POLICY BRIEF – NOVEMBER 2014




The Public Sector and the Parastatal Earnings Structure in Zimbabwe

Submitted by The Labour and Economic Development Research Institute of Zimbabwe (LEDRIZ)

1 INTRODUCTION

In Zimbabwe, executive compensation in the public sector and parastatals is now a matter of public concern. This is due to the growing wage bill, ordinary workers' poverty-level wages and poor service delivery by state-controlled enterprises. As a result, the Labour and Economic Development Research Institute of Zimbabwe (LEDRIZ) conducted a survey of the country's salary structures in both these sectors. LEDRIZ also assessed the compression/decompression of the earnings structures to provide evidence-based policy proposals.

Achieving an equitable and competitive earnings structure is a prerequisite for economic recovery and turnaround. The structure must also be sustainable, internally equitable and externally competitive. Furthermore, the public sector wage bill must be reduced by defining a wage ceiling, compressing salaries, monetizing allowances, imposing a hiring freeze and reducing/controlling employment levels. However, it is important that all reductions be carried out gradually to ensure fiscal sustainability.

2 BACKGROUND

In July 2013, the Government of Zimbabwean agreed to implement the International Monetary Fund-Staff Monitored Programme (IMF-SMP), which, among other issues, aimed at - restoring fiscal sustainability and strengthening fiscal management. One of the major thrusts of this programme was to set the wage bill on a downward path relative to GDP and government revenue, after several years of increases in these ratios. By continuing the hiring freeze that started in July 2012 (but allowing limited flexibility in filling vacancies that opened up as a result of natural attrition in the education and health sectors, as well as for critical positions) the IMF-SMP would result in the civil service wage bill being gradually reduced from 75 per cent to 30 per cent of total government expenditure.

While acknowledging that it accounted for a disproportionate share of overall budget expenditure (75 per cent), the Minister of Finance, Cde Patrick Chinamasa, pointed out in his 2014 National Budget that at individual level, public service remuneration

Labour & Economic Development Research Institute Zimbabwe
FRIEDRICH EBERT STIFTUNG

has remained modest, with monthly salaries under US$316 at entry level. Hence, he suggested that Government operate on a gradual budget wage bill reduction strategy that would see it fall to 55 65 per cent by 2015 and 30 per cent by 2018. Government also committed itself to progressively reviewing public service remuneration in line with the Poverty Datum Line (PDL) and providing non-monetary benefits in areas such as housing. This would be done in a manner that leaves room for continued funding of government operations, including service delivery.

The Minister of Finance also expressed concern over the extent to which employment costs tend to crowd out the conduct of the core business of most public enterprises. He highlighted the fact that the unsustainable employment costs are largely on account of the salaries, allowances and perks accorded to top management. Government subsequently committed itself to tightening governance oversight structures over remuneration, giving consideration to ability to pay, taking account of service delivery targets and rewarding corporate performance that exceeds its target.

However, contrary to the recommendations of the SMP and the Corporate Governance Framework for State Enterprises and Parastatals regarding principles of affordability and sustainability, Chief Executive Officers (CEOs) of parastatals are receiving excessive salaries and allowances from ailing state-controlled firms whose service delivery is at its lowest. There was public outrage when it was revealed that the average monthly salary was US$18,694 and the highest US$500,000 (including allowances), as the former amount is more or less equal to the collective wages of 80 workers. While CEOs and top executives are living a life of ease, their employees struggle along in abject poverty, deprived of basic amenities. Moreover, most CEOs' salary increases were effected after Government agreed to the SMP.

In response to these revelations and the ensuing public anger, the Minister of Finance, who is also the chairperson of the Cabinet Committee on State Enterprises and Parastatals Development, made the following announcements at a press conference on 18 March 2014: as an interim measure, Government resolved that CEOs of state-owned enterprises, parastatals and local authorities should receive a total pay package of not more than US$6,000 per month, while the lowest paid employee should not fall below the PDL of US$515, and with immediate effect; salaries would be immediately cascaded downwards in each organization; the total pay package would be split into basic salaries and benefits at a ratio of 60 per cent and 40 per cent respectively.

The Minister also announced that the government had approved principles that should guide remuneration policy for public enterprises, namely, the performance of the economy, the organization's capacity to pay and its level of responsibility. At the same press conference, the Minister of Information, Media and Broadcasting Services, Professor Jonathan Moyo, expressed confidence that the new measures would improve the competitiveness of the local economy.

Given the public interest and debate this issue generated, LEDRIZ carried out a survey of the salary structure in public sector and parastatals in Zimbabwe and assessed the compression/decompression of the earnings structure in order to provide evidence-based policy proposals to improve the local economy. Achieving an equitable and competitive earnings structure is a prerequisite of economic recovery and turnaround.

