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Public Governance in Ukraine

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Introduction

Since independence, Ukraine has faced many challenges in its attempts to become a competitive country capable of promoting sustainable economic and social progress. It is clear now that one of the main obstacles to change has been a vast, inefficient and inflexible public administration system, which continuously undermined Ukraine's capacity to respond quickly, timely and successfully to its mounting economic, social and political problems. Despite a number of efforts to rationalize public administration, government officials failed to separate personal businesses from policy formulation and from policy implementation. Corruption was rampant. Regulatory policies were complex and nontransparent, and often just interfered with normal business activities. Policy-making tended to be fragmented and uncoordinated and lacked transparency and accountability. Even minor decisions required a large number of intergovernmental consultations and approvals. More important, the strategic and management framework of policy-making remained weak. Policy-makers, preoccupied with narrow short-term issues and vested interests, had little incentives to pursue meaningful long-term development goals. Moreover, an increasing bias in the balance of functions, roles and financial resources towards the central government was among key reasons for the political crisis in late 2013-14, which led to the Ukrainian authorities' loss of control over the Crimea peninsula as well as current insurgencies in the eastern oblasts of the country. Therefore, the improvement of public governance is now more critical than ever.

A failure to improve the Ukrainian government machinery as well as further delays with all-embracing and effective public administration reform severely jeopardizes the implementation of all other reforms. Moreover, in view of the recent political developments, there is a growing consensus that decentralization should be a key component of public administration reform as a solution to reduce conflict, build peace, and protect the interests of local communities across the country.

Decentralization, however, should not be mixed with federalization of the country. The first implies a transfer of authority, administration, functions and responsibilities from the central government to local authorities or non-government organizations. Being in the immediate proximity to final consumers of public goods and services, local authorities are best equipped with knowledge and expertise of how to use scarce public resources to address the pressing social and economic needs of local communities. Consequently, they can deliver vital public services more efficiently than the central government. At the same time, the regions continue function under the authority and legitimacy of the unitary national state. While federal constitution is one, much deeper, form of decentralization, it implies the existence of 'federal states', which represent plural societies deeply-divided by linguistic, religious, racial or other identities. The creation of federal structures bears the risk of unraveling and break-up of the national state, which particularly increases when democratic institutions are weak or lacking as they will not provide for efficient check and balances in the autonomous territories if their leaders were to

chose the ‘nationalist’ card, promoting ethnic intolerance and secessionism (which actually happened in Crimea).

The ability of the central and local governments to design, implement and sustain government economic policies and programs, address and overcome structural challenges (including regional ones) relies heavily on the overall efficiency of the entire administrative system. For this reason, public administration reform in Ukraine is indispensable for the success of all essential economic and social reforms.

The Quality of Public Governance

According to a ranking of public governance in 200 countries carried out by the World Bank, the quality of governance in Ukraine has remained quite poor and even deteriorated across virtually all governance indicators since 2007. Indeed, the quality of public governance in Ukraine remained in the bottom one-third of the 200 countries rated by the World Bank. The performance of Ukraine’s public administration lagged significantly behind that of comparable to Ukraine’s regional peers, let alone developed market economies. For example, on Government Effectiveness, Ukraine’s percentile rank was 32 in 2012 (100 being the top ranking), compared to 70 for Georgia, 72 for Poland and 74 for Lithuania. Similar negative results are shown in the comparison of other indicators, such as regulatory quality, rule of law, voice and accountability and control of corruption, as noted in the table below:

Table 1. World Bank Governance Indicators for Select Countries

	Ukraine					Georgia			Poland			Lithuania		
	1996	2000	2004	2008	2012	1996	2004	2012	1996	2004	2012	1996	2004	2012
Government Effectiveness														
Estimate (-2.5 to + 2.5)	-0.7	-0.7	-0.5	-0.7	-0.6	-0.7	-0.5	0.6	0.8	0.5	0.7	0.3	0.7	0.8
Percentile Rank (0-100)	26	25	34	28	32	28	37	70	77	71	72	64	76	74
Regulatory Quality														
Estimate (-2.5 to + 2.5)	-0.3	-0.5	-0.4	-0.5	-0.6	-1.0	-0.5	0.7	0.6	0.8	1.0	1.2	1.1	1.1
Percentile Rank (0-100)	38	29	40	33	29	18	36	73	71	75	78	86	82	83
Rule of Law														
Estimate (-2.5 to + 2.5)	-0.9	-1.1	-0.8	-0.7	-0.8	-1.5	-0.7	0.0	0.7	0.4	0.7	0.4	0.6	0.8
Percentile Rank (0-100)	20	13	27	29	26	8	31	55	66	63	72	61	67	73
Voice and Accountability														
Estimate (-2.5 to + 2.5)	-0.5	-0.7	-0.6	0.1	-0.3	-0.4	-0.2	0.0	1.0	1.0	1.1	0.9	0.9	0.9
Percentile Rank (0-100)*	35	29	29	50	40	36	45	49	78	81	81	75	77	74
Control of Corruption														
Estimate (-2.5 to + 2.5)	-1.0	-1.1	-0.9	-0.8	-1.0	-1.4	-0.6	0.3	0.5	0.1	0.6	-0.1	0.3	0.3
Percentile Rank (0-100)	13.2	7.8	18.0	22.8	15.8	4.9	28.8	64.1	72.7	58.5	71.8	57.6	65.4	66.0

