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# HOW NOT DOWNSIZE THE PUBLIC SECTOR

## Lessons in optimization from Montenegro

Montenegro's public sector employs about 60 thousand people, and spends more than half a billion euro on salaries every year, a figure that continues to increase. The Government promised to reduce the number of employees in the public sector by 5% at the national level, and by 10% at the regional level by 2020, i.e. to let go about 3200 employees from the public service.

This is not the first time the Government has made such promises. The promise of the 2013 Public Sector Reorganization - to cut staff by 10% - remained empty words on paper. Sectoral initiatives launched since then, such as the rationalization of the school network and reduction of employment levels in education also failed to yield results.

Employment in the public sector represents one of key political resources, one which is used (and abused) throughout the government's term, but is especially linked to the election process, during which votes are bought with promises of employment in the public sector. Evidence for this practice comes from the 2013 "Audio Recordings" affair, which revealed a clear link between employment and the vote-buying in the elections. In the context of inappropriate political relations, several studies show that the highest degree of discrimination in employment is caused by political affiliation.<sup>1</sup> At the same time, social pressure for employment in the public sector is strong because many perceive employment in the public sector as the pinnacle of one's professional ambition, as evidenced by the fact that a large percentage of young adults would rather seek employment in the public than in the private sector, even if that meant a significantly lower income.<sup>2</sup>

At the local level, despite ongoing debt restructuring and the worsening financial situations in some municipalities, the government has been unable to force local self-governments to reduce employment levels, which have instead continued to grow.

1 / CEDEM, 2017; IPSOS 2016, 2018.

2 / Centre for Civic Education, „Young people in Montenegro – Social Ornament or Social Capital?“ 2016, <http://media.cgo-ccc.org/2016/12/Mladi-drustveni-dekor-ili-drustveni-kapital.pdf>



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Public enterprises at the national level are regarded as business organizations competing in the free market, in which the government has no right to interfere with their hiring policies - despite the some estimates claiming they employ around 10 000 people. This disregards the fact that most are operating at a loss, and function as monopolies in their respective fields. Also, although public administration bodies were forced by the EU and local forces to adhere to more rigorous hiring procedures (especially since 2011), the part of the public sector that includes public enterprises at the local and national levels still employ procedures identical to those used in the private sector, which are open to abuse.

The current process of optimization<sup>3</sup>, instead of systematically addressing the problem of human resource planning in the public administration, wants to achieve the planned cuts through quick one-off fixes (early retirements, severance payments, abolishment of fixed-term contracts). The process is regarded as an externally enforced obligation, and is motivated by the prospect of financial gain – not through savings and reduction of current expenses, but through financial support from the EU.

This analysis presents the current trends in the optimization process and brings to attention the lessons we could learn from the previous attempts at downsizing, including some critical flaws that will doom the process to failure unless some fundamental changes are made in the way it is implemented.

## **NEW PROMISES – OPTIMIZATION IN 2017-2018**

Regarding staff cuts, the 2016-2020 Public Administration Reform Strategy states as its aim “Determining target values for optimization of the number of employees in public administration”<sup>4</sup>. The deadline for Strategy’s implementation is, and the preparatory activities for optimization ought to be carried out by 2019. Provided that these preliminary activities are actually implemented, the planned cuts are to be carried out in 2019 and partly in 2020.

According to January 2018 data from the Ministry of Public Administration, there are 39,306 public employees at the national level, and 12,174 at the local level - 51,480 employees in total. Of this number, 3,963 employees of the central government have a fixed-term contract, the same as 868 employees at the local level.

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3 / **Optimization** of the public sector can be defined as a type of administrative transformation that allows it to become fully functional, i.e. to reach its maximum possible effectiveness. The process is made up of a rationalization phase, in which measures are taken with the objective of short-term saving but without broader functional organizational and structural changes; followed by a reorganization phase, which entails fundamental changes of its structure, internal and external relations, operations, etc. Definitions referenced from “A modern state – a rational state”, by the Ministry of State and Local Administration, Republic of Serbia, 2015.

4 / Within this objective, the following activities were planned: 1. Formation of an inter-departmental team for coordination and tracking of said activities – 2016, 2. Establishment of methods and criteria for staff number optimization – 2016, 3. Assessment of the current state in accordance with methods established by all bodies – 2017, 4. Definition of goal values by Government – 2018, 5. Establish oversight of implementation of planned staff number optimization – 2019.