3 SURVEY FINDINGS

Chief Executive Officers (CEOs) of parastatals are benefitting from excessive salaries and allowances from ailing state-controlled firms whose service delivery is at its lowest. The highest earner is the CEO of PSMAS, who takes home US$535,529 per month, including allowances, and the lowest the CEO of the National Gallery of Zimbabwe, who earns US$3,025 per month, including allowances. Moreover, sixty-two per cent of the country's 90 parastatals award their CEOs with benefits that exceed the value of their basic salaries; some account for as much as 89 per cent of the total package.

Salaries in public enterprises are severely decompressed. The International Monetary Fund (IMF) defines salary decompression/compression as the ratio between the incomes of the highest and lowest earners on the main salary scale. The IMF includes the compression ratio among the indicators to be used for evaluating government employment and compensation. When the ratio is analyzed using basic pay only, most of Zimbabwe's parastatals have a lower ratio than when allowances are included.[1, 2]

For example, the decompression ratio for Net*One – without benefits – is 13:1,. When these are included it increases to 58:1. According to salary scales published in the first quarter of 2014, the decompression ratio between the highest- and the lowest-paid earner in PSMAS is 653:1. (The ratio is 338:1 when factored without benefits). CEOs in public service (Permanent Secretaries) are paid a monthly average salary of US$1,932; the lowest salary in the civil service is US$218, or US$375 after allowances have been factored in. The decompression ratio between Permanent Secretaries and the lowest-paid civil servants is therefore 9:1. (The ratio increases to 14:1 when benefits are taken into account.)

These decompression ratios show that allowances play a substantial role in the packages awarded to top management. However, when it comes to establishing the 'right' ration, no consensus is available. Management guru Peter Drucker (cited in the Chartered Institute of Management Account (CIMA) Discussion Paper on Executive Remuneration Schemes, May 2010) argues that a more appropriate ratio would be 20:1. The LEDRIZ survey shows that most parastatals fail to meet this ratio in terms of basic salaries, and when benefits are included it rises to as much as 80:1, Air Zimbabwe and the Cold Storage Commission excepted.

Zimbabwe's public sector wage bill has grown rapidly since 2009, and without commensurate increase in the quality of service delivery. Low pay for civil servants has seen the equity of the public service earnings structure being questioned. Public sector pay structures are often complex, consisting of a mix of basic salaries, various allowances, periodic bonuses, overtime payments and other forms of remuneration such as per diems. It is therefore vital that remuneration packages for senior officials and executives in the public sector be designed and communicated in a clear and concise way.

4 CONCLUSION

Executive pay systems should not sit in isolation; they must be an integral part of a company's business model. Executive compensation must strive to provide incentives and motivation for all staff to act in the long-term interests of the business. In addition, pay systems must be fair and proportional to effort and success. Although there is no universal yardstick to show when remuneration is correctly proportionate to effort and value, careful human judgments can prove more than adequate.

Less than a year has passed since Government agreed to the SMP and not only is it failing to meet the set requirements but in some cases it is also implementing policies that contradict the SMP framework. For example, civil servant's wages and salaries have been increased over and above the inflation rate, rising from US$297 (2013) to US$375 (2014). Likewise, CEOs of some parastatals reportedly increased their salaries after the recommendations of the SMP were adopted.

The earnings structure in the Zimbabwe parastatals is decompressed and inequitable. CEOs and top executives are overpaid, ordinary workers are struggling to make ends meet and large sections of the population remain without basic amenities and services. Concerns about excessive executive pay should not be dismissed as a momentary media obsession. Executive pay policies should be re-designed, with a clear link to sustainability and affordability as well as performance and risk.

In the public sector, the salary levels and decompression ratio between top management and shopfloor workers is also high. The mismatch between salaries for middle management and shop-floor workers is too low to attract and retain highly skilled and professional staff in Government. The implications are significant, to the extent that officials with sub-optimal qualifications and skills are awarded permanent positions in the public service.

Although the compression/decompression ratio is a summary statistic and should not be used in isolation, it is a useful starting point for asking further questions about pay and grading. For example, does a low ratio indicate that there are only a few grades in the grading structure, or does it indicate that the differentials between grades are very small? Does a high ratio indicate that workers at the bottom of the salary structure are unskilled, or are they simply earning the national minimum wage? Does it indicate that workers at the top of the salary structure have been granted inordinately high wages and allowances? Considered from this angle, the compression ratio can lead to aspects of pay and grading that need to be properly understood. One key aspect is the issue of wage differentials between salary grades.

