*Chapter 3*

# Managing compensation in a post "New Public Management" era

*Rather than simply downsize, governments now must determine appropriate salary levels and performance expectations for all jobs affected by their restructuring efforts – and that will require adequate HR staff capacity. Policies that base salary increases on seniority or job tenure send a clear message that downplays the importance of employee performance. Salary banding introduces a dramatically different way of managing employees, since their pay does not depend on their job description – and that can enhance recognition of their worth. There have been difficulties introducing performance-related pay, the success of which depends on managers' commitment and a review process to ensure fairness. Executive salaries and bonuses are a hugely contentious issue, but it should be recognised that government executive jobs are simply not comparable to executive jobs in the private sector. There have been advances in gender equality in the world of work, but the gender pay gap persists.*

## Introduction

The current economic and financial crises have, as previous chapters have shown, unveiled financial, governance and public administration challenges. They represent a challenge to the way public sector bodies are organised and managed. Rethinking paradigms, managerial styles and approaches that until now seemed a solid and consolidated agenda is a priority for governments. Approaches such as the New Public Management (NPM) are now being challenged in a number of OECD countries (OECD, 2010). Some demands made of public servants over the past four years in state direction of the private economy  have gone against NPM ideas like organising industrial bailouts and operating industrial policies of the kind scarcely seen since the 1970s (Lodge and Hood, 2012, pp. 79-101).

### Box 3.1. **New Public Management**

The ideas of New Public Management (NPM) have been described in many reports and publications, with certain variations. NPM is a shorthand name for describing or referring to a set of broadly similar administrative reforms that have dominated the bureaucratic reform agenda in many OECD member and non-member countries since late 1970s. NPM intended to make the public sector less distinguishable as a unit from the private sector in personnel, reward, structure and methods of doing business; and reducing the extent to which discretionary power, particularly over staff, contracts and money, was limited by uniform and general rules of procedure (Dunleavy and Hood, 1994). NPM implied the development of an international agenda focused on general issues of public management, policy design, decision styles and international co-operation (Hood: 1991). NPM can be understood, according to Dunleavy and Hood (1994), as a shift that consists of:

- reworking budgets to be transparent in accounting terms, with costs attributed to outputs not inputs, and outputs measured by quantitative performance indicators
- viewing organisations as a chain of low-trust principal/agent relationships, a network of contracts linking incentives to performance
- disaggregating separable functions into quasi-contractual or quasi-market forms, particularly by introducing purchaser/provider distinctions and replacing previously unified functional planning and provision structures
- opening up the provider to competition between agencies – or between public agencies, firms and not-for-profit bodies

Box 3.1. **New Public Management** (*cont.*)

- deconcentrating provider roles to the minimum feasibly sized agency, allowing users more scope to exit from one provider to another

OECD (2010) reports have described the core of NPM as: i) the separation of execution from policy development; ii) more autonomy for line managers in operational management, in both policy development and policy execution; iii) steering and control of executive agencies on the basis of measured outputs; iv) budgeting on the basis of measured output (performance budgeting); and iv) outsourcing of intermediate production to the market.

*Source*: Dunleavy, P. and C. Hood (1994), "From Old Public Administration to New Public Management", *Public Money and Management*, Routledge, Vol. 14, No. 3, July-September. pp. 3-19.

NPM was not without its critics, and its ideas are now being questioned by the current crisis. For example, some commentators (Doing and Wilson, 1998) argued that NPM affected how public managers perceive their roles, functions and future. Although offering high salaries to recruit and retain staff, particularly managers and professionals coming from the private sector, as well as the use of performance-related payments, has been known in the public sector, the adoption of private sector management practices increased the focus on reward for individual initiative and responsibility, without simultaneously integrating and monitoring the public interest perspective. Moreover, OECD (2010) found that in the era of New Public Management, the political desire for downsizing operations led to increased tensions with the civil service, which viewed the new approach as a shield against any political intrusion on its domain.

In the light of that background, this chapter discusses the need to change compensation management in order to adapt to a fast-moving context. It explores different instruments and practices for doing so, and stresses the importance of rewarding senior managers and bridging the gap in gender pay.

## The need for change in compensation management

After two decades of changes associated with what is or was New Public Management, the fiscal crisis is forcing new, more rapid changes.

Corporations can manoeuvre more easily through waves of change because they have a single purpose – to survive and remain successful. In a corporate crisis everyone understands that purpose, and knows the worst-case alternative is bankruptcy. In contrast, government has numerous stakeholders who often disagree. Moreover, shifts in the political climate often push agencies in a new direction.

