Fiscal sustainability effect of the proposed wage review

Presentation to the Public Hearing Meeting on Remuneration Structure for State Officers, KICC, February 26, 2013

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My presentation will focus on:

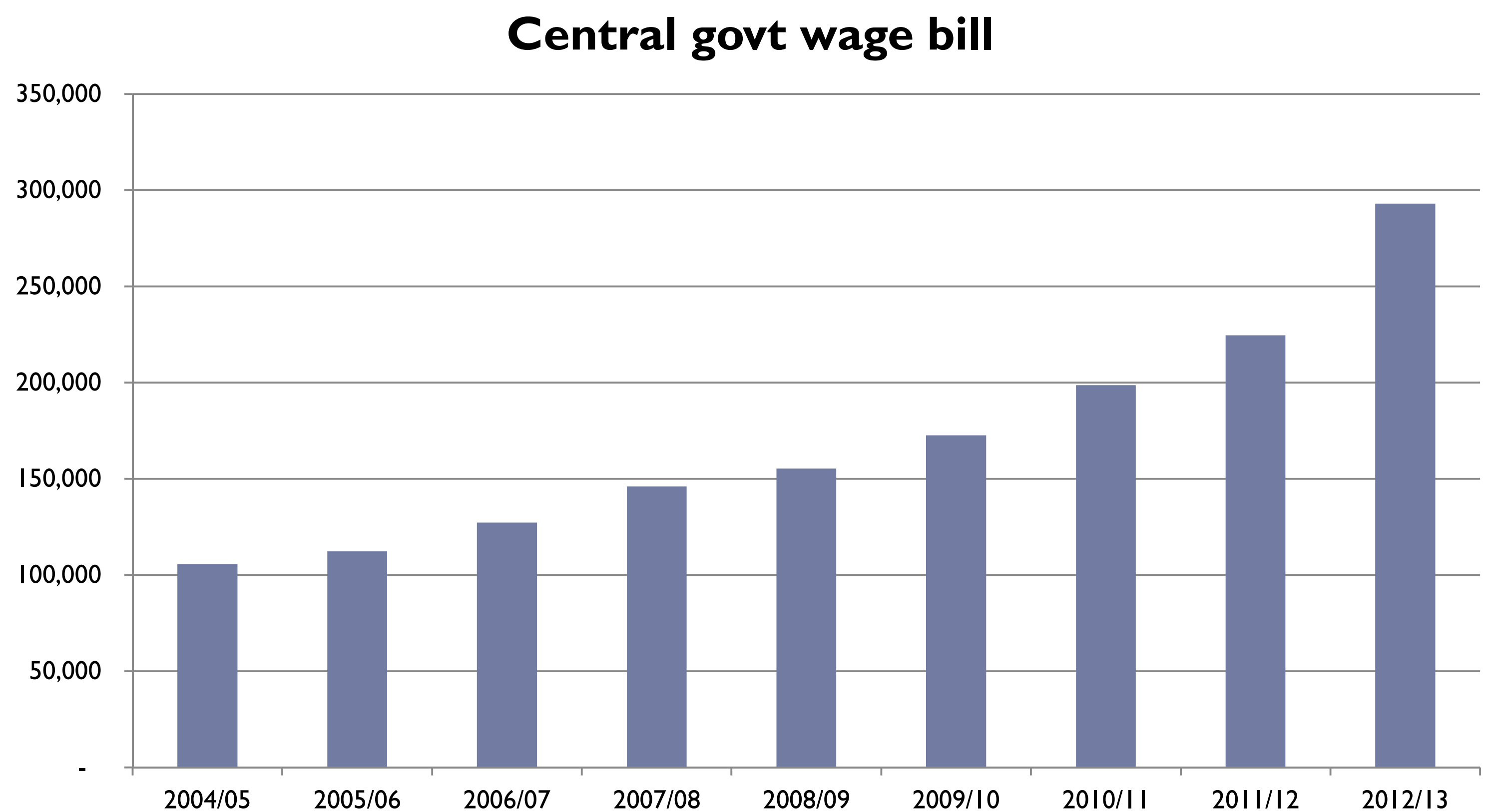
- A brief overview of recent trends in Kenya's wage bill and country comparison
- Impact of the proposed remuneration structure for State Officers on overall public sector wage bill
- Is the proposed pay review fiscal sustainability?