Data from the Ministry of Public Administration regarding the number of employees in the public sector (January 2018)

Central level	Ministries	2 816	39 306	51 480
	Bodies within ministries	11 006		
	Independent bodies	1 610		
	Public institutions	23 874		
Central level	Local administration bodies	4 378	12 174	
	Public institutions at the local level	1 190		
	Public enterprises and independent agencies at the local level	6 606		

Information on the number of employees in the public sector published by the Ministry of Public Administration in January 2018 was compiled based on written responses submitted by each institution and body individually to the Ministry. About 10% of the data was gathered from the information collected by the Ministry of Finance, and refers to institutions with a higher degree of independence (regulatory agencies, independent bodies etc.). Already at the very start of the process, some agencies refused to even send the information on their starting positions, citing statutory independence. This calls into question their readiness to be willing participants of the next steps of the process, which entails reduction in the number of employees.

Montenegro's Armed Forces unilaterally excluded themselves from the process, arguing that their human resource policy has been defined by obligations of NATO membership. Montenegro's Central Bank similarly opted out, citing its institutional independence.

Officials at the Ministry of Public Administration, which is in charge of the process, find it self-evident that "there is no surplus of employees at the central level; indeed there is a large number of vacancies in the Ministries and a need for additional recruitment in certain sectors".<sup>5</sup> The main focus of the optimization, according to the Ministry of Public Administration, should therefore be in the local self-governments and in the health, education, labor and social welfare sectors.

The Ministry of Public Administration has, in accordance with conclusions of the Council for Public Administration Reform, created an Inter-departmental expert team in charge of defining the methodology and Plan for optimization of the number of employees in the public sector. The team, under coordination of the Ministry of Public Administration, includes secretaries of all ministries, representatives of the Human Resource Office, the Association of Municipalities and the NGO sector. Their task will be to oversee implementation of the Plan for optimization of the number of employees, which includes the formation of mini-teams in each Ministry. Once the overall methodology has been defined, these teams will be responsible for preparing a draft plan for optimization in their respective sectors<sup>6</sup>, after determining a methodology. The Plan for optimization of the number of employees in the public sector should have been completed by the second quarter of 2018.

5 / Minutes from the 3<sup>rd</sup> meeting of the Team for optimization in the Public Sector, January 2018.

6 / Pribilović: We're making a plan for optimizing the number of employees in the Public Sector<sup>6</sup>, Portal Analitika, article available at: <https://goo.gl/orps4x>

The process of optimization so far has not tackled the problem of the so-called **unassigned officials**.<sup>7</sup> These are officials who have not been assigned to jobs defined by the new Rulebook of employment organization in the public sector by the legally set deadline, but who continue to work on tasks assigned to them by the previous system. There are many reasons for this failure, and the problem is more acute in some departments than in others.<sup>8</sup>

As a special incentive for reform, the European Union's new financial instrument introduced a mechanism for direct budget support, which includes 15 million euro for public administration in Montenegro in the period 2018 – 2020. One of the key indicators to be periodically assessed a prerequisite for payment is the number of employees in government bodies at the central level and in local self-governments.<sup>9</sup> As a measure of success on this front the share for employee's salaries in current budget expenditure is expected to fall by 4% by 2020, and the number of employees by 10%.

## **STATE-OWNED ENTERPRISES – A PART OF THE PUBLIC SECTOR OR NOT?**

In 2013 The Ministry of Finance summarized the problems of state-owned enterprises in the following manner:

.....  
*“One of the important characteristics of majority state-owned enterprises is that they mostly produce losses, most of them have excess employees, and the average salaries, especially those of the management, exceed average salaries in public administration – the central government.”*<sup>10</sup>  
.....

According to research by Institute Alternative, at the end of 2015, 39 of the largest companies part or majority owned by the government had about 9,861 employees at the central level.<sup>11</sup> The Plan for Internal Reorganization of the Public Sector, which contains information regarding a smaller number of public companies (31), cites a total number of 8,589 employees at the end of 2012.

Even though the Plan on Internal Reorganization included public companies at the central level, the Ministry of Public Administration decided not to include public companies in the total sum of employees at the central level (and thus exclude them from the Plan for Optimization of the Public Sector). However, the Plan does include public companies founded by municipalities. The justi-

7 / According to the Information System for Human Resources Management, there are some 700 employees (of about 9,600 registered in the Human Resources Management Authority system) that are not linked to any of the positions prescribed by the Organisational Act. Of this number, 328 work in the Ministry of Interior and Police Administration. According to the information provided by the institutions themselves, the number of such employees is 320 (of which 280 in the Police Administration).

8 / For more information on the possible causes of this phenomenon on the example of Police Administration please see "Unlawful decisions and bosses' discretion" (MNE), available at <https://goo.gl/ieif64>

9 / Information on the Proposed Financing Agreement between the Government of Montenegro and the European Commission on the yearly action program for Montenegro for 2017 – pt. 2, with the Proposed Financing Agreement

10 / Plan for Internal Reorganization of the Public Sector, July 2013.