The contentious 2011 debate in the US Congress over how to "solve" the debt crisis is an example – followed closely by world media – of how scenarios can change rapidly in a political environment. Now US federal employees are working in an environment of uncertainty, as the impact of the budget cuts is assessed and agency leaders decide how to function within the constraint of a reduced spending. An unknown number of employees will lose their jobs. Reporting relationships and job responsibilities will change. It has been reported that morale and performance have already begun to deteriorate.

The restructuring of government can take an endless array of forms – breakups of centralised agencies, shared services, downsizing, outsourcing, delayering, centres of excellence, etc. Over the past 20 years the changes have come in waves (OECD, 2011a).

A common thread that runs through each restructuring initiative is the intent to reduce staff and payroll. A related thread, although often not acknowledged in the literature, is the need to determine appropriate salaries for all affected jobs in the new organisation structure. A third common thread following a reorganisation is the need to define performance expectations for each of the jobs. With a traditional government pay programme there needs to be a paper trail documenting the changes, along with any reclassification actions and pay adjustments. The experience of reform in the United Kingdom, for example (see Box 2.1 in Chapter 2), shows the importance of adhering to principles for reform. Those send on the message of what direction the reform is taking and government's priorities on compensation policy.

The administrative work prompted by a restructuring can be substantial. With the downsizing of HR staffs and the possible increased workload on employees related to layoffs and retirements, it may be that HR staff capacity is already stretched for conducting reforms to the compensation system. An additional consideration is that the changes, as mentioned in the previous chapter, will be a source of anxiety and possibly trigger resistance that complicates the effort.

The restructuring of government began with the New Public Management (NPM) in the early 1990s. National governments followed the lead of the business world and began to reconsider the way they organised and managed work processes. It was also in this period that re-engineering gained popularity, along with the idea that front-line workers could often develop better answers to problems than the "experts". NPM encompassed a patchwork of changes focused on efficiency, delegation, measurement and results. NPM may be challenged but those concerns are more important today. The linkage of pay to results was another of the ideas that gained acceptance in this era.

## The use of pay bands to manage salaries

A story from 1980 is perhaps more relevant to agencies struggling with downsizing and the need for significant restructuring. The US Navy decided to merge the staffs of two research laboratories near San Diego, California to form a larger facility now known as China Lake. The Commanding Officer (CO) was told by his Human Resource office that they would need up to two years to reclassify all the jobs. He told them that this was unacceptable, and that they had to develop a better answer. Fortunately this was shortly after the passage of a law allowing federal agencies to "experiment" with new approaches to compensation management.

The HR office proposed what was then a radical alternative, the idea that salaries could be managed within "broad bands" or "salary bands". The concept is a variation on the widely used model for managing university faculty salaries (with "bands" for professors, assistant professors, etc.) A decade later the idea gained rapid acceptance in the business world when it was adopted by General Electric and IBM, and it is now an accepted alternative to the traditional model. As for the research labs, it gave them the flexibility to be more competitive for engineers and scientists in a tight labour market. Since it dramatically changes the traditional approach to job classification, it eliminates delays such as those that triggered the CO's resistance.

Traditional pay programmes were planned for highly centralised organisations; regulations governed virtually every situation. Every employee knew what to expect, often years into the future. Managers had little ability to control or influence pay decisions, unless of course they "gamed" the system. That possibility was always a concern.

Clearly then, a traditional pay programme can be an impediment to change. The regulatory requirements tend to be restrictive and controlling. The opportunities for innovative answers to new problems are severely constrained. And each administrative action can take weeks or months and require everyone involved to invest hours working to secure the satisfactory resolution of a problem. For a massive restructuring the time spent is difficult to justify.

The environment in which agencies operate is also changing, prompting shifting priorities and fresh problems. The public is becoming more demanding. The media are exposing government operations to more intensive scrutiny. Efficiency is a continuously heard mantra. Perhaps most importantly, the response time expected when new problems emerge is dramatically reduced. The (obvious) fact is that increased attention is being paid to the functioning of government.

Box 3.2. **An alternative programme model: Salary banding**

The new programme model, originally referred to as “broad banding”, is in many respects a radical alternative to the traditional salary structure or schedule, composed of overlapping grades and ranges. The idea was first adopted for a research laboratory, where a high percentage of the employees had graduate degrees and were thus familiar with the management of university faculty salaries. (At universities, each “rank” – Instructor, Assistant Professor, Associate Professor and Professor – has a separate “salary band” with associated benefits and employment rights.)