Why should we be Concerned about public sector remuneration?

- The public sector is one of the largest employers in many countries-- especially in developing economies.
- Remuneration policy therefore has critical implications for the budget—fiscal implications are critical.
- If the wage bill is very high this will result in:
  - (a) Crowding out resources that could be used in other development priorities.
  - (b) Large fiscal deficits—macroeconomic instability (inflation: wage-price spiral, exchange rate impact).
  - (c) Unsustainable public debt
  - (d) Loss of competitiveness of the economy, ultimately impacting negatively on growth and employment.

Recent trend in central government wage bill

- An upward trend over last 6 yrs or so.
- Annual growth rate in wage bill averaged over the last three year is about 13 percent (for 2012/13 alone, it was 30% increase), well above the nominal GDP growth of about 14 percent and population growth rate of about 3 percent.

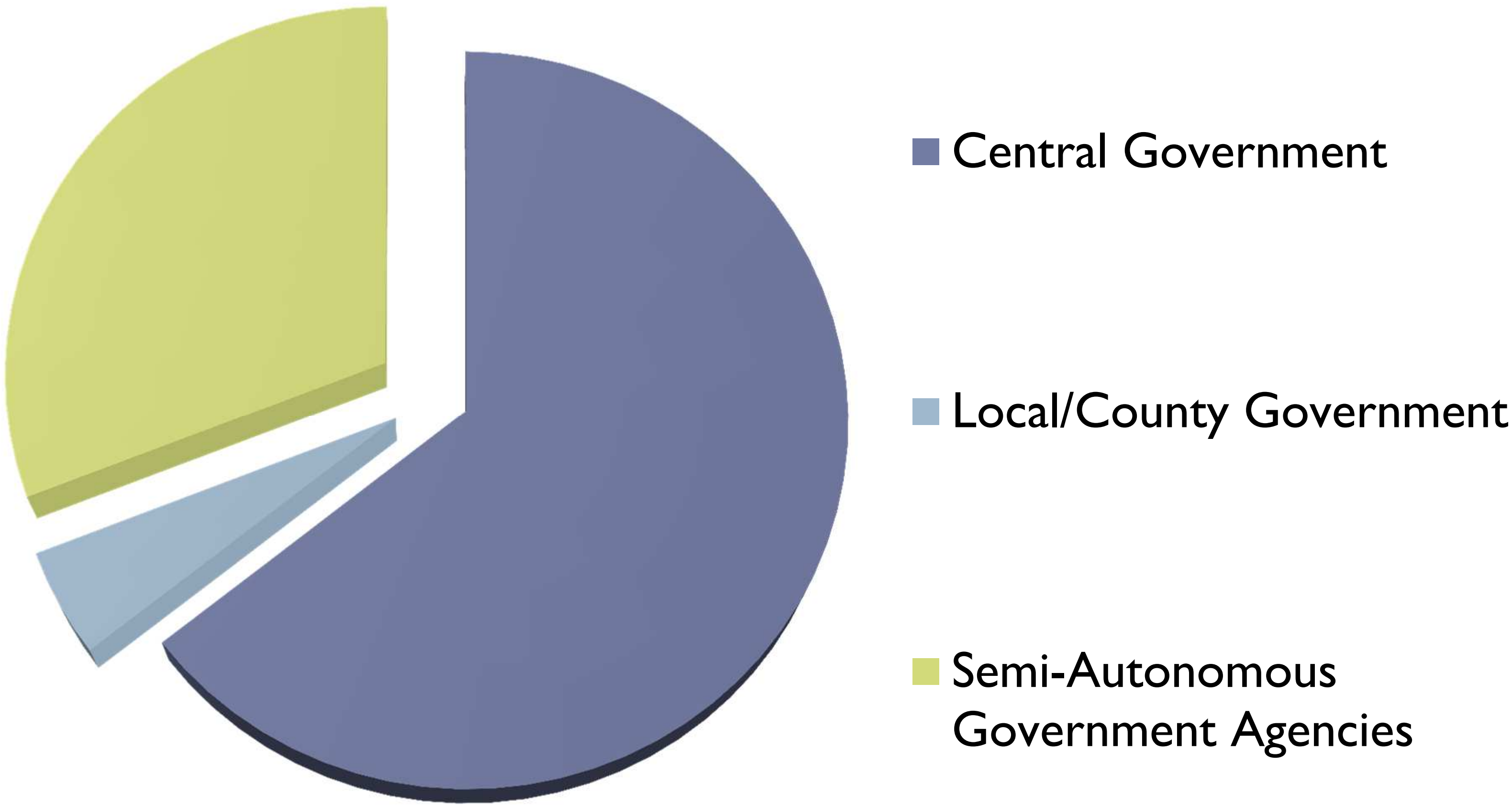


Current level of Kenya's Wage Bill, 2012/13

- After the recent wage increases (teachers, doctors etc) the central govt wage bill now stands at about **<u>Ksh 295.3 billion.</u>**

- However, if we include the wage component for Local government, public universities, defense/NSIS, public investment projects, our wage bill is much higher, about **<u>Ksh 458.7 billion</u>**

Composition of current level of Kenya's public wage Bill, 2012-13



Observations on recent trend

- Overall, Kenya's total wage bill in the public sector has continued to increase in nominal terms.
  - This is due to an increase in the number of employees as well as an increase in the average wage
  - A significant amount of employee compensation is in allowances: personal allowance, hardship allowance, entertainment allowance, risks, e.t.c
- **Is this ballooning public wage bill sustainable**?
