

Dr Aleksandra Rabrenovic,
Institute of Comparative Law
Belgrade, Serbia

**MAIN PRINCIPLES AND APPROACHES
TO CIVIL SERVICE PAY REFORM:
EXAMPLE OF WESTERN BALKAN COUNTRIES**

1. INTRODUCTION

The reform of civil service remuneration has emerged as one of the most important issues in the development of civil service systems in the Western Balkans over the past decade aimed at increasing civil servants' motivation. The traditional salary system that was in operation in most countries in the region was inadequate and opaque, providing few incentives to young qualified staff to join the civil service and, for experienced professionals to remain in the administration, posing serious problems for the operation of the civil service systems.

The aim of the any civil service pay system is to motivate civil servants to carry out their duties in a way that that will enable the Government to achieve its strategic objectives, having regard to affordability and equity (SIGMA, 2007). The pay system should be structured in such a way to ensure that the state will be able to attract and retain a bureaucracy of sufficient quality and quantity for it to be able to ensure the effective governance of the country.

Despite the importance of civil service pay, a fairly limited amount of research has been conducted on this topic, which has been mainly reserved for pay specialists expert community. A more systematic investigation has recently been undertaken to address the issues of rewards for high public offices under the NISPACEE auspices, following the methodology outlined in similar pieces of work that covered European and Asian region (Hood, Peters, 1994; Hood, Peters, Lee, 2003), but did not discuss the challenges of pay systems of the core civil service. An important contribution to this topic was recently provided by a SIGMA study on civil service professionalization in the Western Balkans (SIGMA, 2012), which focused mainly on analysis of transparency and predictability of civil service systems in the region, as well as their pay levels. Similar research was earlier conducted with respect to broader analysis of the civil service pay systems of the South and East European countries (Rabrenovic, 2009).

The objective of this paper is to discuss main principles and approaches to civil service pay reform, underpinned by the examples of the countries of the Western Balkans. This paper analyzes the attempts at reforming the civil service remuneration system in the Western Balkan countries that took place over the past decade, being partly driven by the EU accession process and supported by involvement of bilateral and multilateral donors. Special attention is paid to civil service pay reforms efforts undertaken in Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro

and Serbia. The Croatian civil service pay system has been analysed to a lesser extent as it has remained largely unreformed since 2001.

2. IMPORTANCE OF CIVIL SERVICE PAY ISSUES

The civil service pay issues have attracted continuous attention of political scientists and philosophers from various points of view. In early XIX century, Hegel understood the importance of adequate pay to elevate the public service above narrow sectional concerns. Bentham, on the other hand, in line with his utilitarian philosophy of government was more concerned with the cost of public administration and stressed the importance of honorific service and methods of keeping public salaries as low as possible (Hood, Peters, 1994).

Nowadays, the argument that adequate pay is crucial to sustaining motivation, performance and integrity of public servants appears to be widely accepted and documented. The World Bank (1993) argues that there is an important connection between rewards and economic performance. There is evidence from all around the world that Government workers either cut back their productivity or hours of work when salaries are inadequate (Lindauer, Nunberg, 1994).

If individual civil servants salaries are not competitive with their benchmark positions in the private sector, civil servants will actively seek to change jobs to the private sector or be more prone to corruption. For example, a microdata analysis of individual pay levels and imputed bribery in Ukraine found fairly robust evidence that, public servants through bribery, on average, just compensate for the extent to which their formal pay falls short of what they could command in Ukraine's private sector (Gorodichenko, Yuri, Peter, 2006). For this reason, it is recommended that the total compensation including pay, perks and prestige, must be competitive with the private sector (World Bank, 1993).

Relationship between civil service *average* pay and corruption, on the other hand, should be treated with caution. While some studies show a negative relationship between average public sector pay levels and corruption (IMF, 1997), others find no evidence of a positive relationship between average public sector pay and corruption practices (Gong, Wu, 2012) and instead of increasing the average level of pay recommend integrity enhancement in personnel recruitment, training, appraisal and promotion.

The mixed results of studies of average public sector remuneration and corruption, coupled with micro-data corruption study suggest that adjusting *average* public sector salaries may not be as important as improving the overall structure of public sector remuneration and its consistency (Reid, Orac, 2007). Improving the structure of civil service remuneration assumes not only ensuring consistency in the competitiveness of total remuneration with the private sector, but also observance of internal fairness and the transparency of the system, as important underlying principles of the civil service pay systems.

Finally, it should be born in mind that pay represents an important part of extrinsic motivation of people, which has a powerful, but not a long-lasting effect if not

complemented and followed up by other motivating factors. A number of studies have shown that the intrinsic motivators, which are concerned with the quality of working life and work/life balance, are likely to have a deeper and longer term effect because they are inherent in individuals and not imposed from outside, although they may be encouraged by the organisation (Armstrong, Murlis, 2005; Frey 1997). Therefore, in order to be effective, civil service pay system needs to be complemented by other factors that foster intrinsic motivation, that is derived from the content of the job, such as: responsibility (feeling the work be important and having control over one's own resources), freedom to act, scope to use and develop skills and abilities, interesting and challenging work and opportunities for advancement (Armstrong, Murlis, 2005), which are unfortunately often missing in the transitional civil service environments.

3. KEY CIVIL SERVICE PAY PRINCIPLES

There are two key issues that need to be taken into account when looking at civil service pay: *internal* and *external* fairness of the system. Internal fairness needs to ensure that the level of a civil servant's remuneration is determined fairly in relation to other civil service positions, while the external fairness assumes that civil servants' work needs to be remunerated fairly in relation to similar types of work in the private sector.

What are the ways to ensure internal fairness of the system? The key answer lies in promoting the principle of equal pay for equal work, which assumes that the pay level (or pay range) for each job should correspond to the level of the job's responsibility, complexity, decision making, knowledge and skills required to perform the job (DFID, World Bank, 2004). The knowledge and skills necessary for performing specific levels of responsibilities are called by some authors as human capital requirements of the positions, that need to be directly linked to remuneration levels (Reid, Orac, 2007). Definition of the human capital requirements should be based on an accurate description and evaluation of the *job* and not the person occupying the job. The establishment of a common structure and common pay levels facilitates the movement of people between ministries and agencies and helps to foster a corporate civil service identity (DAI, 2006).