11 / Information on the number of employees in public companies available on the website "Moj Novac" <http://javnapreduzeca.mojnovac.me/uporedna-analiza/broj-zaposlenih> (MNE).

fication claimed that these “business entities were trending towards privatization, which would automatically take them out of the public sector and render them irrelevant for the tracking of optimization process. It would therefore not give us a precise picture of employment reductions, as employees of these enterprises would cease to be employees of the public sector regardless of the optimization process”. Meanwhile, “the local level requires a different approach, as there are far more employees working for public companies at the municipal level, where they generally provide public services to the citizens, i.e. in water supply and public utilities.”<sup>12</sup>

This approach applied by the Ministry of Public Administration is contrary to earlier statements made by the Minister of Public Administration, that “the scope of the public sector difficult to define, which is why we chose to follow up with the definition adopted by the 2013 Plan on reorganization, meaning that the whole public sector would be covered in the analysis.”<sup>13</sup>

In addition to avoiding on of the key sources of excess employment in the public sector, this decision to exclude state-owned enterprises at the central level also opens up the possibility for shifting employees from institutions and administrative bodies to state-owned enterprises. It is not difficult to imagine that reductions in public administration would be compensated by increases in public enterprises, as long as the state as the owner and founder of these entities introduces more rigorous limitations on employment or at least transparency as concerns their basic operations.

## **HOW TO REDUCE THE NUMBER OF EMPLOYEES?**

In addition to recommendations on the possible introduction of short term horizontal measures, such as banning new employment and reduction of the number of employees on fixed-term contracts, methodological instructions for the optimization of the number of employees from February 2018 suggested first collecting data necessary for analysis and forecast of the impact of such general measures.

However, by mid-March 2018 the data necessary for such analysis had not yet been collected.<sup>14</sup> For instance, only 7 out of 23 local self-governments gave answers to the second questionnaire administered by the Ministry of Public Administration.<sup>15</sup> Nor was an overview prepared of the five key sectors at the national level - the justice department, labor and social welfare, internal affairs, healthcare and education.

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12 / <http://www.vijesti.me/vijesti/nastavljeno-nekontrolisano-zaposljavanje-kad-partije-krenu-malo-je-stolica-979387>

13 / Record from the 1<sup>st</sup> meeting of Inter-department team in charge of determining methodology and plan for optimization of the number of employees in the public sector, 19 July 2017.

14 / Some of these matters also include: “The number of employees whose term will end ex lege (retirement) during 2018, 2019, 2020: How many employees and which positions (titles) can retire during 2018, 2019, and 2020? Are there any restrictions to filling these positions via institutional assignment (including internal tenders between bodies)? Which sectors should increase the number of employees and why?”

15 / The municipalities in question are Andrijevica, Bar, Budva, Cetinje, Kotor, Niškić and Rožaje.

From the adoption of the Strategy until May 2018, only the Ministry of Public Administration and Human Resources Management Authority had begun to implement functional assessment of human resources, administered by the World Bank. Until mid-May, the results of the assessment were not made available to the optimization team.

Horizontal measures of rationalization<sup>16</sup> do not help to decide which of the active employees are required for the institutions to function properly. Nor do they help to determine whether the positions they occupy are necessary in certain institutions. Prior experience of public administration bodies, which for years have been working on establishing a system for the management of human resources, shows that not even the advanced mechanisms of resource management, human resource planning, past practices of adoption of organizational rulebooks, and even strategies of human resource management in some public bodies are enough to determine whether certain jobs and positions are required.

Methodology for development of human resource plans indicates that human resources should not only be planned according to the demand for additional employment, but also relative to the overemployment in some positions.<sup>17</sup> And yet, the latest human resource plans of the Government (for 2016 and 2018), apart from highlighting how many employees will retire, talk exclusively about the need for new employment, without mentioning the surplus of employees.<sup>18</sup> The same is true of the Programme of Accession of Montenegro to the EU, which notes that an additional 673 employees will be required by the accession process to the EU.<sup>19</sup>

Measures that would “free” individuals who have fulfilled conditions for retirement, individuals employed on fixed-term contracts, as well as a number of individuals who would consensually terminate their contract in order to obtain severance pay, could lead to the conclusion that the current employees aren’t required for their respective institutions to function properly. Also, short term horizontal measures could lead to a “brain drain” of quality staff with positive professional performance, regardless of the fact that they work in areas affected by the measures (e.g. fixed-term contracts).

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16 / Restrictions on hiring, retiring of officials who fulfill the statutory requirements for pension, decisions not to renew active short-term contracts, as well as a consensual contract termination for those employees who wish to terminate their employment in order to gain severance pay.