  - Huge wage bill strains government budget and denying the economy the much needed resources for infrastructure and social services like health and education.

Impact of the proposed pay structure for State Officers on Overall Wage Bill

If we align the proposed pay structure to other civil service cadre, the total wage bill increases by about Ksh 90 billion (or about 20%)

	Current, 2012/13	Proposed, 2012/13
Central Government	295.3	354.7
Local/County Government	21.60	26.79
Semi-Autonomous Government Agencies	141.8	167.3
Total	458.7	548.8

What are the fiscal sustainability effect of the proposed wage review

- We assess this by looking at the following parameters
  - Wage bill as a share of GDP
  - Wage bill as a share of total spending
  - Wage bill as a share of domestic revenue
  - Average government wage as a share of GDP per capita
  - Debt/fiscal sustainability of the proposed wage bill

As a proportion of GDP, the wage bill deviate from the target path

- It also deviates from regional averages and with countries at similar levels of development.

	% of GDP		
	Current	Proposed	Medium- to Long-term Target
Total public sector wage bill	12.2	14.6	< 8.0
Civil service wage bill	7.8	9.3	< 6.5 – 5.0
Africa (9.5%),; Low Income Countries (7%); Middle Income Countries (8.5%);			

The ratio of recurrent expenditure to total budget will exceed the ceiling in the PFM law

- Under the PFM law, the government should spend at least 30 percent of development expenditure

	Current	Proposed	Target
Ratio of recurrent exp. to total budget	69.7	71.9	< 70.0
Ratio of development exp. to total budget	30.3	28.1	> 30.0

Also, the ratio of public wage bill to revenue will exceed the ceiling in the PFM regulation

- This will means that wages will take up a sizeable amount of fiscal resources, leaving little room for operations and maintenance, critical investment in health and education, as well as in infrastructure investment.