Some experts argue that, in special circumstances, it is justifiable to have exceptions from internal fairness of the system based on external, i.e. market considerations (DFID, World Bank, 2004). Namely, some positions in the civil service, such as high level IT specialists or financial specialists may be difficult to hire in the civil service due to high level of remuneration they can obtain in the private sector. For this reason, higher pay levels may be sometimes provided for specific jobs which are at a premium in the market. Such pay levels should, however, regarded as exceptional, require specific justification, and are subject to regular reviews (DFID, World Bank, 2004).

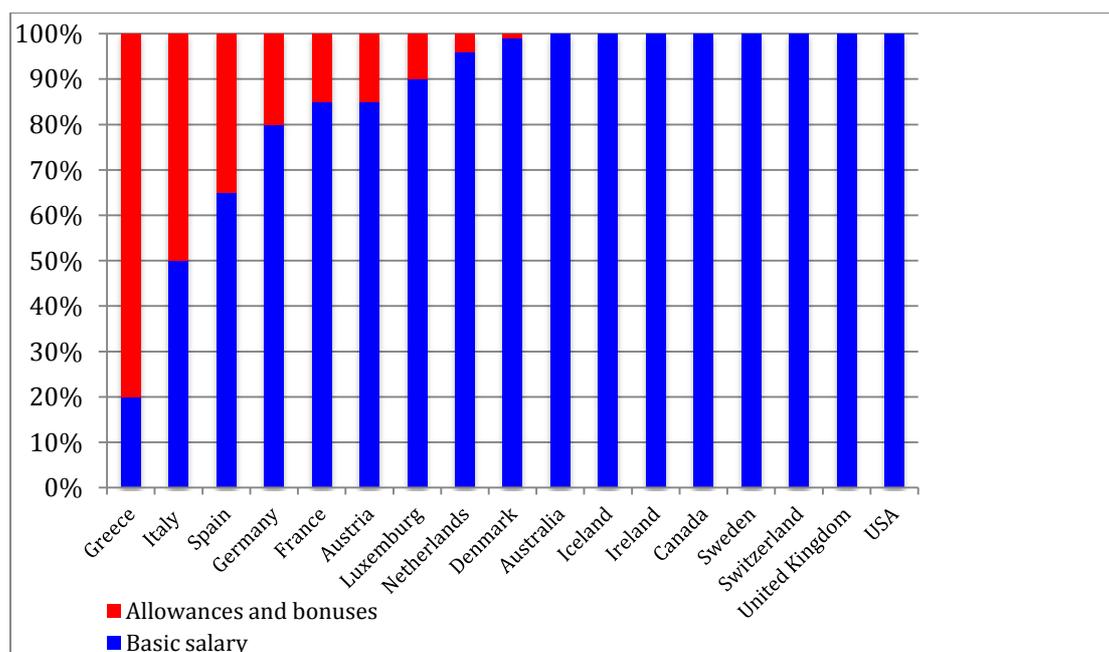
Other professionals, however, strongly disagree with selective raising of salaries, as in their view, they may have a disastrous consequences in the medium term, as it risks to distort the whole system and only aggravates the existing problems (Cardona, 2006). Their argument is that although the reasons for selectively increasing the salaries for certain professionals such as tax inspectors, collectors of fines, EU issues related

people are easy to find, they are not easy to justify to other civil servants or to a public at large and have a de-motivating effect on those who did not benefit from them (Cardona, 2006). Therefore, a great deal of caution is advised against introduction of selective benefits that go against the principles of internal fairness of the civil service pay systems.

Closely linked principle that underpins the internal fairness of the pay system is the principle of predictability and transparency, i.e. ease with which civil servants and members of the public can see how the pay system is constructed and how civil servants are paid for their contribution compared to others. A transparent and predictable system is one in which it is clear how pay is related to the importance of the job and is generally measured in terms of the ratio between basic salary and total salary. A transparent civil service pay system assumes that the number of pay allowances and bonuses is minimal (forming remaining 10-20% of pay). This means that basic salary is the main element of total salary, typically forming at least 80% (and usually more) of total salary (DFID, World Bank, 2004). Transparency of the pay system also enables ease of administration, i.e. ensures that it is easy to implement and monitor the pay system.

In some OECD countries ratio between the basic salary and total salary is even 100 per cent, which means that there are no allowances and bonuses but only basic salary, which reflects the level of responsibility and complexity of a certain position. This is, for example, the case is in Switzerland, Sweden, Canada, Australia and Iceland. On the contrary, countries with substantive number of allowances and low level of ratio between basic and total salary, such as Greece, Italy and Spain, are currently experiencing serious financial difficulties and are forced to reduce the number of allowances as well as the levels of civil servants salaries.

Figure 11: Ratio between basic salary and total civil service salary in selected OECD countries



Source: The World Bank Technical Note prepared for the Programmatic Public Expenditure Review: Kyrgyz Republic Civil Service: Pay and Employment Analysis, 2007

In addition to fairness principles, it is important to ensure that civil service pay system also provides sufficient leeway for career progression throughout the whole civil servants working life (usually around 35 years). It is very important from the point of view of motivation of a civil servant to have an opportunity of career progression. A person that has obtained the highest possible position in a short period of time may well be de-motivated and not invest the same amount of efforts as he/she used to, and, at the same time does not enjoy his/her work as when he/she had an outlook of promotion (Pusic, 1973). Special attention needs to be paid in position-based systems in which opportunities for career progression are fairly limited. Such limitations are usually overcome by introduction of wide opportunities for horizontal career progression, whereby civil servants at the lower pay grade at this end of their pay grade scale, can obtain a higher salary than civil servants of a higher pay grade.

In order to further foster civil servants motivation to take on higher levels of responsibility, there should also be a reasonable difference of pay between the lowest and highest salary, i.e. decompression ratio. The decompression ratio should, however, not be either too high or too small. A ratio of 1: 4 - 5 would be deemed to offer a good incentivized career path in a professional civil service (that includes university graduates as the lowest civil servants). The decompression ratio between the lowest civil service salary and the highest political posts could be higher amounting to 1: 7-10 (DFID, World Bank, 2004). In both cases attention should be taken that salaries of the lower levels of staff are not at or below subsistence levels.