17 / The methodology for developing human resource plans states the following: “The relationship between the supply and demand of human resources is analyzed in order to determine if the two variables are balanced, i.e. whether there is a deficit or surplus of personnel, or whether it is expected. These presumptions are used to form a Plan for hiring and keeping quality staff, and if necessary, the Plan to reduce the number of employees.”

18 / “In 2018 an additional employment of 704 state officials and employees is planned. It is expected that an additional 580 employees and state officials will be hired on open-ended contracts, while 124 would be hired on a fixed-term contracts in 2018. The number of officials to go into retirement in 2018 is 35” – 2018 Human resources plan for public administrations and departments.

“In 2016 an additional employment of 470 state officials and employees is planned, of which 466 are state officials and 4 employees. During 2016 the employment of 419 state officials and employees will be hired on an indeterminate period, and another 51 on a fixed-term contract, 470 in total” – Human resources plan for state administrations and departments in 2016.

19 / The Programme of Accession of Montenegro to the EU 2018 – 2020, available at: <https://goo.gl/dJd2Wi>

Exclusive reliance on horizontal measures would have to take into account the lessons learned from experiences of the earlier moratorium on public employment. The Government had ordered the Human Resources Management Authority in February 2009 to suspend new requests for employment for the first half of the year. The review by the State Audit Institution found that the Government, despite restrictive measures, did not manage to significantly restrict employment in public administration, especially as public institutions bypassed its employment restrictions by recourse to internships and service contracts.<sup>20</sup>

## **THE FAILURE OF THE PLAN FOR INTERNAL REORGANIZATION OF THE PUBLIC SECTOR**

The current optimization process of the public sector is not without precedent: in fact, it is the second such attempt in just the last five years. In July 2013 the Government of Montenegro adopted the **Plan for Internal Reorganization of the Public Sector (2013-2017)**, the key goal of which was reduction of the number of employees in the public sector. The plan envisaged continued restrictions on new employment and reduction of the current employment levels by 10%. As the prior analysis showed the number of employees in the public sector to be 58,766, this meant **laying off a total of 5,378 employees by the end of 2017**.

However, the first implementation report (for 2014) showed that the number of employees at the central level, far from falling, had actually **increased by 1,846<sup>21</sup>**, of which 1,207 were employed at the local level.<sup>22</sup> In addition to the failure to reduce the overall number of employees, Government resolutions stipulating the obligation to adopt the Plan to reduce the number of employees in all sectors or departments were also ignored. Moreover, the departments that recorded a significant increase in employment did not provide information on the reasons for the increase, nor did they provide an estimate on the optimal number of employees.

The last implementation report concluded that “in the period May 2013 – December 2015 there was an increase in the number of employees by 1,199 persons”, and that “out of 5 sectors that were supposed to implement direct reductions, only 2 sectors did so: department of interior affairs, and department of health. Meanwhile, 3 sectors failed to apply the measures: the department of defense, department of education, and the justice department.”<sup>23</sup>

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20 / More on this subject in the Institute Alternative report “State Administration Reform in Montenegro – Between ambitious plans and real possibilities”, 2013, p. 55, available at: <https://goo.gl/HE6iN1>

21 / According to data found in the Plan (May 2013), there were 54,131 people employed in the public sector, and according to data received in December 2014, there were 55,997.

22 / The drastic increase on a local level was caused by an imprecisely determined starting balance on the number of employees in the Plan for Reorganization, because municipalities didn't report on all of their existing organizations and public institutions.

23 / Plan for Internal Reorganization of the Public Sector Status Report, 2015

The Ministry of Interior prepared two annual reports of the implementation of this plan, in 2014 and 2015. In 2016, 2016-2020 the Strategy for Public Administration Reform was adopted. Unofficially and without explanation, the Strategy took the Plan off the books, before its formal expiry (2017).<sup>24</sup>

Veselin Vukčević, the former director of the Directorate for Public Administration stated that the problem with the Plan for Internal Reorganization of the Public Sector was a "lack of honesty and objectivity, and that that was the reason why they were aiming at a linear decrease."<sup>25</sup>

However, an expert from SIGMA stated in a 2016 document that the optimization could have been continued according to the Plan on Internal Reorganization:

.....  
*"It's clear that the optimization envisioned by the 2013 Plan could have continued, if there were no further delays, on to the new plan. It could have stayed as the first element of vertical optimization, which could be complemented by a horizontal functional analysis, with the goal of a better horizontal distribution of jobs and determining whether all of them were necessary".<sup>26</sup>*  
.....