	Current	Proposed	Target
Ratio of recurrent exp. to total budget	53.7	66.8	< 35
Comparator: Africa (33.4%); LICs (26.8%); MICs (28.2%); HICs (25.9%)			

Comparison with private sector and per capita GDP

Average Wage Earnings per Employee, 2007-2011 (Ksh per annum)

	2007	2008	2009	2010	2011
Private Sector	353,945	369,069	384,560	390,855	405,957
Public Sector	323,409	353,322	373,099	394,913	427,991
Average public sector wages as a share of comparator private sector wages	**0.91**	**0.96**	**0.97**	**1.01**	**1.05**
GDP per capita (Ksh)	49,288	55,050	61,321	64,216	74,072
Avg. public sector wage as a share of GDP per capita	**6.56**	**6.42**	**6.08**	**6.15**	**5.78**

Source: Economic Survey, 2012

Proposed pay structure and fiscal sustainability

- What is fiscal sustainability?
  - Refers to the ability of a government to sustain its current spending, tax and other policies in the long run without threatening government solvency or defaulting on some of its liabilities or promised expenditures.
- How is it assessed?
  - Done based on the sustainability of fiscal policies based on long-run projections of country's public finances.

Debt Sustainability thresholds for Kenya, which is ranked as medium performer

Indicator (threshold)	Medium performer (based on CPIA rating)
Debt-to-GDP ratio	40
Debt-to-export ratio	150
Debt-to-revenue ratio	250
Debt service-to-revenue ratio	20
Debt service-to-exports ratio	30

Wage increase and debt/fiscal sustainability—Assumptions

- **GDP growth** – assume that our economy grows by **6 percent** on average over 2013-2030. This is well above historical average of 4.6 percent.
- **Inflation** – assume a moderate inflation of 5 percent over the same period
- New wage proposal increases the wage bill by **2.4 percentage points of GDP** (from the current 12.2 percent to 14.6 percent).
  - Because there is no room for offsetting increase in revenue, this will lead to a **deficit financing**