External fairness of the system, i.e. competitiveness of civil service salaries is becoming increasingly important principle for European civil service systems, which have been fighting a fierce battle with the private sector to attract and retain highly qualified and talented staff (OECD, 2004a). The levels of civil servants' salaries in most European countries are reasonably in line with market pay levels in order to be able to attract and retain qualified staff. In this way, tendency for staff to seek illegal ways of supplementing their income is also reduced.

Competitiveness of the civil service pay systems is usually ensured by conducting regular pay comparator survey between public and private sector and adjusting the pay levels accordingly. For example, in Japanese Civil Service Law requires the Government to conduct annual pay comparator surveys which are used to make annual adjustments in the civil service pay. In order to keep this there is a need for compensation plans to be periodically reviewed and systematically revised to assure validity of the compensation plan.

However, it should also be noted that total pay levels in the civil service are normally lower than for comparable jobs in the private sector, typically 80% - 90% of private sector pay levels (OECD, 2006). This somewhat lower compensation of civil servants is compensated usually by greater job security than in the private sector and better working conditions, such as longer vacations, and in some cases better conditions for pension insurance (DFID, World Bank 2004; Pusic, 1973). This argument, however, is often confronted with another equally valuable claim and that is that civil servants, due to integrity concerns, are forbidden from performing other jobs (especially enterpreneurial) after their working hours and that the nature of their work is very often

overly specialized that they are not in a position to look for jobs in the private sector as an alternative job (Pusic, 1973, p. 187).

One of the biggest constraints to reforming civil service pay systems is, of course, the budget limitation, especially in the time of the economic crises. It is essential that the wage bill be affordable within public sector budget ceilings. It must also be sustainable into the future, and must not have a detrimental effect on pay in other areas of the public sector.

Finally, one of the most controversial issues with respect to civil service pay is undoubtedly performance related pay. The issue of performance related pay has attracted huge attention both in OECD and transitional countries, including countries of the Western Balkans. The adoption of performance-related pay in the public sector reflects the influence of the private sector culture of incentives and individual accountability on public administration.

4. CIVIL SERVICE PAY IN WESTERN BALKANS COUNTRIES: REFORM BACKGROUND AND KEY CHALLENGES

In most of the Western Balkan countries the key approach to civil service pay issues traditionally consisted of simple index-link salary adjustments, i.e. adjustment of civil service salaries for the inflation factor. Thus, for example, in former Yugoslavia salaries were calculated by multiplying the coefficients and the basic salary, both of which were determined by a Federal Government Decree. It is interesting to note that the basic pay was published annually in the Official Gazette. The Federal Government, however, was able to reduce the basic salary in the course of the year by 20 per cent, depending of the revenues of the budget.¹ Underpinning the salary indexation was a non-transparent pay structure that was determined by the Federal Government (State Executive Council). However, in accordance with the Law that regulated the status of civil servants since 1978 (Law on Basis of State Administration System and Federal Executive Council and Federal Administration Organs)² salary structure was to be based on the system of job evaluation, which included the following criteria: complexity of work, responsibility, scope and quality of work and conditions for carrying out these duties.

Index linked salary adjustment system was coupled with the collective bargaining process, which was a conventional approach to pay adjustments for all unionisable employees. However, while the unions of larger group of public service employees, such as education and health, have traditionally been strong due, inter alia, the high number of employees they gather and their right to strike, civil servants have always had unfavourable position, due to the absence of the right to strike and relatively low number of staff in comparison to other public sector employees (World Bank, 2004).

At the beginning of 1990s, most Western Balkans countries established career-based civil service models, which means that career development is based primarily on

¹ Article 290g, paragraph 2 of the Law on Basis of State Administration System and the Federal Executive Council and Federal Administration Organs.

² Official Gazette of the SFRY, No. 23/78, 58/79, 21/82, 18/85, 37/88, 18/89, 40/89, 72/89, 42/90, 44/90, 74/90, 35/91.

education qualifications and ‘years of service’, instead of the content of the job and job evaluation. Although the principle of seniority is very much present in most continental European career systems, it has proved to an adverse effect on development of civil service systems in the region. There are a couple of reasons for that: 1) a gradual career/wage growth principle creates strong disincentives for young staff to remain in the civil service, who stay for 2-3 years to gain experience and then go to the private sector, which has much better opportunities for career advancement and more competitive pay levels 2) there tends to be a large number of end-career officials, whose salaries are significantly higher due to years in service increments 3) there is a lack of qualified upper level professionals and middle level managers (so called ‘missing middle’) who should be the leading force in carrying out professional public administration duties and tasks. Bearing in mind the transitional environment of SEE countries with rapidly growing private sector opportunities for work, there was a clear need for reforming the public sector pay systems in order to be able to attract and retain talented and qualified personnel.

Another serious problem was a high degree of fragmentation in civil service pay systems, which allowed some institutions to have higher pay levels than the rest of the civil service and has an adverse effect on morale of civil servants working in other institutions with lower pay. For example, in Macedonia, special laws, complemented by the General Labor Code, regulate status (including pay) of specific corps of civil servants, e.g. customs, tax and police, which have higher levels of pay in relation to civil servants working in other institutions (SIGMA, 2006). Decentralized, more advantageous pay regimes for tax, customs and police officials could also be found in Serbia, before the pay reform conducted in 2006 and unfortunately also after the reform process.

Although decentralized pay systems do exist in many OECD countries, this phenomenon is considered problematic in transitional countries for a couple of reasons. First, in case when special laws substituted with General Labor Code provisions regulate the work relationship and conditions, too much scope is left for discretionary rights to heads of institutions. Second, differences in pay between civil service institutions have a negative effect on the work motivation of civil servants in other institutions, who are naturally inclined to look for a job in the institutions with higher pay levels for performing the same job. Finally, there is no rationale as to why civil servants who are performing tasks of similar levels of responsibility and complexity should receive higher pay in some civil service institutions than in others.