* Percentage of countries, where a governance indicator is below the level observed for a selected country

Source: World Bank Worldwide Governance Indicators

Interestingly, the above table shows that voice and accountability improved between 2005 to 2008, which may be attributed to general liberalization of the political environment, better access to freedom of expressions, and more independent media during the first few years of former President Yushchenko. But there was a clear retreat in this and other indicators over 2008-2013. It seems that

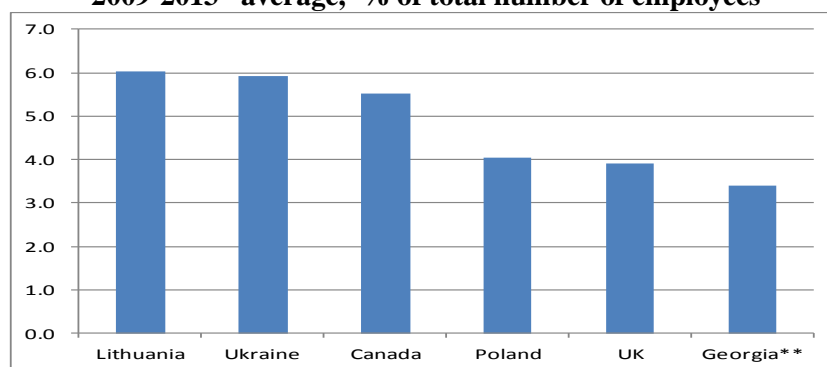
this compression of freedom and democracy during the authoritarian regime of former President Yanukovich led to the so-called “Euro Revolution” and to the president ouster at the beginning of 2014.

The new authorities have already announced broad reform agenda with public administration holding a prominent place in it. Decentralization and smaller central apparatus will be the focus of new public administration reform efforts. At the same time, the improvement in the overall functional and operational efficiency of the entire administrative system is crucial as it would facilitate policy making and will reduce the risks of improper implementation of other social and economic strategies of the country. The dramatic events from the end of autumn 2013 through spring 2014 (Euro Revolution) clearly shows that the majority of Ukrainian population, aspiring high living standards of rich Western countries, was no longer prepared to tolerate the betrayal of their pro-European aspirations by former government authorities, pervasive corruption and enrichment of government leaders and their cronies. Therefore, the new government authorities and, the effectiveness of Ukrainian civil service, will be under close scrutiny. In particular, government institutions and agencies will be increasingly required to ensure provision of high quality public services and to serve more as a partner to Ukraine’s private sector rather than a competitor. For that reason, the existing system of civil service in Ukraine should be one of the key institutional components of public administration that had to be significantly modernized.

Trends in Public Administration Sector Employment in Ukraine and Select Countries

Quantitatively, the government machinery of Ukraine is over-equipped with personnel. Moreover, over the last two decades, the total number of civil servants more than doubled and reached 433,269 employees at the end of 2013, accounting for about 1% of the total population or 2.1% of the employed labor force. At the same time, the number of employees in public administration¹, which also includes defense and public order services, justice and judicial activities, customs and some other regulatory services, constituted more significant proportion. Indeed, the share of public servants grew from about 3% of total employees in 1995 to about 6% on average over the last five years. On these indicators, Ukraine seems to be standing on the higher end, as noted in the chart below.

Chart 1. Employees in Public Administration, Select Countries, 2009-2013* average, % of total number of employees



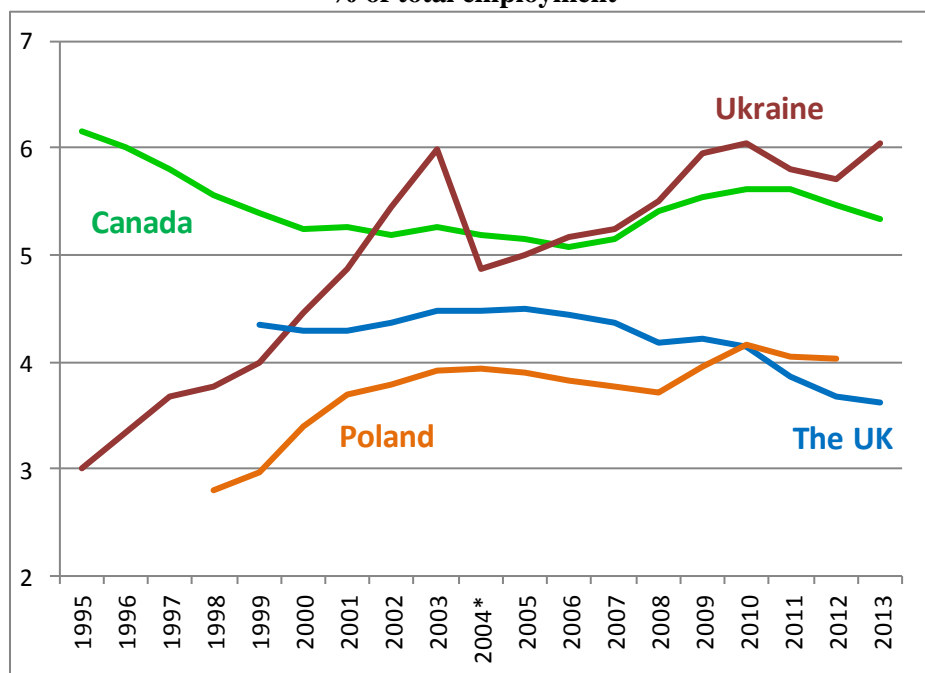
* Average for 2009-12 for Poland; ** Average of the number of people employed in the civil service to total number of employed in 2010 and 2012.

