

Slovak Republic

Summary of Joint IMF/EC Technical Assistance Follow-up Mission in Support of Expenditure Review

David Coady, Ignatius de Bidegain, Raphaele Hours, and Hans Kordik

Technical Report | February 2019



F I S C A L A F F A I R S D E P A R T M E N T

S T R U C T U R A L R E F O R M
S U P P O R T S E R V I C E

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PREFACE

In response to a request from the Ministry of Finance (MoF) of the Slovak Republic, a joint International Monetary Fund (IMF) and European Commission (EC) technical assistance (TA) mission visited Bratislava from November 12–14, 2018, to advise on the development of policy options for public wage bill management, and spending on agriculture and rural development. The mission comprised: David Coady and Ignatius de Bidegain (both IMF staff) and Hans Kordik and Raphaelle Hours (both IMF experts). Natalia Zbirciog-Vandenberghe (EC/SRSS) joined by videoconference. The mission participated in a series of workshops organized by staff of the MoF's Value for Money (VfM) Division and wishes to express its appreciation to Stefan Kiss, Juraj Mach, and Matej Kurian, for their excellent support prior to and during its visit to Bratislava.

I. BACKGROUND

1. A joint IMF/EC technical assistance team visited Slovakia from November 12 to 14, 2018, as part of its ongoing support for the Slovakian Expenditure Review (SER) project. The purpose of the mission was to provide input into the finalization of the interim reports for the third round of the SER and to identify issues and analysis that could be taken up in the final reports scheduled to be completed in March 2019. In particular, the objective of the mission was to discuss the analysis undertaken by the Public Wage Bill and Agriculture and Rural Development technical teams based on draft interim reports, and to provide input into policy options under development.¹ This report summarizes the key issues discussed during the mission, including areas where further action is needed to enhance the effectiveness of the SER.

II. STRENGTHENING INSTITUTIONAL INFRASTRUCTURE

2. Institutional reform continues to be an important component of the SER. The Value for Money (VfM) project has taken a central role in policy dialogue and has been embedded in the budget preparation process through national legislation via an amendment to the Act on Budget Rules. Future governments will now be required to conduct spending reviews covering at least half of general government expenditure for every four-year parliament and to publish implementation reports containing the recommendations of the reviews as a mandatory part of the budget documentation. The Ministry of Finance (MoF) will also be required by law to evaluate and publish the assessment of investment projects larger than €40 million.

3. Efforts to continue to strengthen the foundation for successful spending reviews continue. The Implementation Unit continues to follow up on spending measures identified in earlier rounds of the SER with the aim of further refining these measures and integrating them into the budget.² Technical assistance on developing expenditure baselines, focusing on wage bill, health and agriculture, was provided in May 2018 under the SER project. This provides a basis for strengthening baselines across all sectors. A staff member from the VfM team will visit the IMF in Washington in mid-2019 to work with experts from the Fiscal Affairs Department on reviewing experience to date with the SER and identifying areas where it can be further strengthened.

¹ Delays to the interim report focusing on spending in support of marginalized groups meant that input could not be provided during the mission.

² This is especially the case for health spending, where increases in real health spending will be conditional on demonstrating effectiveness of spending as well as on addressing growing hospital indebtedness, changing the remuneration mechanism for health care workers, improving the prescription process, and full functionality of modern DRG and eHealth systems. The final report with measures to be integrated into the 2019–2021 public finance budget will be published by end-September 2019.

4. Communication with the public on progress with the SER remains strong. During the mission, IMF experts gave interviews on overall progress to date and ongoing challenges as well as on issues arising in the context of the Agriculture and Rural Development Spending Review. Such engagement helps to maintain public support for the SER and oversight of the reforms. A technical assistance mission on managing the investment process is also planned for early 2019.³

5. Planning for the next round of the SER continues. This will include a review of spending in the Ministry of Culture, scheduled to be launched in mid-2019. Other possible candidates include the Ministries of Interior, Defense, and Justice.

III. PUBLIC WAGE BILL SPENDING REVIEW

A. Background

6. The Public Wage Bill Spending Review has completed a critical stage in data analysis and diagnosis of some fundamental issues arising from the evidence.

a. The technical team from the VfM unit have produced a rich compendium of evidence to support the examination of key issues in public wage bill management. Following an extensive data collection exercise, the team have consolidated and integrated administrative data from various sources and different workforces to offer a coherent and detailed view of the public wage bill.

b. Comparisons with the private sector now provide a more nuanced assessment. The team have used survey data to produce some preliminary comparisons by workforce and age between the public and the private sector to add to the international benchmarking previously conducted. Econometric analysis of the public wage premium is ongoing.