In many Western Balkans countries there are also large pay variations among positions with the same title throughout the civil service under the unified legal framework. This lack of consistency between job content and its hierarchy leads to the distortions of pay levels across the administration and distortion of the principle equal pay for equal work. For example, in Bosnia and Herzegovina, a review of the state’s payroll data for April 2005 showed that there were significant differences in salaries for the same positions across positions that cannot be explained by the salary and allowance structure (DFID, 2005). For example, there was around a 70 percent difference in salaries for “head of department” within the newly created agencies. Given that all civil servants fall under the unified legal framework, these wide differences are very likely to reflect some degree of favoritism or poor payroll procedures and controls.

In addition, uneven salary levels for similar types of positions could be attributed to an elaborate system of allowances and discretionary payments, which constitute a large proportion of pay and therefore imply significant managerial discretion in assigning them to individual staff. The higher the number of allowances, the greater the complexity and inefficiency of administering the system, and the less the transparency to an external observer.

All Western Balkan countries use a separate ‘years of service’ allowance, which gives disproportionate weight to a person’s length of service in determining total pay and discourages performance. Years of service allowances can in some instances add up to 35% to overall pay.³ Although length of service is a legitimate factor in pay awards, and many governments give automatic annual increases, in Western Balkans transitional environments seniority increases have proved to have an adverse effect on staff motivation, particularly on young personnel. As the years of service make a big difference in the total pay they discourage young personnel to join and stay in the civil service, due to uncompetitive salary levels and also discourage performance.

There are also other allowances, such as those for temporary duties and for work in various commissions that are awarded selectively to a few individuals and are open to possible abuse. For example, Montenegro adopted the new Law on Salaries in 2012, which represents a step back with regard to predictability and transparency of the system. The Law introduces an allowance for carrying out duties on certain work positions, which is to be regulated by a Government decree.⁴ It is interesting to note that this decree are not widely available (have not been posted on the website of the Civil Service Agency) which makes the system non transparent and also not also not very predictable.

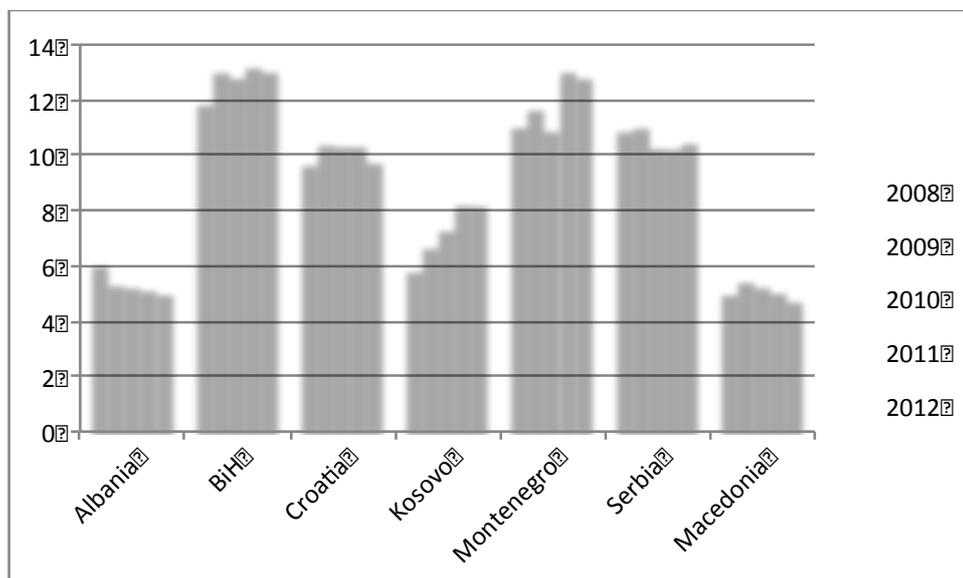
Most Western Balkan countries civil service pay systems traditionally have a low compression ratio, which is reflected in little difference in total net pay between grades, constituting a significant impediment for performance. Low compression ratios discourage staff from taking on higher level responsibilities and therefore negatively impact the quality of the civil service. For example, in Bosnia and Herzegovina, before initiation of reforms in 2008, a person who would enter the civil service in the rank of associate could expect her net base pay to rise by no more than 20 percent after three promotions. Hence, strong performers had little incentive to take on additional responsibilities. Whereas, as we could see earlier, overall compression ratios in European countries can go up to 1:7 and even 1:11, in SEE states, ratios of around 1:3 or 1:4 are no exception.

One of the biggest constrains to reforming civil service pay systems is, of course, the budget limitation, especially in the time of the global economic crises. Majority of the analysed countries have rather high wage bills in relation to GDP, with the exception of Albania and Macedonia. Although the civil service wage bill constitutes only a small fraction of the overall public sector wage bills, its effect on the overall wage bill levels should not be underestimated. The wage bill concerns are the most apparent in

³ In Serbia, the maximum ratio of years in service increment in total pay in Serbia is 16 percent, in Bosnia and Herzegovina and Croatia 20 percent, while in Montenegro it can go up to 35 percent.

⁴ Articles 18 and 19 of the Law on Salaries of Civil Servants and Employees.

Bosnia and Herzegovina and Montenegro, as the general Government wage bill constitutes around 13 per cent of GDP (see graph 2 below), which is much higher than the ECA average of 8.6 per cent. For this reason, reform of the civil service pay system needs to be carried out with a great deal of caution in these countries.



Source: World Bank's FACE database

The performance-based elements, that have traditionally been absent from the civil service pay systems in Western Balkans, have started to be introduced with mixed results, as shall be discussed in more depth in the following sections.

5. MAIN APPROACHES TO CIVIL SERVICE PAY REFORM

5.1. Job evaluation and salary re-grading

It is interesting to note that in a number of Western Balkan countries traditional career based system has been reformed through introduction of principles of position-based systems, such as the equal pay for equal work. The most visible reforms were carried out in Macedonia, Serbia and Albania, in which pay grades were clearly linked with content of the job (degree of complexity, responsibility, independence etc.). Bosnia and Herzegovina and Kosovo have also embraced position based models in their legislation, but the implementation has not followed.