Source: Statistics Canada, Central Statistical Office of Poland, Office for National Statistics of the UK, State Statistical Service of Ukraine, Civil Service Bureau of Georgia, Official Statistics Portal of Lithuania

¹ Section O, according to NACE Rev.2 statistical classification.

Over the last years, a number of countries have been engaged in civil service reform as a part of broader efforts to reduce fiscal expenditures and government administration costs for their economies in particular. This translated into a gradual reduction in the public administration employment across many countries. In the UK the number of public servants declined from about 4.4% of total employment in 2007 to about 3.6% in 2013. In Canada, except for an increase in 2007-08 associated with the financial crisis, public sector employment declined from 6.2% of total employment to 5.3% in 2013. In Poland, since 2003 public employment stabilized at around 4%. In contrast with these countries, Ukraine's public sector employment has been on a rising trend from 1995 to 2013, when it reached 6% of total employment.

Chart 2. Employment Trend in Public Administration, Select Countries, % of total employment



* Since 2004, public administration employment numbers in Ukraine do not include military service employees. Therefore, the numbers before and after 2004 are not fully comparable.

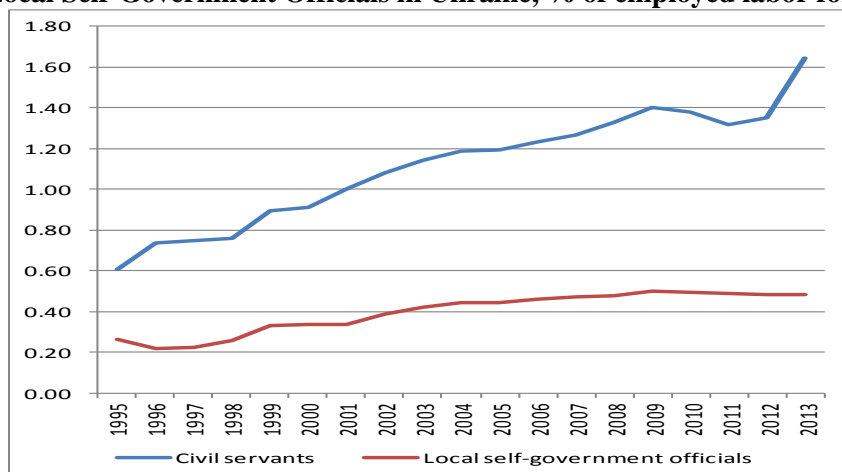
Source: Statistics Canada, Central Statistical Office of Poland, Office for National Statistics of the UK, State Statistical Service of Ukraine

Starting in 1993, Ukraine's civil service has been increasing faster at the central government level than at the local regional level, as noted in the chart below. While the central civil service in Ukraine absorbed more power and size, the regional (i.e., oblast) level civil service remained weak and un-modernized. Moreover, despite the broad recognition of the importance and the need of decentralization -- and the drafting of comprehensive reform programs on 2007-2009 during the last years of former President Yushchenko and the 2011-12 reform plans developed by former President Yanukovych -- implementation of reform initiatives in the field of local and regional self-government failed to yield practical results. Moreover, a number of political decisions made under the presidency of Yanukovych during 2010-2013 even strengthened the centralized political power. Following the Constitutional Court revocation of 2004 amendments to the constitution that had created a mixed parliamentary-presidential system, a strong presidency was reestablished in 2010. The power distribution at local and regional levels clearly shifted to the advantage of local administrations appointed by the center², while the activity of local authorities was driven by the need to show political loyalty to the central leadership rather

² For example, in November 2010, positions of Kyiv city mayor and head of Kyiv city administration were separated with the latter effectively performing the responsibilities of the mayor.

than the residents' needs. As a result, local level institutions still experience a significant deficit in resources and suffer from the existing irregularities in the distribution of power between the center and the regions.