5 RECOMMENDATIONS

The need to create an equitable earnings structure cannot be overemphasized. Salary structures are an important component of effective compensation programmes as they help to ensure that pay levels/grades are externally competitive and internally equitable. Failing to consider these can lead to a drop in employee morale, resulting in lowered performance, absenteeism and/or loss of competent personnel. Creating an earnings structure that meets these requirements involves internally ranking the positions in an organization in relation to each other and structuring pay according to the market pay data.[3] A salary structure that is well-designed should allow management to reward performance and skills development while controlling overall base salary cost by providing a cap on the range paid for particular jobs.

The goal of earnings policy should be to pay top management and shopfloor workers salaries that will attract and retain competent people as well as sustaining performance and personal motivation. Poor salary levels can result in absenteeism, moonlighting, shirking, corruption and/or low productivity. Thus, the development of an earnings policy is an integral part of strategic human resource management in the public service.

RECOMMENDATIONS FOR PARASTATALS

a. Defining a wage bill ceiling for stability and sustenance.

A wage ceiling must be set up in parastatal salary structures. This will assist in avoiding abuse of funds should CEOs and members of the Board collude/attempt to increase salaries and benefits over and above set levels. As there are no set standards currently in place, thus salary sizes and increases remain at the discretion of aforementioned persons.

At a press conference on 18 March 2014, the Minister of Finance announced that Government had resolved – as an interim measure – that CEOs of state-owned enterprises, parastatals and local authorities should receive a total pay package of no more than US$6,000 per month and the lowest-paid employee no less than US$515, with immediate effect. This needs to be followed up with a Statutory Instrument that makes it legal and binding.

b. Enhancing the fairness, equity and efficiency of the salary structure and improving the post-employment compensation structure.

This can be achieved by determining the cost of the minimum acceptable standard of living for workers and using it as the basis for establishing a target minimum salary. Achieving an internally equitable and externally competitive earnings structure in Zimbabwe calls for salary compression in public enterprises. This can be achieved by deliberately suppressing the salaries of those at the top levels and raising the salaries of shopfloor workers. However, if this process is not applied with caution, it can lead to an organization losing some of its most skilled employees due to unacceptable drops in their remuneration. Salary compression must therefore be based on acceptable scientific criteria.

c. Reviewing/rationalizing allowances

As an interim measure, the Minister of Finance resolved that the total pay packages of CEOs be split into basic salary and benefits at a 60:40 ratio. Since allowances and non-monetary benefits play a substantial role in the remuneration of senior management, an initial step in pay reform must be to monetize these benefits in order to curb the abuse of open-ended privileges and entitlements.

d. Basing remuneration on the organization's capacity to pay and the level of each employee's responsibility.

Pay should be linked to roles, functions and responsibilities, with promotion and pay increases being linked to improved performance.

e. Strengthening the governance and supervision of public enterprises.

Good practice would dictate that remuneration practices in parastatals should not exceed those in the private sector, given that they are partly funded by public money. As parastatals receive grants for employment costs, the Ministry of Finance should be in a position to monitor employment levels, salary levels and benefits and allowances in order to verify that existing policies and practices are reasonable when compared with the public and private sectors. Rolling out results-based management (RBM) to parastatals and the public enterprise sector can also work towards ensuring accountability for results and greater cost-effectiveness.

RECOMMENDATIONS FOR THE PUBLIC SECTOR

Both the SMP and the Government's 2014 National Budget Statement recommended a gradual wage bill reduction. Except where GDP is high, a reduction in the wage bill to GDP ratio would necessarily compel a reduction in average pay levels or in employment numbers. Reforming of civil service pay and employment is essential to improving the effectiveness of the public service and an essential precondition for reaping the intended benefits of public expenditure programmes.

1. Controlling the public sector wage bill.

At present, it is a strategic imperative to bring the public service wage bill – and thus employment and pay – under effective control in the pursuit of two priority policy objectives:

1. *To ensure aggregate fiscal discipline – Any wage bill variances will have a significant impact on the overall fiscal outcome. The wage bill is already the single dominant expenditure item in the national budget. As of 2013, it accounted for nearly 50 per cent of government expenditure and about 18 per cent of the country's GDP. Zimbabwe's excessive wage bill expenditures relative to other recurrent costs compromise service delivery capacity by limiting access to complementary inputs and constraining infrastructure development.*
2. *To fund drivers for growth and service delivery. In order to improve the current level and quality of public service delivery and critical investments and facilities, and avoid a 'crowding-out' effect, the budget must set an acceptable threshold of allocations to operational and maintenance expenditures.*

Without these funds, the complementary inputs and facilities necessary for effective performance by public servants will not be available. In other words, the resources allocated to the wage bill will simply transfer to public and be lost to the public, who will suffer further deterioration in government-provided services.