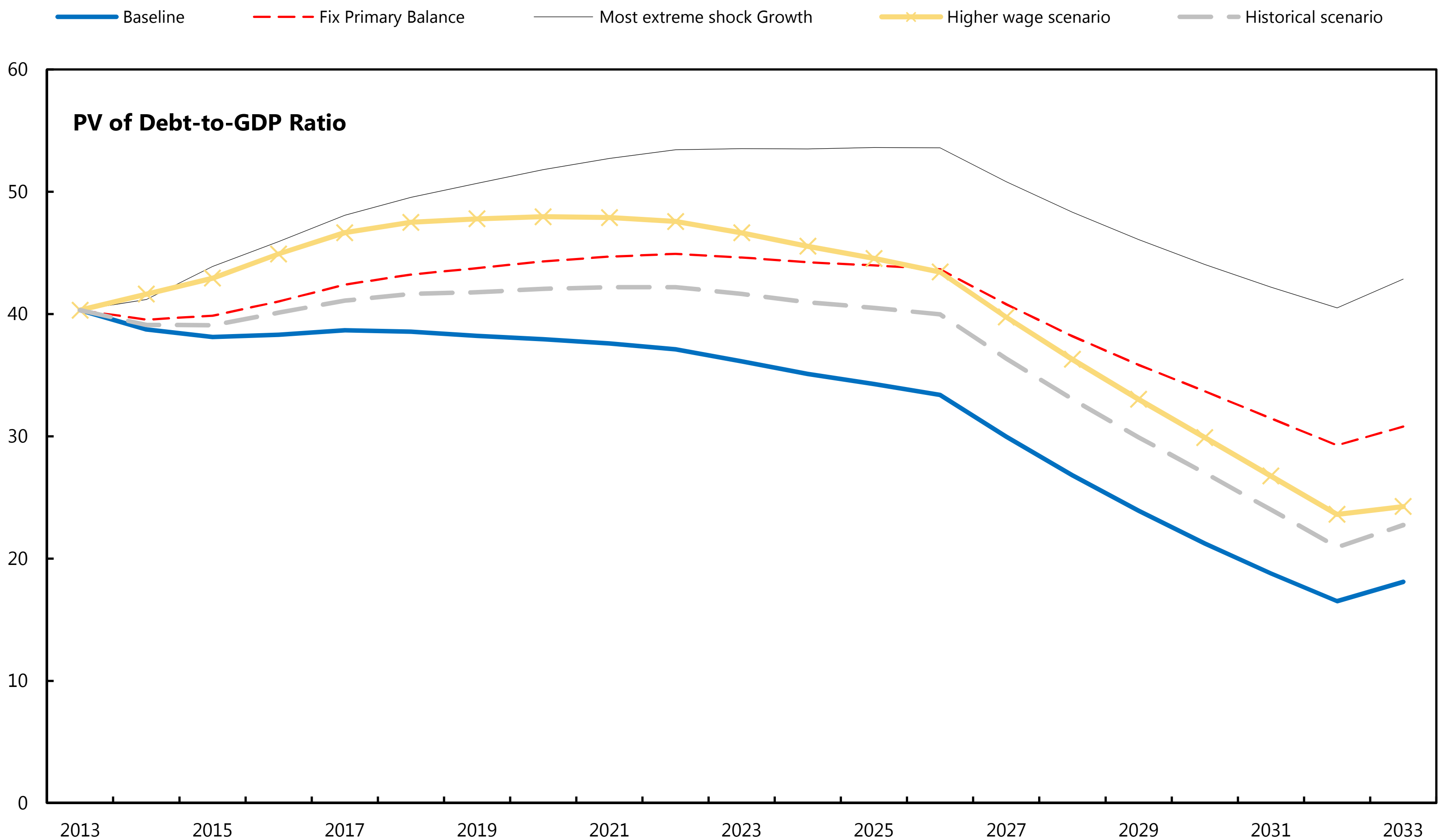
Wage increase and debt/fiscal sustainability (cont…)

- Higher deficit will negatively affect debt dynamics and put the country at risk of debt distress, like in the case of Greece.
- Debt indicators worsen and result in a breach of the thresholds during the projection period (say 2013-2030).
- At least for the next 10 years, debt level relative to GDP rises to well above the 40 percent threshold
- Therefore, we can conclude that the **proposed remuneration is fiscally unsustainable.**