It may be argued that Serbia has been the most advanced reformer in this respect, as it has designed job classification methodology which implementation assumed development of detailed job descriptions for each civil service post. The methodology was drafted with a considerable donors assistance that was also followed by effective implementation.

In Macedonia and Albania, linking the job complexity with pay was done though introduction of the position supplement, which rewards each position relative to the nature and scope of work, complexity and responsibility for carrying out the work (SIGMA, 2006). Albania has also introduced a position based civil service system,

linking pay grades to the nature of job performed. The most important part of the salary is the “position supplement”. According to the Council of Ministers decrees the position supplements varies from 73% of the total salary for the lowest executive positions to almost 91% of the salary for the highest civil service positions.⁵ The position supplement is based on the job evaluation for the positions (Shundi, 2010).

However, there have been a number of difficulties associated with a job evaluation and re- grading exercise. First, the exercise is expensive and time consuming. To complete job evaluation for, a medium sized civil service (such as Serbia’s) took several months of efforts by a fairly large team of consultants working alongside an even larger team of Government officers. Even more efforts and financial resources are needed to implement the results of the job evaluation. Consequently, in some countries, such as for example Bosnia and Herzegovina and Kosovo the implementation has not been taken through to its logical conclusion. Second, the introduction of job evaluation requires strong central human resources management leadership and capacity in individual organisations which is still missing in most of the countries. Third, usually the results of job evaluation are contested by many groups of employees, because they may perceive bias in the evaluation process or they seek to protect their status and interests that are challenged by the results (Kiragu, Mukandala, 2003). Therefore, while job evaluation and regarding remains a valid, although sometimes controversial, management tool in addressing public service pay issues, the feasibility of its introduction needs to be considered carefully before its recommended introduction.

5.2. Increasing the transparency and predictability of the pay system

Over the past decade most Western Balkan countries have increased transparency of their pay systems through rationalization of the number of allowances and thus increasing the base pay to real pay ratio. In Serbia, almost all allowances, except again for ‘years of service’ allowance have been integrated in the base pay. Management allowances were integrated in the job classification and grading and bonuses which were paid quarterly without a proper performance appraisal system were also abolished. It is further interesting that overtime hours are not any longer paid through monetary allowance, but provide a basis for taking days off. Only if the number of overtime work is excessive, it could provide an exceptional basis for monetary allowance. This provision refers only to career civil servants while managers are not entitled to any overtime allowances. Croatia also introduced some rationalization of allowances under the 2001 Law on Salaries. However, due to entitlements under the Labor code that are reflected in Civil Service employment conditions civil servants still obtain a large number of additional allowances that make up a significant element of pay.

Kosovo has recently reformed its pay system by adopting the new Civil Service Pay Law, in which it has kept an allowance for specific working conditions and allowances for specific conditions and requests of job positions and work market, which are to be regulated by a Government decree. Although use of such allowances may be justified in some circumstances, there is a danger that they would be used excessively in practice, which goes against the principles of predictability and transparency. In Bosnia, recent amendments of the Civil Service Pay Law have

⁵ Council of Ministers Decree No. 475, of 13 July 2007.

reduced the number of allowances,⁶ due to fiscal concerns, which is a positive development.

Good example of limited use of special allowances may be the case of Albania, whereby the supplement for specific job conditions is applied only for posts of IT staff. This supplement was introduced to counterbalance the difficulties in recruiting and maintaining IT staff in the ministries. Because the private sector attracts this category of staff with better reward packages, the government decided to introduce this salary supplement for all IT positions in the ministries. This supplement constitutes around 23% of the salary for specialist positions and 15% for director positions (Shundi, 2010).

Albanian case is interesting as it also rationalized the pay system, by abolishing the management allowance (in 2006) and allowance for scientific qualification (master or PhD in 2000), but has re-introduced allowance for scientific qualification again in 2007. This allowance was re-introduced in the framework of the government's efforts to attract and maintain in the civil service candidates who have postgraduate degree either from domestic or international universities (Shundi, 2010). The allowances constitute from 22% of the overall salary for lower executive level to almost 19% of the overall salary for the highest civil service positions. The paradox of re-introducing the academic qualification supplement is furthered by envisaging that the differentiating the level of the supplement by the nationality of university. This supports the views of the authors who claim that the levels in fact are set very randomly, sometimes without logic in itself (e.g. the PhD level in Albania is equal to Master degree in western universities), (see Shundi, 2010).

Another interesting (and perhaps expected) feature of fairly transparent civil service pay systems is that remaining allowances tend to be interpreted fairly broadly, in order to get around the established rationalized pay systems. For example, in Montenegro, extensive use of 'difficult working conditions' allowance, which was introduced by amendments of Civil Service Law in January 2008, has been subject of fierce debate and a review by Constitutional Court.⁷ In Serbia also, one of the remaining allowances, such as for work 'on standby' (u pripravnosti), was started to be applied to a number of personnel which did not have to be called on duty after working hours, which is an obvious misuse of the newly established system. These experiences show that it is fairly difficult to abolish system of allowances, both via regulatory framework and in practice and that there is an obvious need for firm control of the payroll process.

Finally, a contentious issue that has been subject of debate in several countries in the region is whether there is a need for providing separate allowances/better pay conditions to tax and customs staff. The main argument for this is that in these

⁶ The amendments of the Law on Salaries and Allowances in Institutions of Bosnia and Herzegovina of 2012 have excluded the provisions regarding the principle of flexibility which allowed that some civil service positions may obtain up to 50 per cent of salary increase, based on a minister's decision. See: Article 1, paragraphs 2 and 3 of the Amendments of the Law on Salaries and Allowances in Institutions of Bosnia and Herzegovina, Official Gazette, No. 50/12.

⁷ The Administrative Court of Montenegro has initiated a procedure for review of legality of amendments of Civil Servants and Employees Salary law, by which salaries of a number of officials and senior civil servants could be increased by 30% on the basis of the allowance of 'difficult working conditions'. Review request No. IV-14/08, Podgorica, 22.01.2008.

institutions there is a need to offer a better reward package to avoid corruption practices or in some other institutions because the service they provide is specialized (ex. The Concessions Authority). For example, in Albania, the use of special supplements in these cases seems to be fully accepted (Shundi, 2010).