Apart from the horizontal strategic Acts on optimization, there are departmental documents that regulate employment, and whose implementation is questionable. In education, which is often held up as one of the priority areas for optimization, one should keep in mind that in November 2010 the Rulebook on Norms and Standards for Obtaining Assets from Public Revenue was adopted for institutions that realize publicly certified programmes<sup>27</sup>. Changes to this Act in 2017 nullified the restriction that allows for employment of a **maximum one additional person** in a given position. According to the current version of the Rulebook, the institution may be granted an unlimited number of additional operatives.<sup>28</sup> In other words, this sectoral optimization process has also failed to deliver results, as data from the Ministry of Education Performance Report for 2017 show that "there was an increase in the number of employees since September 2017, due to the amendments made in the Law on Education".

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24 / During the adoption of the Plan for Internal Reorganization of the Public Sector Status Report in 2015, the Government charged the Ministry of Interior to "recognize the main goals and further direction of the reorganization of the public sector, to revise all activities determined by the Plan for internal reorganization of the public sector and to consider the possibility of its integration into the new Public Administration Reform Strategy for 2016 – 2020."

25 / Record from 3<sup>rd</sup> meeting of optimization team for optimization in the public sector, January 2018.

26 / Klaudijus Manokas, SIGMA expert, Methodological comment, on the method of optimization in Montenegro.

27 / The act prescribes the appropriate number of employees (professional associates, associates, administrative – accounting department, technical department and other), "Official Gazette of Montenegro", No. 066/10 from 19.11.2010, 041/13 from 27.8.2013, 067/17 from 19.10.2017.

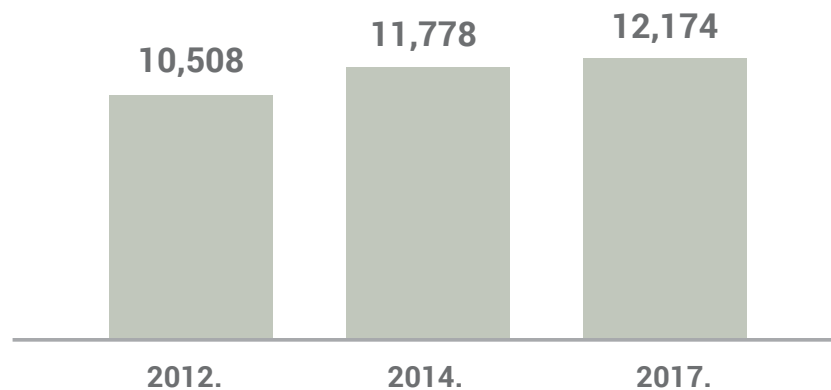
28 / Article 48, Rulebook on norms and standards on receiving funds from public revenue for institutions that realize publicly certified programmes, "Official Gazette of Montenegro", No. 066/10 from 19.11.2010, 041/13 from 27.8.2013, 067/17 from 19.10.2017.



## GOVERNMENT POWERLESS BEFORE MUNICIPALITIES

The number of employees at the local level is **constantly rising**, despite the financial crisis of the municipalities, and the various forms of pressure to implement rationalization measures and cut costs.

According to the Plan for Internal Reorganization of the public sector, in 2012 there were **10,508** employees in local administration bodies and companies founded by municipalities.



Increase in employment at the local level

According to data delivered by municipalities to the Ministry of Finance, the total number of employees in local administrations at the end of 2014 was **11,778**.<sup>29</sup> According to data from the Ministry of Public Administration, local administrations had a total of **12,174** employees in 2017. So the number of employees has since 2014 increased by 396, and the increase is the greatest in Rožaje, Kotor, Tivat and Podgorica.

In determining employment reduction targets, the Strategy on Public Administration Reform for Local Administration relies on the methodology from the Plan for Internal Reorganization and prescribes 10% reduction by 2020 (although it states that these values may be prone to change, depending on later assessments of the situation, which would be determined at a later date).

It is unclear how the Government will force local self-governments to reduce the number of employees in the optimization process, when none of the earlier mechanism succeeded, including binding contracts that promised employment reduction in exchange for debt restructuring.

<sup>29</sup> / Ministry of Finance, Information on the status of public finance and the number of employees at the local level, December 2014

The Ministry of Finance had signed contracts for restructuring of debt incurred through tax arrears<sup>30</sup>, according to which the municipalities were obligated to create plans for reducing the surplus of employees and required permission from the Ministry of Finance for each new hire. A year after they signed such contracts, 7 out of 16 municipalities violated it to the point meriting termination<sup>31</sup>. Most of the violations concerned failing to obtain the Ministry's permission for new hires, although some concerned problems with debt repayments in accordance with the programme.<sup>32</sup>

The terms of contracts specified that the Ministry of Finance would end a contract if a municipality didn't meet the requirements stated in the contract regarding, among other things, receiving a green light by the Ministry of Finance to hire a new employee. Furthermore, even though municipalities were obligated to create plans for reorganization, which would lead to a reduction in the number of employees and provide a plan to reconcile the remainder of their tax debt, they failed to do so. Three years after signing the contracts on debt reprogramming, the Tax Administration declared that 1<sup>st</sup> of April 2018 would be the new deadline for the municipalities to deliver their plans on rationalization of the number of employees.<sup>33</sup>

Meanwhile, municipalities Nikšić<sup>34</sup> and Kolašin maintain that they had already their rationalization programme, while Budva also announced rationalization as a separate and parallel process.