c. The analysis also offers detailed insights on the composition of remuneration, by different types of pay, separating base pay, bonuses, allowances.

d. The team has started to consider the role of performance pay and possible productivity measures. The data collection exercise has offered a more detailed view on bonus allocation and on the size and cost of automatic pay increments.

e. Baselines have been produced and now provide the basis for analyzing the fiscal impact of the policy options under consideration. This includes estimates of wage drift and a calculation of the wage bill effects of automatic progression pay. The process of producing the baselines has also revealed anomalies in budgeting practices across departments that have

³ Spending review reports and other materials related to IMF/EC technical support (presentations, mission summary reports) continue to be available at: <https://www.finance.gov.sk/en/finance/value-money/about-value-money/>.

motivated further questions that will help improve the overall efficiency of the budget allocation process.

f. *Potential areas for efficiency gains have been identified.* Preliminary insights show that State Owned Enterprises (SOEs) have scope to improve wage bill management to help rationalize expenditure. Analysis has highlighted the efficiency of non-teaching staff as an area with potential for improvement. The team have also started to explore how to incentivize productivity through better governance and incentive structures, including performance pay and bonuses. This is especially important given the flagship government initiative to increase compensation levels for employees earning below the minimum wage; significant parts of the bonus pot were used to top up base pay for the lowest earners, and the reform is an opportunity to refocus the use of bonuses on performance.

g. *Plans are in place to collect and consolidate detailed data on the employment, wages and salary structure of all public employees.* The team is also studying ways to improve the process of data collection for the Information System on Labor Costs, including improvements to the quality control of this dataset.

B. Issues and Recommendations

7. *Formulating full proposals to reform pay structures will require further work building on the existing evidence base.* Structural change in the remuneration system is a complex project and addressing the different challenges for each workforce will require further data collection. Building on the analysis undertaken for the Interim Report, the team should establish a strategy to reach out and work with Line Ministries and experts on different workforces to design the structures that will best align wage bill expenditure to support broader government objectives so that comprehensive workforce reform plans can be laid out in the Final Report.

Recommendation 1.1: The technical team should explore how to collect and analyze detailed Recruitment and Retention data for the various staff groups in each workforce. These data would greatly enhance the analysis already undertaken by giving a detailed view of different demographic and professional elements of each workforce. The Interim Report could contain an assessment of what analysis is possible in this area. This analysis should then be conducted to inform more specific initiatives proposed in the Final Report.

Recommendation 1.2: The team should consider, for each workforce, how potential changes to the level and length of the bands for base pay would interact with other elements of pay such as bonuses and allowances. The technical team has already analyzed data on the components of pay. Overhauling the pay matrices and the wider pay system will require rethinking the role and purpose of different pay components, and the Interim Report could set out how the VfM unit will engage with Line Ministries to identify the ways in which pay systems would be best adapted to each workforce.

Recommendation 1.3: Productivity can be supported by reducing the role of automatic pay increments. *Instead, pay increments can be designed to reward performance or acquisition of key skills that enhance the effectiveness of the workforce. Building on Recommendation 1.2, engagement with Line Ministries should also help identify the career paths and required skills that new non-automatic progression pay systems should map to. The Interim Report could propose a program to rationalize bonuses by improving how they are budgeted for and developing guidance and frameworks for their allocation, as part of broader changes to HR management.*

Recommendation 1.4: Alternatives to regional allowances should be considered as they might not be the best way to tackle the diversity of labor market conditions throughout the country. *Large cities within provinces often have more similarities amongst themselves than with rural areas in their own provinces. Instead of committing to explore regional pay allowances, the Interim Report could recognize that analysis of trends in recruitment and retention is likely to reveal more nuanced differences that can motivate specific pay instruments to announce in the Final Report.*

8. Budgeting for the wage bill in Line Ministries should be improved following issues identified by the technical team. This will result in greater efficiency of wage bill expenditure. It will also improve understanding of the implicit spending trade-offs for the government when making pay decisions, given the significant impact decisions on pay policy have on the overall affordability of other projects.

Recommendation 1.5: Line Ministries should stop carrying-over unfilled vacancies. *This will make it easier for the Ministry of Finance to prioritize expenditure in line with government objectives when negotiating settlements with Line Ministries.*

Recommendation 1.6: Indexation of public sector salaries should be modelled and stress-tested. *Some workforces have their pay indexed to private sector wage growth. The technical team should model different scenarios to understand potential future spending pressures. It would also be helpful for the MoF to establish how and when indexation will be reviewed, to provide flexibility if conditions change significantly.*

9. Forward-looking workforce planning should be enhanced to ensure the public sector is in a strong position to deliver the high-quality services. The analytical team has shown that one third of employees are due to retire within 10 years, and demographic developments provides an opportunity to bring in new skills and adapt the shape of the workforce to changing needs.