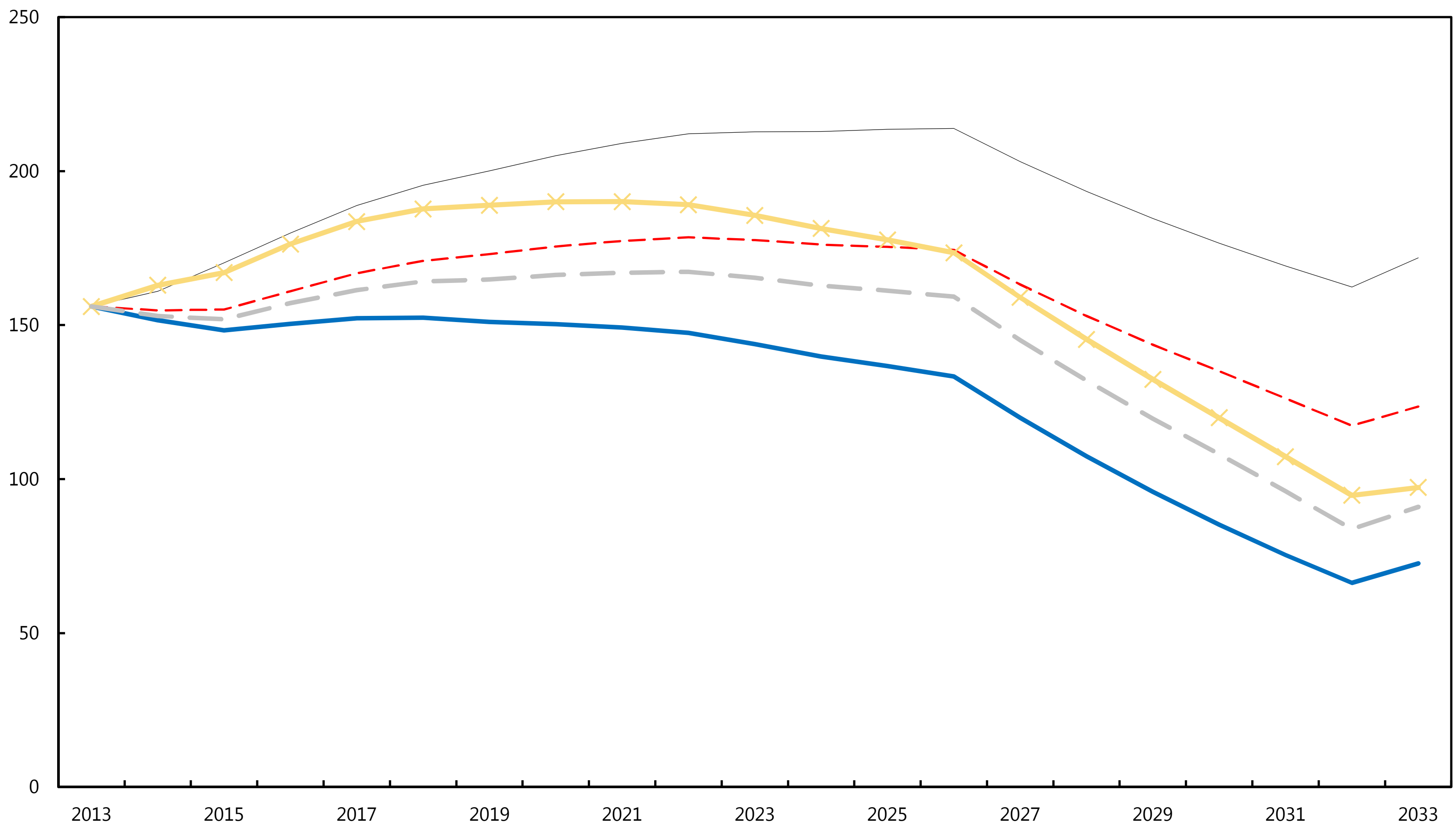
Wage review proposal and Debt/fiscal Sustainability thresholds

Indicator (in present value)	Threshold	Outcome based on proposed pay by SRC	Assessment
Debt-to-GDP ratio	40	Increases to 47 by 2023	Unsustainable
Debt-to-revenue ratio	250	Increases to 186 by 2023	Sustainable
Debt service-to-revenue ratio	20	Increases initially to 28 in 2014 before declining to 26 by 2023	Unsustainable