It is obvious that the mechanisms used so far to help local self-governments to rationalize their costs and reduce the number of employees aren't working. The Ministry of Finance isn't ready to restrict the will of local self-governments and is vulnerable to political pressure and to pressure from local self-governments. The key mechanism of budget oversight, which requires that all draft budgets of municipalities are cleared by the Ministry of Finance before they can be officially adopted<sup>35</sup>, has never been used to enforce the conditions laid out in the debt restructuring contracts. On

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30 / The Ministry of Finance had signed contracts on tax debt reprograms with 16 municipalities in 2015: Andrijevica, Bar, Berane, Bijelo Polje, Budva, Danilovgrad, Kolašin, Mojkovac, Nikšić, Plav, Pljevlja, Rožaje, Ulcinj, Cetinje, Šavnik and Žabljak. The total tax debt amount reprogrammed in these contracts was 90.25 million euros and the repayment period in most cases in 20 years.

31 / The number of employment offers that didn't receive approval from the Ministry of Finance: 83 in Nikšić, 12 in Plav, 35 in Pljevlja, 13 in Bar, 31 in Berane, 23 in Cetinje, 28 in Danilovgrad. Source: Information on fulfillment of obligations defined in the contracts on tax debt reprograms and contracts on regulating relations between the State and municipalities regarding their debt guaranteed by the state, The Ministry of Finance, 2016, [http://www.gov.me/sjednice\\_vlade/167](http://www.gov.me/sjednice_vlade/167)

32 / The Tax Administration revealed that contract signees were neither paying off their debt, nor their current personal income taxes, in some cases for longer than a year. The Tax Administration marked a series of documents on tax payments for local self-governments as tax secrets. During 2017, the Ministry of Finance didn't publish information on the realization of obligations defined by the contracts on the reprogram of tax debts of the municipalities.

33 / The Tax Administration, "Meeting held with representatives of municipalities and local companies – a solution is required regarding the matter of tax debt", article available at: <https://goo.gl/ecPfmq>

34 / Veselinka Jauković, a representative from the municipality of Nikšić pointed out that the municipality had already honored the earlier rationalization plan from 2015, and that it had reduced its number of employees by 10%, and later raised a loan in order to pay out its severance pays. She pointed out that the current number of employed personnel was at an optimal level, and that there was no further need for reduction, and asked that the questionnaire include 2015.

35 / Article 35, Law on budgeting and fiscal responsibility, "Official Gazette of Montenegro", No. 020/14 from 25.4.2014, 056/14 from 24.12.2014, 070/17 from 27.10.2017, 004/18 from 26.1.2018

the other hand, even if the tax debt restructuring contracts were terminated, the result would be to freeze the bank account of the municipality in question, which would then require government assistance to pay salaries to employees and provide services to citizens. Not only did the state fail to hold the municipalities accountable, but two new legislative initiatives in 2017 sought to provide them with greater sources of income.<sup>36</sup>

Local finances, before and now (in millions of euros)  
(Source of data: Ministry of Finance)

	2008.	2017,
Revenue	347,8	219,12
Debt	23,5	166,9
Spending on gross wages	42	46,7

Consistent application of any of the mechanisms available to the Government in relation to local self-governments would lead to the measure of last resort: dissolution of the municipal assembly.<sup>37</sup> Bearing all this in mind, it is unclear how the new Strategy will succeed in imposing obligations on local self-governments in the current optimization process, without resorting to a more aggressive policy of limiting support, finances, as well as stricter inspection and other oversight of local self-governments from the central level.

<sup>36</sup> / Adoption of the Law on Old Royal Capital Cetinje which doubled the income of Cetinje and the process of amending the Law on financing local self-governments which the Association of Municipalities see exclusively as an opportunity to increase municipal revenue. See article by RTCG: "Bojadžić: Return part of revenue to Municipalities" available at: <https://goo.gl/3X7PvM>

<sup>37</sup> / Law on local self-governments, article No. 185 ("Official Gazette of Montenegro". No. 2/2018) gives the Government the possibility to dissolve the municipal assembly for failure to act or perform its duties.