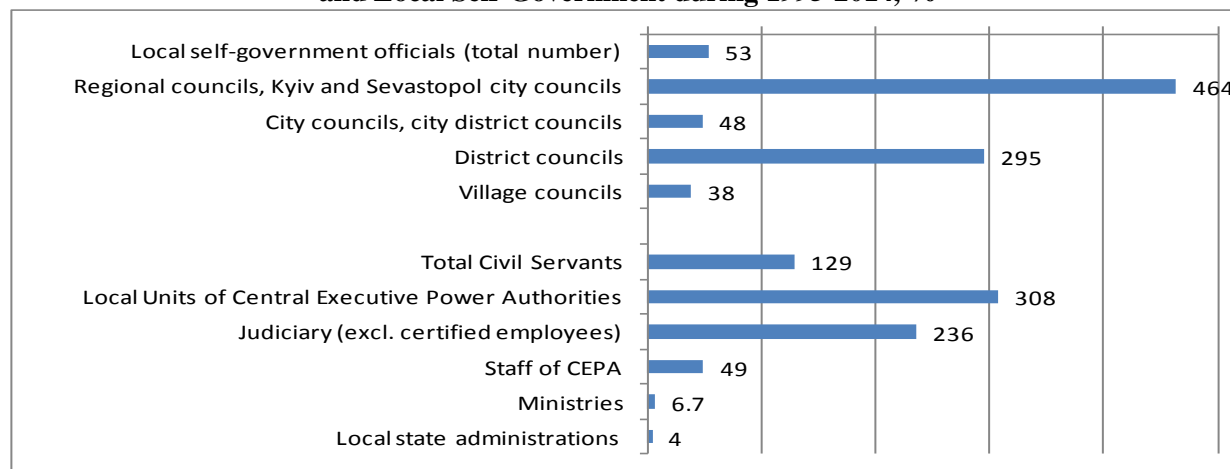
Chart 3. Evolution of Total Number of Civil Servants and Local Self-Government Officials in Ukraine, % of employed labor force



Source: National Agency of Ukraine on Civil Service, State Statistical Service of Ukraine, The Bleyzer Foundation

The distribution between central civil service and local self-governance service reflected the allocation of powers at the central and sub-national levels, confirming that the real “power” is concentrated in the center but not at the local level. Indeed, the expansion of the central government bureaucracy throughout the country posted a substantially higher rate of growth compared to the growth of local self-governance. In 1995-2013, the period growth rate in the number of local officials amounted to 53% while the number of civil servants employed by the local units of ministries and other central executive power agencies located in the regions surged by more than 300%. Although the latter servants are physically located in the regions, they still operate under the central agencies' authority and their accountability to local communities and local governments is rather weak. The inflated size of public administrations at the local level delayed relocation of functions from central to sub-national governments and led to functional overlapping and execution of many unnecessary operations. At a purely central level, agencies such as the Presidential Secretariat, Office of the Parliament (excluding elected positions), and the Secretariat of the Cabinet of Ministries demonstrated high rates of growth as well. Overall, civil servant employment has surged by nearly 130% during this period. As a result, the share of local officials in the total quantity of country's civil servants fell from about 30% in 1995 to less than 23% in 2013.

Chart 4. The Cumulative Growth of Employment in the Ukrainian Civil Service and Local Self-Government during 1995-2014, %



Source: National Agency of Ukraine on Civil Service, The Bleyzer Foundation

Since independence, the first most significant annual increase in the number of civil servant in Ukraine was registered in 1996-97 when their total number increased by an average of 10.7%. This expansion was mainly due to (i) a 27% increase in the number of personnel employed by the local units of ministries and other central executive power agencies and (ii) a 16% increase in the number of personnel employed by judicial authorities and prosecutors (excluding certified employees). The economic and financial crisis of 1998-99 and macroeconomic stabilization efforts, which included consolidation of fiscal accounts, led to a notable deceleration in the rate of growth of public sector employment over this period. From 2001 to 2013, the general upward trend in the government bureaucracy was alternated by government attempts to carry out administrative reform in 2005-06 and 2010-12. The slowdown in employment growth numbers in 2005-06 may be attributed to the constitutional amendments of December 2004, which transformed Ukraine from presidential to parliamentary-presidential republic, and a drastic change in political leadership and some improvement in operating principles of the public administrations.

During the initial years of his presidency, Yanukovich reversed the 2004 constitutional reform and moved the country towards greater centralization and consolidation of power. At the same time, this process was accompanied by staff reductions at both central and local levels of public administration as well as cuts in the number of in central executive bodies.³ The approved laws “On the Cabinet of Ministers of Ukraine” and “On Central Executive Bodies” improved operational capacity of the government by bringing more certainty and formal order, but it was done at the cost of less accountability and public oversight as well as limiting checks and balances. All these changes were introduced without public discussion and lacked such key elements of public administration reform as functional review, separation of political and administrative posts, decentralization and improving public procurement. However, as the public support for the ruling elite had been falling sharply since 2010 and as the next presidential election was approaching, these earlier positive trends in public sector employment statistics were reversed. In 2013, the number of civil servants reported a record increase, expanding by 22%, particularly on account of employees in the ministries and their local units, and agencies supporting execution of authority of the President, Parliament and the Cabinet of Ministers. In contrast, the number of local self-government officials kept declining.