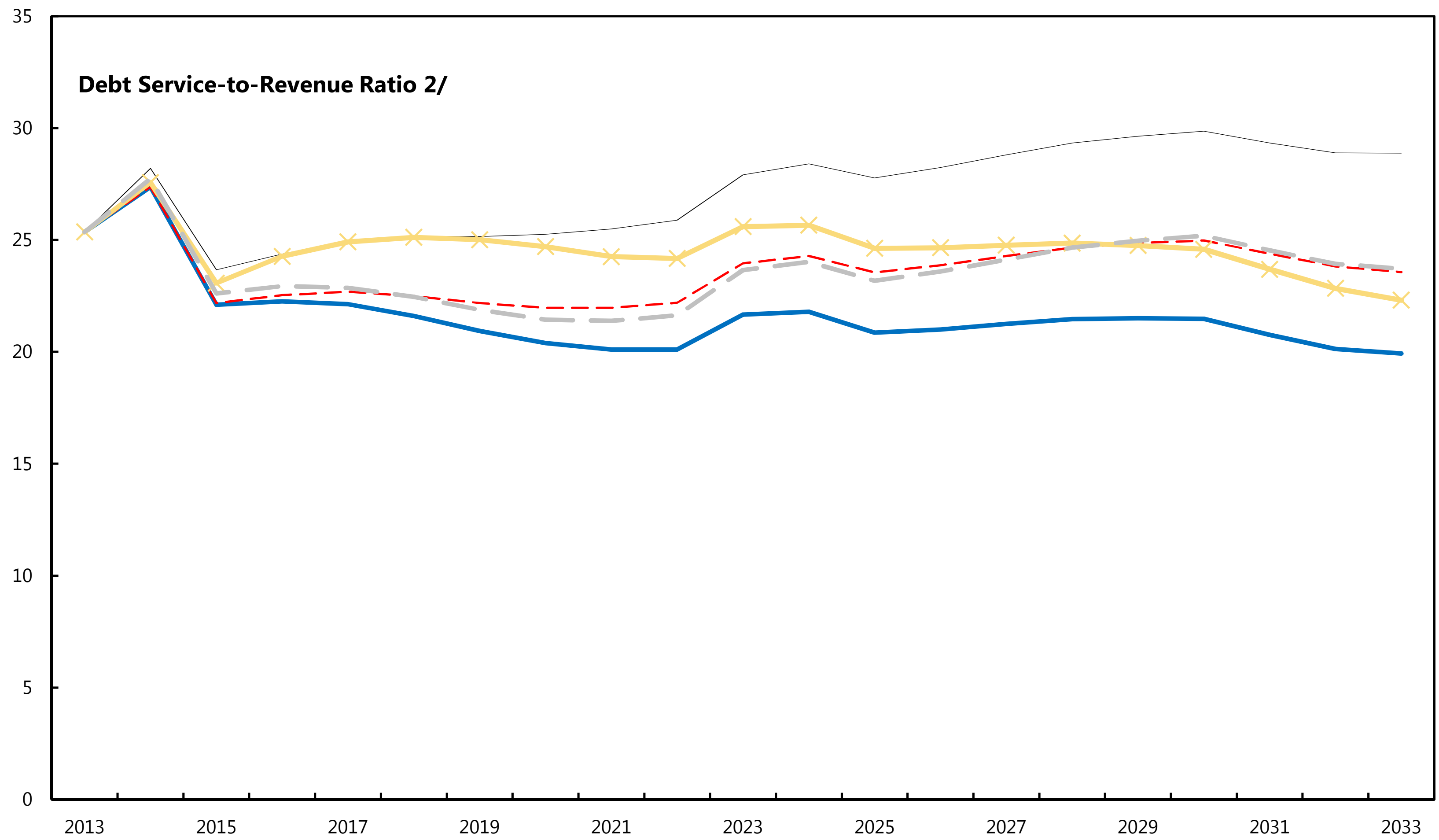
PV of Debt-to-GDP Ratio



PV of Debt-to-Revenue Ratio



Debt Service-to-Revenue Ratio



Concluding Remarks

- The proposed wage reviews significantly alters remuneration parameters and is not fiscal feasibility and sustainable.
  - As we have seen, the wage bill impact on debt dynamics is negative (that is, it worsening debt level to GDP).
  - Also, the wage bill impact of gov't revenue is unaffordable, because the wage bill to revenue is above norm. This means that the proposed remuneration is will eat up more resources at the expense of other critical expenditures, hence unsustainable
- Therefore, the task is to make adjustments on the proposed pay reviews and subject them to an iterative process to arrive at an appropriate remuneration proposal that is fiscally sustainable

Thank You