In Serbia, tax and customs offices have traditionally had higher pay levels, that were reduced and aligned with the rest of the civil service pay by new Civil Service Pay Law adopted in 2006. However, ever since the adoption of the Law on Civil Service Salaries in 2006, there have been significant pressures from the Tax and Customs administration to return to the system in which they were able to independently set the level of salaries for their personnel, which was considerably higher in comparison to the rest of the civil service. These pressures have resulted in adoption of a sectoral tax administration law in 2009, which has provided the basis for creating a separate pay system for tax administration employees, followed also by civil servants of customs administration.

5.3. Increasing incentives for career progression and introducing performance related pay

As regards incentives for career progression, important changes can be noticed with regard to increasing the decompression ratio, especially in Serbia and Bosnia and Herzegovina. The compression ratio of 1:9 was introduced in Serbia after civil service pay reform in 2007 and in Bosnia and Herzegovina in 2008, which has made senior civil service positions much more attractive. A decompression of the system, however, has also had a negative effect to lower paid positions, which struggled to make ends meet and have a strong support from labor unions for increase of their salaries. This has led to reduction of the decompression ratio from 1:9, to 1:6.4 in Serbia through 2011 amendments of the Civil Service Pay Law. Therefore, a phased introduction of decompression measures over the period of couple of years may be a good way to go forward.

The proof that decompression of the civil service pay systems can be problematic is also the fact that senior civil servants, who are often politically affiliated, are the main beneficiaries of the salary decompression. If a decompression is introduced in highly politicized environment of Western Balkan countries, only political appointees would really benefit from salary increases, while mid and lower level civil servants would lose out in this process. Therefore, it is important to link decompression of the pay system with de-politicization of highest civil service posts, if this element of reform is to have its desired effect. Whereas some progress has been made in this regard in some Western Balkans countries, this issue still needs lots of attention.

In majority of analysed countries incentives for career progression have also been enabled by introduction of unified wage grids that allow for horizontal progression, usually based on performance appraisal. In Serbia, a unified wage grid for thirteen job categories was introduced by the Law on Civil Servants Salaries adopted in 2006.⁸ While the salaries of the five highest, senior civil service positions, are fixed, other civil servants have an ability for horizontal pay progression, with merit based

⁸ Official Gazette of the RS, No. 62/2006, 101/2007, 99/2010.

increments. The horizontal progression, based on five percent salary increase, depends on an annual performance appraisal marks.⁹ Although civil servants have an opportunity for progression to around 7 steps, many consider such progression as limited, as many civil servants find themselves stuck at the end of the scale after several years. In Kosovo, there are fourteen salary grades and horizontal progression is possible for all them, also depending on performance appraisal results.¹⁰ However, the value of the salary step is not determined by the Law, but was left to be governed by the Government Decree¹¹ which has still not been adopted and hence the system is not yet operational.

Bosnia has also introduced a wage grid with seven horizontal steps by its Law on Salaries and Allowances in Institutions of Bosnia and Herzegovina of 2008.¹² However, due to budget restraints, horizontal progression has also been postponed several times and, in accordance with the most recent amendments will commence only in 2016.¹³

In Macedonia, there are four “horizontal career steps” (A, B, C and D) for each pay grade, which may be acquired after completion of three years of service in the same position, entailing a career supplement of 5%, 10%, 15% and 20%.¹⁴ Performance related pay elements have been introduced by enabling civil servants to be promoted one year earlier when they get an “outstanding” performance assessment mark for two consecutive years.¹⁵ The horizontal progression has also been quite limited to only four steps which provides rather restrictive opportunities for career growth (Analytica, 2008).

The Macedonian experience shows that introduction of ‘pure’ position based system with restricted horizontal progression (only 4 steps) may bring about serious difficulties in the operation of transitional civil service systems. The position based system has been criticized for a lack of flexibility, limited opportunities for career progression and increasing patronage in the promotion process (Analytica, 2008). Absence of managerial skills to implement modern human resource management practices, such as performance appraisal process and career planning has also been reported as an important obstacle to reform. Weak capacity of the Civil Service Agency and human resource management units in individual institutions and lack of comprehensive training on HRM issues have further exacerbated the situation (Analytica, 2008). In order to overcome existing challenges, many voices have been

⁹ Thus, for example, a civil servant who gets exceptional performance appraisal marks for two consecutive years would be able to progress two steps in the horizontal line and thus obtain ten percent increase of salary. A civil servant whose performance was assessed as "exceptional" or "exceptional" and as "excellent" for two consecutive years, irrespective of the sequence of the assessments is promoted for one pay step etc.

¹⁰ There are five steps for the three highest grades and the lowest fourteenth grade and twelve steps for the remaining grades.

¹¹ Article 10 of the Law on Civil Servants Salaries.

¹² Law on Salaries and Allowances in Institutions of Bosnia and Herzegovina, Official Gazette No. 50/08.

¹³ Article 5 of the Amendments of the Law on Salaries of Civil Servants in Institutions of Bosnia and Herzegovina.

¹⁴ Articles 37 and 38 of the Civil Service Law of Macedonia.

¹⁵ In contrast, whenever assessed with an “unsatisfactory” mark, the civil servant is “demoted” to a lower career development step and receives a lower career supplement until the next annual performance assessment.

raised for re-introduction of career system model or introduction of other models which would improve possibilities for career advancement, such as fast-track promotion schemes etc.

In Albania, Montenegro and Macedonia the legislation also provides for an end of the year bonus payment, (usually in the amount of one monthly salary), which depends both on performance and available budget funds. However, instead of rewarding performance of best performing staff, the common practice in Albania is that the same amount of variable pay is provided to all civil servants in the ministry (SIGMA, 2012). In Macedonia, the bonus payment is also awarded only exceptionally (SIGMA, 2012).