## VIŠE OD POLA MILIJARDE GODIŠNJE ZA PLATE U JAVNOM SEKTORU

Every year, employees in the public sector of Montenegro receive more than half a billion euros from public funds. Almost one quarter of the budget on the national and local levels is spent on employee salaries, around 439 million at the national level and 47 million at the local level in 2018. If we add the additional employment-related costs for 10 thousand employees from independent bodies and public enterprises, which are difficult to accurately determine due to data dispersion and a different system of record keeping, the sum certainly exceeds a total of 500 million euros. Legislative attempts to regulate salaries only managed to increase these sums, despite the fact that the Plan on reorganization expected them to decrease total public spending by 64 million euro.

Overview of funds spent on human resource items at the central level  
(in millions of euro)  
Source : Ministry of Finance

	2011.	2012.	2013.	2014.	2015.	2016.	2017.	2018.
Gross salaries and contributions payable by employers	371,25	374,65	371	387,34	382,17	422,49	438,24	438,97
Other personal income	12,82	10,33	12,11	11,95	14,74	10,90	10,29	12,65
Service contracts	/	/	5,2	5,6	6,2	7,3	5,5	6,2
Severance payments	0,07	0,07	2,48	1,17	2,50	1,17	0,88	0,79

Apart from reducing the number of employees, one of the main goals of the Plan for Internal Reorganization of the Public Sector was "Improving of planning and the standardization of wage policies in the public sector". This goal led to the adoption of the Law on Wages in the Public Sector, which caused a drastic increase in spending in these budget position in the whole public sector. Despite announcements of the then Minister of Finance that the Law would cost the budget around 13 million euros<sup>38</sup>, spending on employee gross incomes in the public sector increased by 40 million in 2016<sup>39</sup> compared to that of the previous year and has continued to increase in the next.<sup>40</sup> In 2011 expenditures were 371 million euros and would, according to budget plans, amount

38 / Portal Analitika: "The Law on Wages: 13 million more for wages in the budget", article available at: <https://goo.gl/T4bcLi> (last accessed 8.5.2018)

39 / Even though the Law on Wages in the Public Sector was implemented in March 2016, the budget for 2016 in the last quarter of 2015 was planned based on a version of this Law, predicting a significantly larger income amount for employees, based on the expected fiscal influence of the Law.

40 / More details on the incorrect way of expenditure planning of this law available in article: "Amendments of the budget – what actually happened and who is responsible?", available at: <https://goo.gl/RCBsTG> (last accessed 8.5.2018)

to 439 million euros, which would mean an increase of 18.3%.<sup>41</sup> The inadequate planning of such spending is further supported by the fact that spending on wages and other personal income for employees have topped the limits set by the Guidelines of fiscal and macroeconomic policy for 2015-2018.<sup>42</sup>

Previous experience tells that the Ministry of Public Administration and the Ministry of Finance have neither the capacity nor motivation to conduct a more complex analysis of the financial effects, a fact supported by the poor analysis of the effect of introducing authorities within the ministries.<sup>43</sup>

Spending on human resources is not only listed under "Gross wages and contributions payable by employers". **Other personal income** fell significantly after the Law on wages in the public sector was adopted (from 14.7 in 2015 to 10.9 million in 2016). Still, after four amendments to the Law<sup>44</sup>, which largely eliminated the original restrictions on additional compensation for employees, spending under this item again started to increase in 2018 (by 20% compared to 2017). **Service contract** payments, which on average amount to 6 or 7 million euros (6.29 million euros, according to the plan for 2018), should also be included in the total sum of expenditures for human resources.

Meanwhile, **severance payments**, as a key instrument of rationalization, after a relative rise following adoption of the Plan on internal reorganization for 2013-2016, experienced a significant decline. In addition to all this, a full picture of employment-related spending should include expenses incurred through litigation against state in work-related cases. Between 2012 and 2015, 71,305,707 euro was paid out for court costs, out of which a significant amount was caused by work-related disputes.<sup>45</sup>

At the local level, spending on employee wages is also on the rise. Even as the financial stability of local self-governments drastically worsened in the past 10 years, spending on employee wages increased steadily. Compared to 2008, local self-governments in 2017 have close to 130 million in less in revenues and 140 million more in debts, on average.<sup>46</sup> On the other hand, the spending on wages at the local level in 2017 was higher by 5 million compared to 2008.

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41 / Budget data quoted from data from Institut Alternativa portal, "My Money" <https://goo.gl/5RQdY7>, (last accessed 8.5.2018)

42 / "Processing of expenditures for gross income and other personal income in 2016 was 434.04 mil. Euros, which is 43.05 mil. euros more than the limit defined by the Guidelines of fiscal and macroeconomic policy for 2015-2018". Assessment of the application of criteria of fiscal responsibility, State Audit Institution, October 2017, p. 145, report available at: <https://goo.gl/pnpqCX> (last accessed 8.5.2018)

43 / The financial part of this analysis compares data on budget funds before introducing "authorities within the ministries" (2011 and 2016), as well as funds planned in the 2017 budget, and concludes that the budget expenditures for state administration have increased, without information on the effect on the amount of expenditures on wages or performance.

