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# PRESS RELEASES

## Fiscal risks of raising salaries in civil and public services

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**At its first session on January 28, 2016, the new Government adopted a **Proposal for an Act on the Denial of the Right to Salary Increase Based on Seniority**. This move resulted in temporary budget savings worth HRK 250m. However, the Government is yet to tackle a bigger problem, caused by the trade unions' demand for growth in base salaries of civil servants and public employees. The fiscal cost of the base salary growth is estimated at HRK 1.95bn.**

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**Denying an increase in part of salaries.** Under the Act Proposal, the Government denied the right to a 4%, 8% or 10% salary increase, depending on years of seniority, to all civil servants and public employees. It is noteworthy that the increases in the job complexity coefficients (i.e. salaries, of 4%, 8% and 10%) for 20, 30 and 35 years of service respectively, represent double bonuses received by civil and public service employees on one and the same basis. First the job coefficient (i.e. salary) is raised and then an increase of 0.5% is applied to the increased coefficient for each completed year of service. Under the new Act Proposal, civil servants are denied an increase in job complexity coefficients, whereas public employees are denied an increase in job complexity coefficients, or salary calculation bases, or salaries calculated as a product of the base salary and bonuses depending on working conditions.

**Key reasons why salaries cannot go up.** Reasons for limiting salary growth are already known. Croatia is undergoing an excessive deficit procedure (with a budget deficit exceeding 4% of GDP during the first three quarters of 2015, and a general government debt (excluding guarantees) of over 86% of GDP in the third quarter of 2015 (Eurostat, 2016). Besides, there are claims for the repayment of arrears in the health system worth HRK 2.8bn<sup>1</sup>, as well as arrears in shipbuilding (HRK 147m) from 2015, plus HRK 743m in contractual liabilities to shipyards due in 2016<sup>2</sup>. These liabilities pose an open threat to the stability of public finances, even without the pressures for salary increase in civil and public services. Therefore, planned expenditures for employees must be lower than in 2015. The Government's argument for denying the seniority-based salary increase is that this is not a constitutional right but a privilege, and is therefore subject to changes, depending on the country's economic situation.

**The fiscal risk of the base salary growth is even more serious than the risk of the seniority-based salary growth.** The Denial Act Proposal is a measure with a fiscal effect of HRK 250m in 2016. However, the Government will have to deal with further demands from public and civil service unions, related not only to seniority-based salary increases, but also to a provision on increasing the gross base salary as a consequence of real GDP growth, contained in a **separate agreement**.<sup>3</sup> Consequently, the

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<sup>1</sup> Government's report on the 2011-2015 term of office, p. 1663.

<sup>2</sup> Ibid., p. 351.

<sup>3</sup> Agreement on Amendments to the Agreement on Base Salaries in Civil Service, of March 23, 2009.

national budget is threatened by an increase in expenditures of not only HRK 250m, but of an additional HRK 1.95bn.

**Collective agreement and salary growth.** The Government and the civil service trade union signed a **Collective Agreement** in 2008, governing the working relationships, workweek, and entitlements to annual leave and annual leave allowance, salary bonus, sickness allowance and transportation bonus, annual medical check-up and employment anniversary rewards, base salaries, etc. As early as March 2009, an **Annex to the Agreement**, concluded on 21 November 2006, was signed. This Annex stipulates that, as of April 2009, the salaries of civil servants and public employees are calculated according to the gross base salary of HRK 5,108.84, determined in 2008. It also stipulates that a new, 6% higher gross base (HRK 5,415,37) shall be applied, if real GDP increases by 2% or more, year-on-year, for two consecutive quarters (measured by arithmetic mean).

**Total employment in civil and public services.** According to the Ministry of Finance data, there were 240,860 employees in civil and public services in the third quarter of 2015. *The number of civil servants decreased from 86,875 in 2005 to 75,236 in 2014, and the number of public service employees went up from 154,121 in 2005 to 170,707 in 2014.*

**Potential fiscal cost of base salary growth.** Gross base salary (determined in the Act on Salaries in Public Services and in collective agreements currently in force) is the product of a job complexity coefficient and a salary calculation base, increased by 0.5% for each completed year of service<sup>4</sup>. Compared with the old base, the new base should increase by the gross amount of HRK 306. Consequently, the minimum monthly salary increase, relative to the former base, for 240,860 employees is expected to be HRK 162.9m, or HRK 1.95bn annually (Table 1).

**Table 1** Potential monthly and annual costs of salary growth in civil and public services, 2016 (in mil. HRK)

| Salary calculation according to coefficients | Average expenditures = new base* ((1+average coeff.)* number of employees) | Average expenditures = old base* ((1+average coeff.)* number of employees) | Difference   |
|--|--|--|--------------|
| 1  | 2  | 3  | 2-3          |
| Job type 1                                   | 1,068.0  | 1,007.5  | 60,4         |
| Job type 2                                   | 668.5  | 630.6  | 37.8         |
| Job type 3                                   | 611.4  | 576.8  | 34.6         |
| Job type 4                                   | 529.9  | 499.9  | 29.0         |
| <b>Total</b>                                 | <b>2,877.7</b>   | <b>2,714.8</b>   | <b>162.9</b> |
| Monthly salary growth                        |  | 162.9  |              |
| Annual salary growth                         |  | 1,955.0  |              |

*Note: Given the lack of data on the distribution of employees by job types according to the corresponding coefficients, the calculation was based on a class mark. According to the Act on Salaries in Public Services (OG 27/01 and 39/09, there are four types of jobs, depending on complexity which also determines the corresponding job coefficient: job types 1, 2, 3 and 4. Requirements for particular job types are the following: job type 1 - university qualifications; job type 2 - two-year post-secondary school qualifications; job type 3 - secondary school qualifications; and job type 4 - elementary school degree. The corresponding coefficients for particular job types range between: 1.05 and 3.50 for job type 1 (class mark = 2.275); 20.9 and 1.20 for job type 2 (class mark = 1.05), 0.65 and 1.10 for job type 3 (class mark = 0.875); and between 0.50 and 0.75 for job type 4 (class mark = 0.625). The second projection assumption is that the total number of employees (240,860) is evenly distributed among the four job types.*

Source: Authors' calculations based on the Ministry of Finance data.

**Government finance is entering an extremely sensitive period of potential financial instability**, as a result of promises of salary growth made in previous periods, but to be fulfilled by the new Government. According to the Croatian Bureau of Statistics (CBS) data, real GDP went up by 1.2% and 2.8% in the second and third quarters respectively, and its growth in Q4 is expected to exceed 2%. This will automatically activate the provision to increase the base salaries of civil and public service employees. In the case that the CBS on February 26, 2016 publishes information on GDP growth exceeding 2%, the Government should already have a first proposal for a national budget plan which includes the amount of expenditures for employees. The Government has three options. First, it can challenge the provisions of the collective agreement and of the signed agreements on salary growth on

<sup>4</sup> When calculating the gross base salary, account should also be taken of the provisions of branch collective agreements which provide for increases in the salaries of all employees with 20+ years of service at a rate of 4%, 8% or 10%, and regulate additional rights.

grounds of legal deficiency. Second, it can request the postponement of the base salary increase from trade unions, and spread the burden of the 6% increase in base salaries over the next three years (with salaries going up 2% each year). The third option would be to cut the number of employees in civil and public services.