The lack of implementation of available variable pay instruments poses questions regarding the reasons behind such practice. The common explanation for such a practice may be a wish of managers to 'secure peace in the house', i.e. reward performance of their staff in an equal way in order to avoid management problems that may result from providing higher level of pay to individual employees, as employees that have not been rewarded may be demotivated to continue carrying out their tasks.

Although improved staff motivation is always one of the main reasons for introducing performance related pay, research conducted in the US and Europe has also indicated that the impact of performance related pay on motivation is highly controversial. Performance related pay schemes by their very nature reward a small percentage of employees, with the risk then being that the remaining majority experience some demotivation, especially if the process of awarding pay bonuses is not perceived as credible and fair (World Bank, 2003). Civil servants often stress that non-performance factors influence performance ratings and subsequent pay decisions, due to inherently subjective nature of the performance appraisal process. Some studies conducted in the US found that introduction of pay for performance eroded trust between employees and supervisors and led to decreased organizational commitment and heightened levels of alienations on the part of numerous employees (Rainey, Kellough 2000). In the similar vain, research carried out in the United Kingdom concluded that the existing performance related pay schemes, which were mostly based on individual reward for individual performance, had failed to motivate staff to perform, leaving many employees disappointed with the system (Makinson, 2000). Many studies and staff surveys indicate that it is not performance related pay that motivates, but satisfying job content and career development prospects have been found to be the best incentives for public employees (OECD, 2005). Economic theorists also emphasize that human motivation cannot be restricted to monetary incentives and that intrinsic motivation is of great importance for all human activities (Frey, 1997).

5.4. Wage bill and employment modelling

In all analysed countries, principle of fiscal sustainability wage bill and employment modelling gained prominence in the period of structural adjustment programmes (SAPs) of international financial organisations (World Bank, IMF), which began in the 2000s. It was essentially a model that was imposed from outside in the drive to control wage bill growth and reduce budget deficits for fiscal stabilization. Such an approach requires the national Governments to:

- (a) pay close attention to ratio of the wage bill to GDP, and/or wage bill to total public expenditures ratio;
- (b) maintain pay adjustments to within the wage bill envelope; and
- (c) reduce and/or control growth of public service employment numbers to levels consistent with (a) and (b) above. This approach is therefore associated with retrenchment and employment freeze measures under the SAPs.

At one time or another, all analysed countries have been subjected to the wage bill and employment modelling, which provided the basis for major policy decisions on public service pay adjustments. In most countries, however, the inadequacy of the model has been amply exposed, due to fairly simplistic approach taken to examine civil service pay and employment issues. Still, elements of this approach continue to influence pay decisions in most of the countries.

5.5. Crisis-driven pay adjustments

Crises driven pay adjustments have been prevalent in most of the analysed countries as a response to the global economic downturn that began in 2008. In order to make savings in public expenditure, the Governments tactically responded to pressure by reducing the level of pay and, in some cases, the number of civil servants. Such an approach may be described as tactical to contrast it with strategically oriented pay reform approached described in the previous sections of the paper.

For example, in Macedonia, the anti-crisis measures undertaken by the Government in 2009 consisted of postponement of a planned 10% rise in public sector salaries and abolishment of bonuses (RCPAR, 2010). The total budget for public sector remuneration was reduced by 6,13 % in 2010 compared to 2009. Similar measures were also taken at the state level of Bosnia and Herzegovina.

In Serbia, at the end of April 2009, the National Assembly adopted the Law on Temporary Reduction of Salaries in the Public Sector¹⁶ by which the amount of salaries for officials whose salary was higher than 40.000 dinars (around 400 EUR) was reduced by 10 per cent and for those whose salary was higher than 100.000 dinars (around 1000 EUR) was reduced by 15 percent. The duration of the effectiveness of the law was limited to the period from May 2009 to December 2010. Saved financial resources were allocated to the Solidarity Fund for assistance to people affected most by the economic crises. As of December 31, 2009, the Law has ceased to have effect and the level of salaries in the Serbian civil service was returned to the level before May 2009.

It may be argued that the degree of motivation among civil servants has not been significantly affected by the (temporary) reduction/freeze of pay levels, as the prospect for a getting a better paid job has become very limited, since the private sector was harder hit by the crisis (RCPAR, 2010). Taking into account the general unemployment level in the Western Balkan countries, simply having a job seems to be a powerful motivation factor to remain in the public sector over the past few years.

¹⁶ Law on Temporary Reduction of Salaries in the Public Sector, "Official Gazette of the Republic of Serbia" No 39/09, adopted on April 29, 2010.

6. CONCLUSION

The analysis presented in this paper shows that most of the Western Balkan countries have invested significant efforts in reforming their civil service pay systems over the previous decade. The reform has proved to be a highly difficult task, as it aimed at making remuneration packages of civil servants more attractive and providing performance incentives, while at the same time had to take into account firm fiscal constraints, especially during the current times of global economic downturn. Therefore, most reform efforts concentrated primarily on the simplification of the current pay systems, reduction of the number of discretionary allowances and increase of transparency of the system, which can lead to efficiency savings that could provide additional resources for wage reform.

The only exception to the reform process is the case of Croatia, whereby civil servants salaries are still governed by an obsolete Civil Service Law of 2001. This Law contains general pay principles and ranges of coefficients, while the concrete coefficients for each post have been set by a Government Decree. Since its adoption in 2001, the Decree has been changed around 3 times annually (altogether 34 amendments). Such frequent changes are probably the consequence of different kinds of pressures for increasing the existing coefficients and are not in line with principle of salary predictability. It should be noted that in Croatia reform of the civil service salary system was initiated in 2008, but did not succeed and no attempt has been made to re-launch the process since then (SIGMA, 2012).

Although important progress has been achieved with respect to establishment of merit-based and transparent pay systems in most Western Balkan countries that reflect best international standards, its effectiveness is yet to be checked in practice. In order to be successful, the pay reform has not only to improve the structure and level of remuneration, but also has to be properly linked to civil servants' career advancement and overall process of human resource management, which has a substantial impact on the quality of the staff to be attracted and retained. To the extent that the career advancement 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 most likely find alternative employment.