44 / "Official Gazette of Montenegro", No. 016/16 from 8.3.2016, 083/16 from 31.12.2016, 021/17 from 31.3.2017, 042/17 from 30.6.2017, 012/18 from 23.2.2018

45 / Source: Audit report "Expenditures for court costs in work-related cases", State Audit Institution, March 2016, available at: <https://goo.gl/moqjaX>

46 / Source: Ministry of finance, Mid-term strategy for debt management 2018-2020, p.13, available at: <http://www.mf.gov.me/rubrike/prezentacije/183655/Srednjorocna-strategija-upravljanja-dugom-2018-2020.html>

	Total spending on gross wages at the local level	Total spending on other personal compensation at the local level	Total	Percentage of total spending
2008.	42 092 200,68	7 324 615,14	49 416 815,82	15,62
2009.	40 532 718,95	6 026 649,02	46 559 367,97	17,96
2010.	32 760 897,80	5 724 119,67	38 485 017,47	17,14
2011.	33 685 526,71	7 347 314,02	41 032 840,73	20,53
2012.	33 099 260,94	2 935 022,82	36 034 283,76	17,62
2013.	36 042 059,60	2 484 776,67	38 526 836,27	18,06
2014.	36 789 248,67	2 306 533,60	39 095 782,27	18,47
2015.	46 614 673,85	5 051 688,94	51 666 362,79	21,75
2016.	45 098 519,07	4 422 209,48	49 520 728,55	22,29
2017.	46 744 798,82	3 227 794,96	49 972 593,78	23,87

## HOW TO AVOID THE VICIOUS CYCLE OF OPTIMIZATION?

Previous optimization processes have been characterized by the administration taking action exclusively under EU encouragement, and attempting to reduce the number of employees through horizontal measures without properly assessing the starting situation. The previous plans have been quietly abandoned, and replaced with drafts of new, ever more complex reform documents.

The current optimization process is similarly designed “from the top down”. The umbrella horizontal indicators are not based on individual needs and plans, following analysis at the level of organizations and departments level. It is also difficult to expect successful optimization if the general opinion maintains that there is no room for cuts at the central level and in the ministries. That the opinion is widespread is obvious from answers of individual bodies and institutions, none of which calls for rationalization, but instead often point to the need for more employees. Prior experience shows that heads of departments and institutions are reluctant to implement the necessary staff cuts, which reveals lack of administrative responsibility, bad planning, and systemic challenges of the organizational culture in the public sector.

Horizontal rationalization measures, such as employment bans, retirement, abolishment of fixed-term contracts, as well as consensual contract termination, could individually and in conjunction “hit” the target (the required indicator of employee reduction), but cannot achieve the goal of optimization.

**It also disregards other, related areas, whose improvement would provide better services with fewer employees and lower costs.** In the long run it would be useful if options offered by existing

human resources mechanisms were utilized, as well as future more complex staff and job assessments conducted in certain bodies and organizations, in order to acquire relevant and precise information regarding the needs and general productivity of the public sector.

The number of employees as an indicator of rationalization has been complemented by the financial indicator of spending on human resources in the contract between the Government and the European Commission. However, even with this indicator, there remains the possibility for concealing the actual costs of employment through temporary employment, consultant contracts, employment through agencies and other forms of informal hiring, as prescribed by the Law on Civil Servants and Public Employees.

In order to be successful, the **optimization process of the public sector must be comprehensive**. The exclusion of public enterprises at the central level, as well as of certain institutions (the Central Bank, the Armed Forces) from personnel cuts and other optimization processes (reorganization, improvement of internal procedures, switching to a central record system) is a major drawback, which could negatively impact the whole system. This is especially important for public enterprises that act as monopolies, which could become “sanctuaries” for those dismissed from the national and local administration.

Comprehensiveness also includes **guarantees that the optimization will also be carried out at the local level**. As previous attempts were unsuccessful, a different approach based on stricter budget and employment oversight in the municipalities is required, as well as a more determined stance from the Government that revenues and assistance from the central level must be conditional on the implementation of optimization.

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## **ABOUT INSTITUTE ALTERNATIVE**

We function as a think tank or a research centre, focusing on the overarching areas of good governance, transparency and accountability. Our research and advocacy activities are structured within following programme strands: Public Administration, Accountable Public Finance, Parliamentary Programme, and Security and Defence. On the basis of our programmes, we monitor the process of accession negotiations with the EU, actively participating in working groups for chapters 23 and 32. Our flagship project is the Public Policy School, which is organised since 2012. Institute Alternative was granted with the licence to conduct research activities in the field of social sciences by the Ministry of Science in 2013.

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