Recommendation 1.7: Line Ministries should re-evaluate their current workforce mix. *They should also project how current trends in recruitment, retention and retirements will affect the composition of their workforces, especially for health and education.*

Recommendation 1.8: Line Ministries should consider whether existing pay structures will continue to attract and develop the right skills. *Revisions to the pay system should be designed*

based on future needs and should support wider workforce transformation plans, taking account of existing and projected skills gaps and vulnerabilities.

Recommendation 1.9: The team should set out a plan to assess and discuss workforce planning capacity with key Line Ministries. The Interim Report should acknowledge that detailed redesigning of pay systems will be most effective if it factors in forward-looking plans. Discussions with Line Ministries can explore an agreed framework for how the Ministry of Finance can engage with Line Ministries on workforce planning so that, when changing the pay system, they can jointly secure value for money over the long run; this can potentially lead to a new engagement framework to be discussed in further detail in the Final Report. These discussions will play a crucial role in securing the success of initiatives under consideration such as relocation of services to other provinces, or concentration of services at the local government level to achieve economies of scale.

IV. AGRICULTURE AND RURAL DEVELOPMENT SPENDING REVIEW

A. Background

10. The Slovakian Agriculture Team (SAT) prepared an interim report on the agriculture and rural development spending review. In accordance with the terms of reference (ToR) for the review, the SAT, which works under the purview of the Ministry of Agriculture and Rural Development (MARD), prepared a report on the spending review and provided their draft in timely manner to the external experts at the end of October 2018.

11. A workshop held on November 12, 2018, facilitated the discussions between the external experts, the SAT and the VfM team. Prior to the workshop, the external experts reviewed the interim report, and provided written comments, which were sent to the SAT. In addition, the external experts prepared a PPT presentation, which was used during the workshop, in order to structure the discussions.

12. The interim report on the agriculture and rural development review is rich with analysis and provides a solid diagnostic on the sector's performance. The consultations concluded that the interim report provides comprehensive analysis, and together with the benchmarking against the EU-27, highlights how Slovakian agriculture is performing compared to the other EU member states.

B. Issues and Recommendations

13. Experiences with public spending reviews in other countries provide important insights that can better inform and guide the SAT on its path towards finalizing the spending review. In revising the interim report or preparing the final report, the following five recommendations stand out:

Recommendation 2.1: The objective and scope of the spending review should be clarified.

Lessons learned from agriculture spending reviews in other countries reveal that specifying the breadth and depth of the review provides clearer structure and guidance for the report. As the mandate of the MARD is quite broad, the team should consider highlighting those policy areas that will be the subject of the review. The team should also consider going beyond the effectiveness and efficiency of spending in the review and address equity as well; for example, the current spending is lopsided towards larger farms in Slovakia, while the overall competitiveness of the sector is not improving.

Recommendation 2.2: Highlighting the purpose of public support in Slovakian agriculture is paramount. As a prerequisite for any spending review, the SAT would benefit from explicitly setting out the policy priorities for the agriculture and rural development sector. For instance, as reflected in the significance of direct payments in the overall financial envelope, income support would seem to be a priority. Adding a list of policy documents with visionary or strategic targets for the sector would enable the review to assess if the measures are appropriate or effective in reaching these targets.

Recommendation 2.3: Extend the SWOT analysis beyond the current requirements of the rural development program. In cases where the policy priorities are difficult to determine beforehand, or to test their relevance given the general context, other countries carrying out spending reviews have assessed the strengths, weaknesses, opportunities and threats (SWOT) of the sector in order to facilitate defining policy priorities.

Recommendation 2.4: Commitment to strengthening the impact assessment of current spending will lay the foundation for future programming. Experiences from other countries show that impact assessments are central to a successful spending review. Considering the significant inflows of financial funds under the EU Common Agricultural Policy (CAP) and Slovakia's flexibility in programming out of a menu of measures, it will be of paramount importance to show how the existing programming cycle is supporting (or not) the challenges and opportunities for the sector.

Recommendation 2.5: Establish clear policy recommendations laying out the foundation for ongoing negotiations, possible revision of the current programming cycle, and/or the future CAP implementation. The spending review is timely and will provide the MARD with a window of opportunity. The proposals to shape the future CAP are currently being debated in Brussels, a process that will likely carry forward until mid-2019. In this context, drawing clear policy recommendations could enable MARD to modify their position in the Council. Additionally, 2019 will enable member states to notify changes to the existing programming documents, and the recommendations from the review could provide the necessary foundation for this. As the future CAP post-2020 will be more performance-based and results-oriented, the policy recommendations could also form the basis of the development of the future strategic framework.

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