The reduction of the wage bill must be done progressively or it may demotivate workers and see highly competent employees transfer to the private sector. Increased collaboration of employers and employees in the development of the organization's strategies, plans and future prospective is also required.

Reforms to the public sector wage bill should focus on the following:

2. Defining a ceiling for Government Ministry wage bills to ensure fiscal stability

Agreeing on a wage bill ceiling for each ministry, and providing each one with the authority – as a management tool – to fill vacant positions at any level within this ceiling should ensure fiscal stability.

3. Salary decompression

Public sector salaries between shopfloor workers and middle management are compressed. This situation must be reversed by i) progressively increasing middle management salaries to levels that will attract and retain competent staff and ii) reviewing the salaries of shopfloor workers against the PDL. As the majority of the latter are well below this level, most people in formal employment can be classified as the working poor. In view of this, there is an urgent need for the creation of an equitable earnings structure that sees all workers earning a decent living wage. While sustained economic growth is important, it must go hand in hand with decent wages, improved quality of life and respect for human dignity. Salaries also need to be adjusted within the wage bill envelope and ensure reasonable ratios between grades.

4. Reviewing and/or rationalizing allowances

Many of the de facto and potentially unwarranted salary increases can be found here. To move forward, allowances must be monetized so as to curb the abuse of open-ended privileges and entitlements. Further, allowances and in-kind benefits unassociated with facilitating specific organizational functions or operations should be eliminated. The public sector should also adopt a 60:40 ratio of basic and benefits that is imposed on state owned enterprises, parastatals and local authorities.

5. Performance-related pay

Since 2005, the Government of Zimbabwe has employed a RBM system that speaks of linking pay to performance. As such, pay should be related to roles, functions and responsibilities, with promotion and pay increases linked to improved performance.

Over time, public service executives have not attached due importance to objective performance targets and work plans that would be the basis of subsequent appraisal. Instead, the tendency has been for appraisals to be increasingly casual and subjective. Inevitably, the productivity, quality and quantity of public services has fallen.

To strengthen performance, it is important to shift focus to non-monetary rewards, recognition and sanctions. All three are crucial to high and sustained public service performance.[4] As it currently stands, most public officers, especially those in the lower cadres, do not appreciate non-monetary rewards. This may be due to the fact that while a reward system is likely to raise commitment and motivation, it can be counterproductive if the perception is that good performance is rewarded and poor performance penalized rather than being an opportunity to learn.

6. Reducing and/or controlling employment to within the wage bill ceiling.

This requires adopting the following measures:

i) Removing ghost workers. This will require input on establishment control and payroll management, as there is likely to be collusion from payroll staff. In situations where a wage bill is considered unsustainably high, a first measure to be taken is often to improve existing controls in order to strengthen the integrity of data as well as the systems themselves. A comprehensive payroll and skills audit of the public service carried out by Ernst and Young in 2009 on behalf of the Ministry of Public Service revealed 75,273 ghost workers out of a total of 188,019 employed in various ministries. Eradicating all ghost workers from the payroll will significantly reduce the wage bill.

ii) Maintaining the hiring freeze. This must be continued, but with limited flexibility in filling vacancies that open up as a result of natural attrition in the education and health sectors and other critical positions.

iii) Administrative function consolidation. Common administrative tasks across agencies/ministries need to be identified and functions in central services units consolidated, as this will allow for downsizing.

6 THE FOCUS ON GROWING THE ECONOMY

In a context of scarce resources, and with increasing pressure on expenditures and declining revenues, it is important to ascertain the options available for managing a more sustainable wage bill in order to create fiscal space for more productive expenditure. Thus, creating a virtuous cycle where economic growth creates fiscal space for nominal wage increases to attract and retain a competent and motivated workforce is a strategic imperative. A key lesson from the post-independence experience is that social objectives, including minimum pay meeting the PDL, cannot be achieved without sustained robust growth. Moreover, if wages are to be sustainable, they must be internally generated by taking into account all factors reflecting the ability to pay.

1 The salary decompression ratio is an important attribute of any pay structure, with a low ratio indicating a commitment to an egalitarian system that minimizes pay differentials between employee levels. This is normally achieved by deliberately suppressing the salaries of those at the top and increasing those of low-level workers.

2 Air Zimbabwe is the sole exception: its basic pay ratio of 15:1 decreased to 13:1 when benefits were taken into account.

3 For more information, see www.e-myth.com/cs/user/print/post/creating-an-equitable-pay-structure/

4 A ‘reward system’ refers to a programme set up to reward performance and motivate employees on individual and/or groups basis.