economy challenges associated with CSR are substantial. The political executive exerts wide-ranging influence on civil service structure and actions through an entrenched system of spoils and patronage. The source of this influence is two-fold. First, there is the threat of instability of assignment. Changes in national administration are invariably accompanied by sweeping changes in civil service staffing. An important part of this phenomenon is traceable to the vast powers of the Presidency, exceptional in relation to other countries. Civil service rules, which preserve only rank but not specific assignments, pose no obstacles to the arbitrary replacement of incumbents. Second, the weak and subordinate position of the civil service is reinforced by large differentials between private-sector and public-sector pay and the gap in social status between holders of political positions (whether elected or appointed) and their rank-and-file civil service subordinates. In such circumstances, it is a rational response on the part of civil servants to play a submissive role and abdicate their technical role to accommodate “political decisions”.

The Bureau of Internal Revenue (BIR) exemplifies the governance challenges and complexities of CSR in the Philippines. While the BIR is technically a bureau under the Department of Finance, the Secretary of Finance has traditionally had little influence over the selection of the BIR head and little supervision over BIR functioning. The appointment of the BIR Commissioner has traditionally been regarded as among the significant presidential political appointments. The Commissioner, though not of cabinet rank, serves at the President’s pleasure. Hence the leadership of the BIR changes with every change in administration. The BIR head in practice traditionally reports directly and justifies his or her performance to the President. This has removed the BIR from the usual discipline of regular line agencies of its own level and those immediately above it, and designated it as an area of

large potential rents. As a result, the BIR is an agency in which—with honorable exceptions—corruption has become entrenched. Changes in regime and of political principals may have little impact on the actual practice of and extraction rates from corruption on the bureaucracy’s part. What occurs is merely a reassignment of established rents from old to new principals. Lastly, the BIR has also refused to be audited by the otherwise powerful Commission on Audit.

The source of the rents extracted by corrupt BIR officials is found in the discretion exercised by BIR staff over taxpayers. This power takes the form either of exempting taxpayers from their legal liabilities, or in the selective application of the latter, in a country where tax compliance is low to begin with. There are notoriously large slippages in the payment of corporate and personal income taxes and of value-added taxes. This, plus the inherent complexity and opaqueness of tax laws (specifically those relating to allowable deductions) and spotty record-keeping, makes it inevitable that selective tax audits will provide opportunities for harassment, followed by “tax compromises”.

Other anomalies include diversion of bona fide tax payments to privately owned bank accounts; nonremittance and diversion of tax rebates for small-wage earners; and a brisk business in falsified tax credits. (The rents are so lucrative that some BIR officials have falsified their birth dates to postpone their retirement.) In addition, informal social customs (e.g. generous cash gifts to staff during holidays and lavish staff parties and outings) also reinforce the “insider” culture.

A sustainable medium-term civil service reform strategy will have to take political economy challenges into account. Fiscal pressures can provide an entry point for short-term civil service reform actions. Alone, they cannot sustain the institutional reforms that aim to strengthen civil service management, professionalism, and integrity. These require a strategy that takes into account the political complexity and long-

term nature of these reforms, draws on support from the political leadership and the public, and involves stakeholder consultation.

Suggestions for priority actions

The new Government plans to aggressively promote growth and combat poverty. The key fiscal management challenge here is to sustain the level and improve the efficiency of poverty-reducing public expenditures. To do this, it would be desirable to first contain the fiscal weight of the civil service wage bill. A reallocation from PS to MOOE could improve the effectiveness and efficiency of government spending, especially in sectors such as education.

The short-term priority is to control and then reduce the fiscal weight of the wage bill. Incremental measures are no longer enough. A two-pronged action plan to control the wage bill could comprise:

- *Tapping specific sources of “flexibility” in PS allocations in the short run.* Flexible items within the overall PS allocation comprise wages of nonpermanent personnel, per diems, fringe benefits, and certain other items. Roughly 18–20 percent of the PS allocations across the national budget are “flexible”. This exercise could be undertaken for the 2005 budget and immediate savings identified.
- *Deciding on fiscally affordable compensation modernization and rightsizing options, and presenting needed legislation and a costed action plan in 2004.* Work on a review of the compensation and severance policy is already under way. Developing an appropriate severance package entails amending existing legislation. This will have to be preceded by an exercise to realistically calculate the fiscal impact of such a measure, how it can be financed, and over what period of time such an exercise could be implemented. The CSC and the DBM are equipped with modeling tools to undertake the technical

exercises. Armed with the data, consultations with stakeholders, such as legislators and employee associations, must then take place. It will be important to define a timeline for this initiative, specify responsibilities, prepare a costed action plan, and submit the legislation to congress in 2004 so that it can be implemented from 2005. Preliminary analysis indicates that a reduction of about 10 percent of central government employment, over and above normal attrition, could be achieved by end-2006.³

Modernizing the legal framework for the civil service could be a launching pad for strengthening civil service professionalism and integrity. This has two main aspects:

- *Passage of the Civil Service Code on a priority basis.* A modernized legal framework is indispensable for professionalizing the civil service. Executive commitment to modernizing the civil service legal and integrity framework is undoubted. Given the troubled history of such legislation, proactive and sustained advocacy in favor of the new Code with relevant stakeholders could well determine the success or failure of this attempt. Enactment of the Code should be a priority for the new Government—as history shows, delay is likely to be fatal for civil service reform champions. The updated Code should (i) separate professional civil service positions and positions of confidence, (ii) separate key policy provisions from other details of employment, and (iii) amend the definition applicable to civil servants' selection and promotion to competitive assessment of merit.
- *Amendment and modernization of the Administrative Code of 1987* (Executive

³ There will be incremental costs associated with such downsizing, for which sources of financing will have to be identified. It is important to realize that rightsizing employment while paying severance will not lead to short-term budgetary savings.

Order 292, which deals with how the Government operates administratively and financially) is now overdue. It would be desirable to appoint a task force in the early days of the new administration to implement this urgent and important task.

Reforming the BIR will be a litmus test of the administration's ability to grapple with thorny governance and civil service reform issues and entrenched vested interests. The new administration's first months in office would be the most opportune time to tackle this long-pending issue. Proposals to transform the BIR have been under legislative scrutiny for a while. Regardless of whether such legislation is passed, it will be important to intensify recent efforts (spearheaded by the PCEG, CSC, DOF and BIR management) which focus on administrative measures to strengthen the professionalism of BIR staff. These involve actions to reduce corruption, improve discipline, recognize and reward integrity, promote efficiency and inculcate a customer service ethos. How well these incentives and disincentives are implemented could be a bellwether for civil service reform in the Philippines.

Reducing the number of presidential appointments from the current 11,000 to (say) 5,000 through an executive order would send a strong signal of the new administration's willingness to strengthen civil service meritocracy, professionalism, and morale. This would sharply reduce the number of non-CES appointees to CES positions; redressing this injustice to civil servants would also open the door for promoting capable and upright civil servants. At the same time, redefining the parameters for appointment of non-CES individuals to CES positions would also strengthen professionalism.

Lessons from the political economy of earlier reform attempts can now provide a solid foundation for a more realistic reform strategy and sequencing. Previous attempts indicate that (i) there must be strong