Table 2. Average Annual Growth Rates of Employment in the Ukrainian Civil Service and Local Self-Government, %

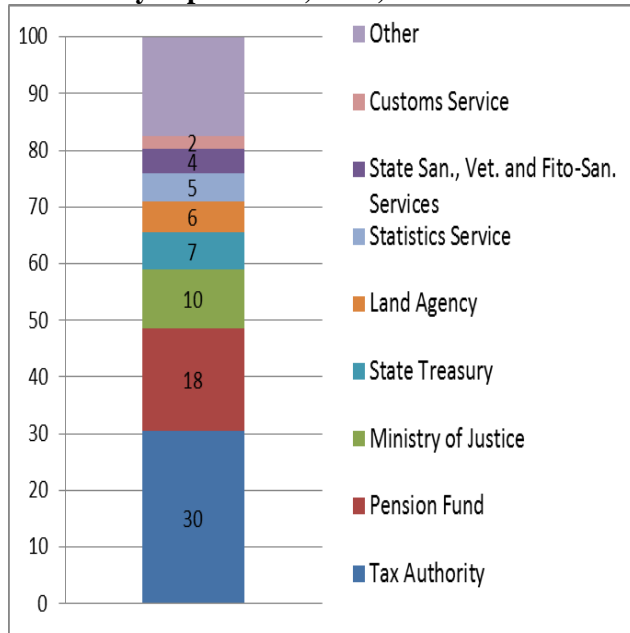
	1996-97	1998-00	2001-04	2005-06	2007-09	2010-12	2013
Ministries*	-9.6	-4.8	4.8	-3.4	4.1	-4.7	34.6
Staff of CEPA, total	-12.4	-0.1	5.7	7.8	5.2	-3.6	17.1
Local units of ministries, other central executive power agencies (CEPA)	26.9	3.6	6.9	7.6	3.7	-1.1	35.8
Local state administrations	2.9	-2.9	1.2	1.2	2.3	-2.7	3.3
Judicial authorities and prosecutors	16.4	-5.8	18.7	-8.1	5.3	6.5	2.7
Total number of civil servants	10.7	1.1	6.2	2.8	3.6	-1.0	22.0
Local self-government officials	-8.5	8.3	6.6	3.3	1.8	-0.9	-0.1
Regional councils, Kyiv and Sevastopol city councils		50.6	5.0	24.9	5.3	-3.6	-0.4
City councils, city district councils and their executive committees	-5.8	9.5	3.3	3.0	2.9	-1.3	0.5
District councils		59.7	3.7	7.1	1.1	-2.2	0.7
Village and settlement councils and their executive committees	-14.1	3.7	11.3	2.7	0.6	-0.2	-0.8

* Excluding Ministry of Defence, Ministry of Internal Affairs, the State Security Service of Ukraine

Source: National Agency of Ukraine on Civil Service, State Statistical Service of Ukraine, The Bleyzer Foundation

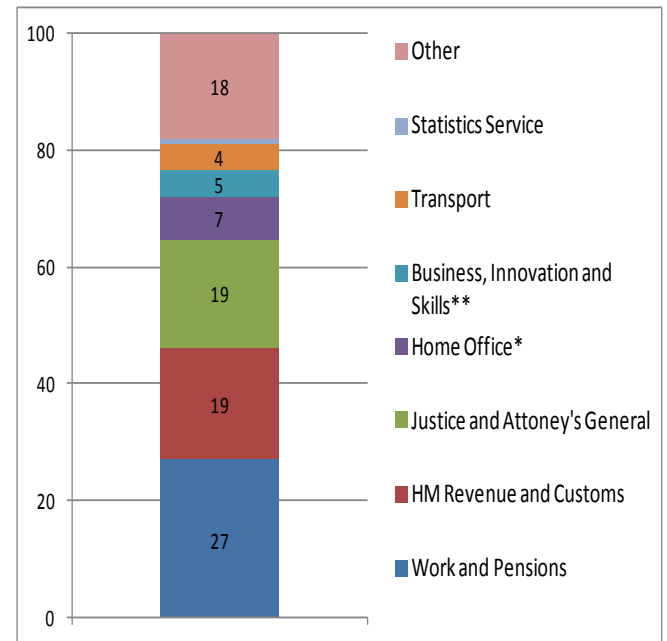
³ On December 9, 2010, Yanukovich issued a decree “On Optimization of the System of Central Executive Power Agencies” according to which cut the number of central executive bodies from 112 to 53 (including ministries from 20 to 16).

Chart 5. Civil Service Employment (Central and Units of Central Executive Power Agencies) in Ukraine by department, 2014, % of total



Source: Decree of the Cabinet of Ministers of Ukraine #85 "About Certain Issues of the Approval of the Maximum Number of Employees in Central and Territorial Units of Central Executive Power Agencies and Other Public Authorities" as of April 2014; The Bleyzer Foundation

Chart 6. Civil Service Employment in the UK by department (excluding Defense), 1Q 2014, % of total