Embracing wide spread performance related pay schemes appear to be quite attractive to both civil servants and politicians in the region, although they are still not been effectively used in practice. It is important to point out that extensive pay for performance schemes, can have counterproductive effects in all countries which do not have solid performance management framework, which is rarely to be found anywhere in the world. In such circumstances, introduction of performance related pay may have an adverse effect and increase problems linked to trust, corruption and patronage. In order to limit these risks, cautious and gradual building of a performance culture, in which individual performance objectives are linked to broader organizational goals, is recommended instead of focusing excessively on pay for performance elements. Innovative techniques of team appraisal and rewards should also be considered, in order to boost the team spirit, enhance level of responsibility, delegation, communication and coordination, that are essential for enhancing the other important side of the coin of the civil service motivation – thoroughly enjoying the civil service work.

References:

Analytica (2008), *Introducing Career-Based System in Civil Service*, Analytica, April 2008, <http://www.analyticamk.org/files/ReportNo12.pdf>

Armstrong M, Murlis H. in association with Hay group (2005), *Reward Management, A Handbook of Remuneration Strategy and Practice*, Kogan Page.

Cardona, P, “Tackling Civil Service Pay Reform” (2006), paper prepared for the seminar on “Remuneration Systems for Civil Servants and Salary Reform”, Vilnius, 14 December 2006.

DAI Europe Ltd. (2006) *Options for a Sustainable Unitary System for Romania*, (unpublished working document).

DFID (2007) *Public Administration Reform in Serbia: Defining the Agenda and Improving Implementation*, (unpublished working document).

DFID (2005) *Bosnia and Herzegovina: Support for the Determination of the Pay and Grading System at state level*, (unpublished working document).

DFID, World Bank, (2004) *Serbian Civil Service: Assessment of Pay and Benefit System*, PricewaterhouseCoopers.

Frey S.B. (1997) *Not Just for the Money, An Economic Theory of Personal Motivation*, Edward Elgar.

Gong T, Wu A (2012), “Does Increased Civil Service Pay Deter Corruption? Evidence from China”, *Review of Public Personnel Administration*, 2012, 32/2, pp. 192-204.

Hood C, Peters G eds. (1994), *The Rewards at the Top: A Comparative Study of High Public Office* (London: Sage).

Hood, C, Peters B.G, with Lee, Grace O. M (2003), *Rewards for High Public Office in Asia*, (London, Routledge).

IMF (1997), ‘Corruption and the Rate of Temptation: Do Low Wages in the Civil Service Cause Corruption?’, prepared by Rijckeghem, Caroline van, and Beatrice Weder, IMF Working Paper WP/97/73 (International Monetary Fund, Washington DC).

Ingraham P.W. (1993) “Of Pigs and Pokes and Policy Diffusion: Another Look at Pay-for-Performance”, *Public Administration Review*, July/August 1993, Vol. 53, No 4, pp. 348-356.

Kiragu K, Mukandala R (2003), *Public Service Pay Reform, Tactics, Sequencing and Politics in Developing Countries*, Draft report, January 2003.

Lindauer D, Nunberg B (1994), *Rehabilitating Government: Pay and Employment Reform in Africa*, The World Bank (Washington DC).

Makinson, J. (2000) *Incentives for Change: Rewarding Performance in National Government Networks*. Public Services Productivity Panel, HM Treasury, London.

OECD (2006) "The State of Public Service – Preliminary findings based on a first analysis of the results of the 2006 surveys on Strategic Human Resource Management and Comparison of Employment in the Public Domain, Paper for discussion at the Public Employment and Management Working Party (PEMWP), (unpublished working document).

OECD (2004a) *Public Sector – An Employer of Choice? Report on the Competitive Public Employer Project*, OECD Headquarters, Paris.

OECD (2004b) *Trends in Human Resources Management Policies in OECD Countries, An analysis of the Results of the OECD Survey on Strategic Human Resources Management*, OECD Headquarters, Paris.

Pusic E. (1973) *Nauka o upravi*, Skolska knjiga, Zagreb.

Rabrenović A. (2009), "Civil Service Pay Reform in Southeast Europe: Creating Incentives for Performance", in M. Vintar, P Pevcin (eds.), *Contemporary Issues in Public Policy and Administrative Organization in South East Europe*, University of Ljubljana, str. 294-213.

Rainey, H.G., Kellough E. (2000), "Civil Service Reform and Incentives in the Public Service", in P.Pfiffner J, Brook D.A. (eds.), *The Future of Merit, Twenty Years after the Civil Service Reform Act*, The Woodrow Wilson Center Press Washington, The John Hopkins University Press.

Reid G., Orac J. (2007), "Human Resource Management Issues in ECA Countries," <http://www1.worldbank.org/publicsector/civilservice/ACSRCourse2007/Session%201/PublicEmployPayIssuesECA.pdf>

SIGMA Paper No. 48 (2012), *Civil Service Professionalism in the Western Balkans*, prepared by Jan-Hinrik Meyer Sahling, SIGMA/OECD, Paris.

SIGMA (2006) *Former Yugoslav Republic of Macedonia: Public Service and Administrative Framework Assessment*.

SIGMA/OECD (2007), "Civil Service Pay Reform", power point presentation, prepared for the Conference on Civil Service Salary Systems in Europe, Bucharest, 25 April 2007

Shundi A, (2010), A, *Civil Service Professionalisation in the Western Balkans, Expert Report prepared for the SIGMA/OECD project on the state of professionalization in the Western Balkan states - Albania*, October 2010.

United Nations Department of Economic and Social Affairs (2005) *Human Resources for Effective Public Administration in a Globalized World*, United Nations.

World Bank (2006a) *Bosnia and Herzegovina, Addressing Fiscal Challenges and Enhancing Growth Prospects, A Public Expenditure and Institutional Review*, Washington DC: World Bank.

World Bank (2006b) *Albania: Restructuring Public Expenditure to Sustain Growth, Volume II*, Washington DC: World Bank.

World Bank (2003) *International Public Administration Reform: Implications for the Russian Federation*, Washington DC: World Bank.

World Bank (1993) *The East Asia Miracle: Economic Growth and Public Policy*, Oxford, Oxford University Press.