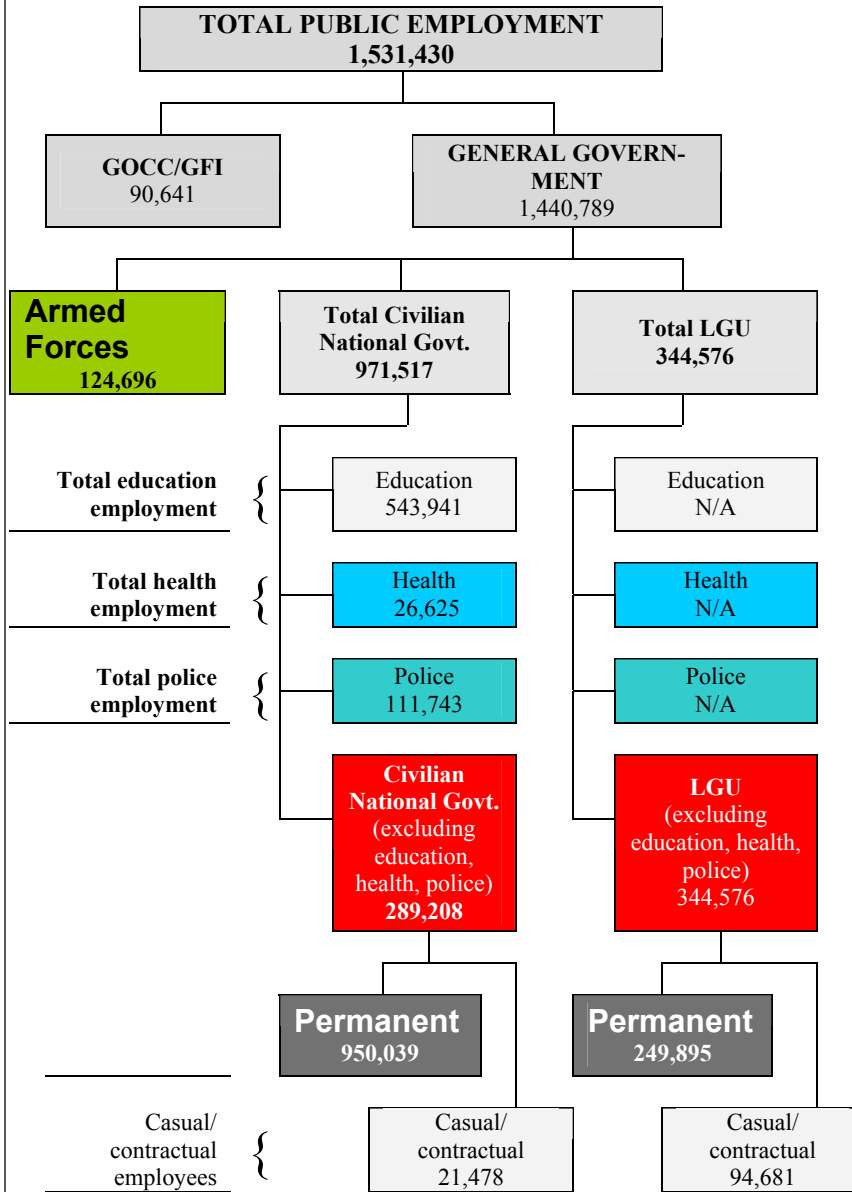
and publicly stated support for such measures from the highest levels of political leadership, (ii) it would be most appropriate for a high-level entity such as the PCEG to lead this exercise, (iii) the CSC and DBM should take the technical lead, coordinate with other agencies, and provide logistical support to the PCEG, and (iv) sequencing and prioritizing reform actions could make the difference between success and failure. Consultations with stakeholders, such as legislators and employee associations, must form an integral part of a CSR strategy. Across-the-board re-engineering and downsizing efforts unaccompanied by advocacy and consultation are likely to fail and provoke cynicism, as have such efforts in the past. Successful implementation of a targeted exercise, especially in respect of the BIR, could instead spur such initiatives.

Over the medium term, two sets of actions to control personnel costs are desirable.

- *Administrative streamlining to accompany employment and compensation adjustments.* Expediting national government initiatives to streamline executive structure and functioning would be appropriate, by e.g., eliminating overlapping or unnecessary functions and entities, and efficiency improvements. Such an exercise needs to be initially targeted to, for example, a few of the 13 departments and agencies already identified for “deactivation”. However, early completion of ongoing diagnostics is essential for developing a sequenced and credible medium-term action plan. It is desirable that the CSC and DBM jointly take the lead in this area, coordinating their efforts with other agencies, to prepare a draft action plan which could form the basis for consultations.
- *Expedite the installation of a personnel information system linked to the payroll.* A grant-financed initiative is being led by the CSC and DBM to monitor and control

employment growth by creating a common personnel database for national government agencies. The exercise will result in a specification and possible cost estimate by late 2004—it would be desirable to provide an allocation in the 2005 budget to initiate installation. The database is intended to have a unique link for each employee to a corresponding authorized position of each agency. Those persons who cannot be assigned to a post will be shown as additional to the authorized establishment and therefore shown as an additional cost for which appropriate authorization must be obtained. Similarly, all posts that are not occupied will be shown as vacant, indicating a potential saving in projected budgetary expenditure. This initiative will be a first step toward remedying the establishment control problem.

Figure: Philippines: Structure of Public Employment, 2002



Source: DBM, World Bank Staff Estimates