* The department for immigration, security, law and order

** The department for Economic Growth

Source: Office for National Statistics of the UK

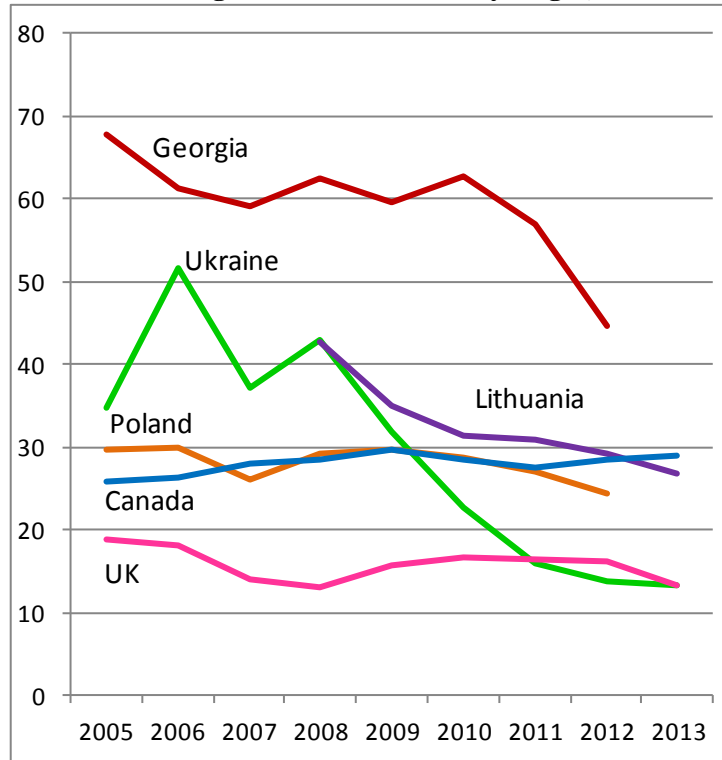
A steady rise in employment in judiciary authorities was observed during 2001-04 and 2007-2013, with the process accompanied by a notable reduction in the independence of judiciary system. During 2010, a judiciary reform was carried out, which notably increased dependence of the court system on the executive branch and effectively turned it into a powerful repressive mechanism. The distribution of civil service employment with a heavy bias towards fiscal revenue generation and regulatory systems were also a reflection of the growing power concentration and misuse, which allowed amassing personal wealth of government officials, the president and his family as well as their close allies. For instance, tax and customs authorities employed about 32% of all civil servants in Ukraine, while the respective ratio in the UK stands at only 19%; highly-prone to rent-seeking activities Land Agency, State Sanitary and Phytosanitary Services employ about 10% of civil servants in Ukraine, while the economic and environment, food and rural affairs departments employ about 7% of the civil service workforce. Oversized statistics service and state treasury in Ukraine may be another indicator of low efficiency of both government employees as well as operational systems of government agencies, resulting in generally poor public services delivery.

Remuneration of Public Service Employees in Ukraine and Select Countries

Uncompetitive wages in the public sector also undermine the effectiveness of public administration. As in many developing countries with weak democratic institutions and rule of law, civil servants are regularly confronted with a tradeoff between impartial and professional execution of their duties and involvement in various corrupt activities. Excessive, costly and time-consuming regulatory procedures encourage state officials to charge hapless businesses for various informal favors. This creates a complex informal network of private middlemen and nourishes corruption. As a result, despite trivial salaries, government occupations are notorious for their capacity to generate handsome illegal incomes. Worse, informal personal networks became a fundamental component of the state administration at virtually every level. A person is often appointed at the high- and middle-rank civil servant position in accordance to personal and political loyalty

criterion, destroying performance-related remuneration and undermining incentives to improve efficiency and carry out its functions in an effective manner.

Chart 7. Evolution of the Wage* Gap between Public Administration wages and Total Economy wages, Select Countries, %**



* Average monthly earnings for the UK; ** A positive (negative) number indicates that average wage in public administration is higher (lower) than average for the sector

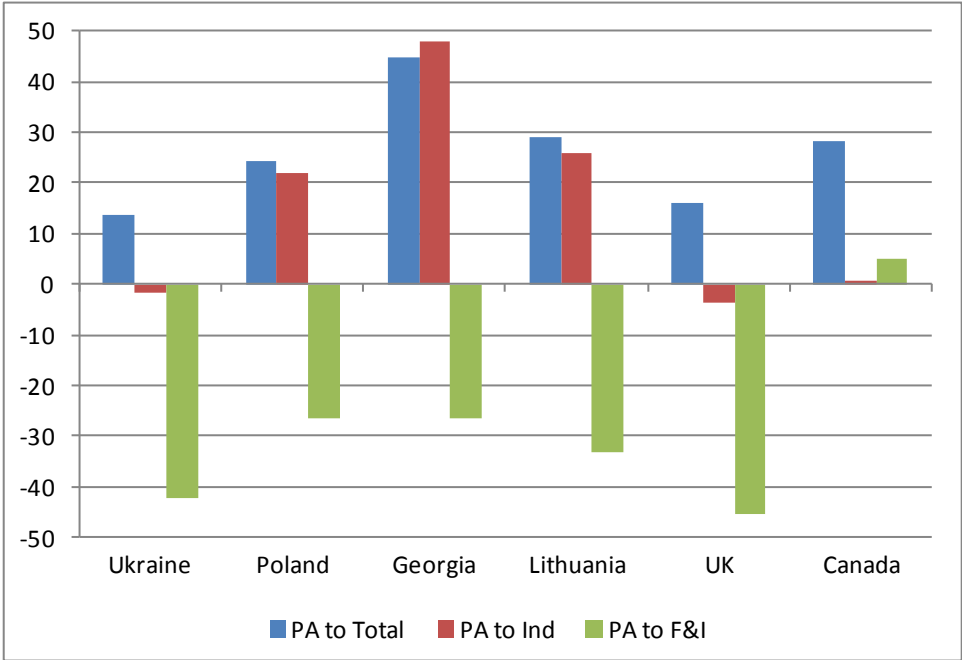
Source: Statistics Canada, Central Statistical Office of Poland, Office for National Statistics of the UK, State Statistical Service of Ukraine, Civil Service Bureau of Georgia, Official Statistics Portal of Lithuania

The above chart shows that in all countries the wages of public administration employees is higher than the average for the economy, since public employees are expected to be more qualified than in the total economy. In fact, a higher level of remuneration of public administration employees compared to wages in the total economy should motivate them to provide the public with high quality services and refrain from corrupt activities. In Ukraine, compared with the average salary in the economy, the gap between wages received by employees of the public administration sector and the rest of the economy is quite low and declined from about 50% in 2006 to only 13% in 2013. Moreover, taking into consideration that a significant portion of civil jobs are located in Kiev, where the average salary was almost 50% higher than the private sector average in 2013, the wage incentive for public servants was negligible. While the decline in the wage gap may be observed in a number of other countries, it may be attributed to the impact of 2007-08 liquidity crises and the need of fiscal consolidation. At the same time, despite the decreasing trend these countries still maintain the attractiveness of public administration sector employment at a relatively high level.

The wage gap between public and overall wages in Georgia, however, may have another explanation. Public wages do not reflect the bonuses and incentives provided by the Georgia administration to public employees. For countries tackling rampant and pervasive corruption, introduction of effective systems of incentives may be an effective mechanism of enhancing moral, raising the cost of being engaged in corrupt activities and attracting highly professional individuals into civil service. With time, when the respective reform efforts start to yield sustainable results, the difference in formal salaries among public administration sector and other wages in the economy may start converging towards peer average level - the process likely taking place in Georgia since 2010.

The chart below should that in Ukraine, as in most countries, the wages in public administration are significantly below wages in the finance and insurance sector. In Ukraine, it is even lower than in the industrial sector.

Chart 8. The Wage* Gap between Public Administration (PA) and Total Economy, Industry (Ind) and Finance and Insurance (F&I) in 2012, Select Countries, %**



* Average monthly earnings for the UK; ** A positive (negative) number indicates that average wage in public administration is higher (lower) than average for the sector

Source: Statistics Canada, Central Statistical Office of Poland, Office for National Statistics of the UK, State Statistical Service of Ukraine, Civil Service Bureau of Georgia, Official Statistics Portal of Lithuania

As it becomes evident from the above numbers, public servants in Ukraine are substantially underpaid in comparison to other countries. In 2012, the salaries in public administration sector were only about 13% above the average market wage and about 2% below the average wage in the industrial sector. For comparison, the respective wage gaps amounted to 45% and 48% in Georgia, 24% and 22% in Poland and 29% and 26% in Lithuania. Taking into account the worsening political environment since 2006 (interpersonal battles among political leaders during 2005-06, power consolidation, reduction in judiciary independence and public accountability since 2010, etc.), it is not surprising that Ukraine demonstrated modest deterioration in its main governance indicators (as noted in the first table). Moreover, the size of kickbacks has grown considerably over time. Thus, according to unofficial data, unofficial demands for settling VAT refund from the budget, one of the most common corrupt services in Ukraine, stood at about 1-2% of the VAT claim 15 years ago. The size of kickbacks rose to about 20-30% by 2008 and surged to 50% after 2010. The size of kickbacks in public procurement almost tripled over the last eight years and reached 60% in 2013, while in certain areas exceeded 70%, according to Oleksiy Khmara, president of TORO Creative Union, the contact group of Transparency International in Ukraine.

Policy Recommendations

The new Ukrainian government and President have a strong mandate from the public to carry out structural reforms and reduce corruption. However, without transforming the way government agencies work now, Ukraine risks to fail implementation of all other reforms and to meet successfully large challenges faced by the country, including preserving the unity of Ukraine and securing peace. The reform of public administration should include the following components:

Redefine the Government's Role

A comprehensive and shared vision for the role and function of the government towards supporting private sector activities is a key prerequisite for productive public administration reform in Ukraine. This clear definition should discourage from putting undue emphasis on administrative and fund-raising functions, delivering goods and services that are normally provided by private sector, and excessive intervention on businesses. Instead, the government should establish partnership relations with the private sector.

Build Broad Support for Reform

Authorities should show **strong leadership** in their commitment to proceed with a deep public administration reform. Without such leadership, it would be impossible to consolidate the efforts of all parties involved in the reform as well as shape and achieve common targets. For this reason, public administration reform must be prioritized as a key item on the government's agenda.

A detailed and feasible plan of action for public administration reform must be enacted. This plan should be designed as a broad policy instrument (based on a thorough feasibility study) rather than a mere statement of intentions. Existing institutional and procedural weaknesses and obstacles that may put off the execution of this reform must be fixed. The plan should represent a well-structured and detailed list of activities and measures to be implemented, including specification of clear-cut targets, timing, deadlines, and the distribution of responsibilities between all involved state agencies. All stakeholders must understand their roles and responsibilities during every phase of the reform. This allocation of responsibilities and roles should reflect internal capacities and resources of every involved party to which specific duties are to be assigned.

Government **information**, including public procurement procedures, should become more **transparent and available to the public**, except for national security reasons. Improving information transparency and openness will also be an important weapon to combat corruption.

The institutional framework of public administration reform must be properly shaped. The revision and modernization of state functions should be maintained on a regular basis through the application of innovative technologies and modern managerial skills in the public sector. The government should create and support educational and research networks, facilities and institutions that actively encourage the diffusion and utilization of this knowledge within state institutions and advance civil service and its human capital capacities.

Perform a meaningful functional review

A functional review of the government must rely on a clear and common vision of state core functions in the modern market economy. Effective execution of core government functions and efficient utilization of public resources must be set as key priorities of any government agency or institution.

A functional review must rely on good methodological procedures, which can detect current problems and offer effective solutions. Essentially, each function or program performed by state agencies must pass six fundamental tests: whether this function (1) serves public interests, (2) should or should not be performed by the government, (3) can be transferred to local governments, (4) can be outsourced or privatized, (5) whether and how the function can be rationalized, (6) whether the government can afford to pursue this function. Results of these tests must be consolidated in a meaningful and informative way. Such "audit" of functions and programs should help to identify functions or programs that do not service public interests and to detect areas of overlapping responsibilities.

Based on the results of the functional review, the government should prepare a detailed plan of reorganization of the public sector in Ukraine. Consolidation or reduction in the number of agencies, privatization, outsourcing, partnership with the private sector, and decentralization should be considered as principal

options to boost public sector efficiency, reduce costs and improve the quality of public services delivery. All necessary regulatory procedures and laws should be properly developed and enforced to make these options feasible at all levels of the government.

Improve efficiency of the public sector (operational review)

The government has to review the **modus operandi** of each public institution and prepare recommendations on streamlining their operational systems. This review seeks to clarify the roles, responsibilities and accountability of all line ministries and agencies as well as senior public servants.

The accountability of public services delivery must be considerably strengthened. The government should develop and enforce modern quality standards and ethical codes while all parties involved in service delivery must adhere to these rules. Furthermore, user charges for public services must be transparently set on a competitive basis rather than heavily regulated by the state.

Better access for consumers to public services may be achieved through the modernization of public infrastructure, simplification of service delivery, integration of service delivery channels into one-stop centers and paperwork and red tape reduction. The coverage and quality of service delivery processes may be improved by employing capacities of IT-government and other alternative means.

It is necessary to ensure that privatization, outsourcing and partnership with the private sector are organized through strictly **competitive procurement procedures**. The government must adopt a transparent and unbiased approach to the selection of private contractors and place efficiency and quality considerations at the top of its list of requirements.

A good balance should be maintained between centralized control over the utilization of budget funds and openness of the public sector to private contractors. **Effective cooperation with the private sector** relies on the flexibility of all levels of the government to select private partners and negotiate contract terms. Therefore, the government should alleviate the excessive bureaucratic burden on state procurement procedures as well as expand the mandate of local authorities to engage private contractors in public services delivery.

Reform Civil Service

A key part of the reform should be the reduction in the number of civil servants while increasing the salaries of the remaining staff. As higher remunerations and better security of civil service employment do not necessarily improve efficiency, these measures should be accompanied by an upgrade in the quality of human resource management, including induction of merit-based hiring procedures, performance-based payment and promotion, enforcement of codes of ethics and strengthening responsibility and accountability. Also, it is desirable to delegate more authority/power to middle level managers to empower them to act effectively. There is also a need to introduce effective training programs in order to increase civil servants' qualifications to EU standards.

Advance with decentralization reform

Decentralization should become a policy vehicle to expand the capacity of local governments to implement policy measures, effectively targeting issues specific to local communities. Deadweight losses incurred through lengthy bureaucratic approval procedures and administration of cumbersome inter-governmental communication must be minimized. As a result, higher flexibility of local governments to implement local policy initiatives will improve the wellbeing of local communities and enhance the quality of public services delivery, as well as will reduce the locals' discontent with the central government authorizes. This will also diminish the risk of a particular region with population differing by linguistic, religious or other identity to break up.

Successful decentralization assumes a transfer of vital public services to the lower levels of government. The principle rationale behind this transfer is superior knowledge and competence of sub-national governments to utilize local public resources optimally when addressing the needs of final consumers of public services. A thorough identification of functions that can be performed by sub-national governments is a necessary prerequisite at this stage of the reform. It is critical to evaluate whether local governments have sufficient policy-making and implementation expertise as well as strong revenue capacity to execute and finance transferred and assigned functions.

A transfer of economically feasible functions to sub-national governments will improve cost recovery as the inclination of users to pay for public services increases when services are managed closest to final consumers. This is particularly the case for the most basic services, such as water, sanitation, education and healthcare. Thus, it is fundamental to build a strong culture of users being charged for public facilities and utilities at the local level. For this reason, local authorities must be equipped with fair and market-based mechanisms of tariff-setting for local public services. If local consumers are uncertain about quality and costs of such services, sub-national governments will fail to promote a customer-friendly image and gain the trust of local users.

Vertical fiscal imbalances, which arise when local governments lack the resources to finance social programs that have been assigned to them by the central government, or which they have adopted for themselves under the local legislation, should be fixed.

The central government should implement policy measures that improve nation-wide tax compliance and expand the tax base at the local level. Furthermore, full cost recovery of public services delivered by local governments must be supported.