Banded salary programmes tend to be designed uniquely for each employer. For management jobs there is typically a separate band for each management level (*e.g.* all directors are in the same band). For lower-level employees the bands are generally defined around the stages or levels in career ladders. Research has shown that the typical career ladder has three levels – entry or trainee, developmental, and full performance. In some situations professional occupations have a fourth – expert.

The primary advantage of banding is that it dramatically reduces the time and resources necessary for classifying jobs to grade levels. All time spent by managers and employees on a reclassification request can now be used productively.

Banding is also different in that the focus is on the employee and his or her progress in developing important job skills: that is the basis for moving to higher bands. Notably, it introduces a dramatically different way of managing employees since their pay does not depend on their job description. They can be asked to tackle new problems and otherwise empowered to make better use of their capabilities. Employees generally like the change, because the philosophy supports their development.

A further advantage is that the transition from a conventional salary structure, with multiple grades, is less disruptive since the assignment to bands is normally straightforward.

Ultimately, performance-related pay has to be the basis for salary progression. It would make no sense to rely on step increases – the number of steps would be too high. In the private sector the high and low salaries are often not communicated as a maximum or minimum, since that suggests employees can expect to reach the highest salary. Experience suggests that managers and employees need to be heavily involved in developing the policies governing salary adjustments.

Box 3.2. **An alternative programme model: Salary banding** (*cont.*)

Employers have experienced problems when salaries are allowed to rise too far above market levels; managing salaries requires a disciplined approach. Problems can also arise if employees become dissatisfied by the small number of band-to-band promotions. For that reason some employers recognise changes within a job band as "small" promotions, with reduced pay adjustments, and changes from one band to another as "large" promotions. One of the key issues in the use of salary banding to ensure its adequate functioning is a commitment to revisit the programme annually and address any problems that surface.

*Source:* Risher, H. (2007), "Second-Generation Banded Salary Systems", WorldatWork Journal. Vol.16, No. 1, pp. 20-28 Delegating the responsibility for compensation management.

With a classic government or corporate compensation programme, control of all decisions related to funding is centralised. Salary increases are negotiated in a single agreement in 19 OECD countries. In four other member countries increases are based on the recommendation of the president/prime minister. National decision making remains the dominant practice.

In three OECD countries – Greece, Iceland and Japan – advisory bodies, usually independently of the government, make annual recommendations on necessary adjustments to base salary (see Annex 2 for more information). The United Kingdom and the United States employ variations of this approach. In the United States the increases under the General Schedule (GS) pay system are centrally determined for employees working in 35 of the larger metropolitan areas.[1]

An alternative and certainly more controversial approach is delegation of responsibility for compensation management from the central office to agencies. In ten countries, negotiations at the central office determine the budget for increases but allow adjustments by department/sector. Decentralised bargaining of some kind is allowed in 13 other countries. The logic is that agency leaders are in the best position to decide what pay adjustments are warranted and what the agency can afford.

Delegation of responsibility for programme management is one of the ideas that gained acceptance in the NPM era. As it relates to compensation management, it can encompass a range of policies and practices. Delegated responsibility can be extended to local offices, which is the common approach of private sector employers. Under a typical company policy, each manager is allocated a pro rata percentage of the payroll under his or her control, and is responsible for determining individual increases within the budget. The common control mechanism is an annually reviewed salary increase policy that specifies the percentage increase permitted at each performance rating level. Managers are required to determine increases within the budget that are consistent with policy.

As a rule, in a delegated environment there are policies that dictate how salaries are to be managed. Performance is the dominant factor, but the need for separate salary policies for selected occupations where performance, although important, is not the determining factor for pay increases – such as police and teachers - is another possibility. In the 1990s, as another example, the high demand for technology specialists prompted employers to grant increases two or more times in a year as well as to establish separate salary programmes.

A number of countries have moved in this direction, part of a broader strategy to make managers accountable for their work group. It follows that they cannot be held accountable if they are denied the control of day-to-day decisions. The degree of delegation varies from country to country and no doubt varies significantly within countries, since it can only happen if permitted by senior agency officials.

There are a number of employee-related decisions that are best delegated to front-line supervisors. In any case, delegation of pay decisions needs to be considered within a framework of controls intended to limit "mistakes".

At the extreme, employees are "empowered" and expected to function autonomously. The phrase "autonomous work teams", now self-managed teams, surfaced almost 40 years ago in Sweden. Employees rarely work autonomously, but in many situations supervisors see their staff only occasionally. Close supervision is often impossible. Managers "supervise" by monitoring results data generated by performance measurement systems. In these situations customers and clients are in the best position to provide feedback on the employee's performance.

Figure 3.1 shows that many OECD member countries have delegated managerial discretion on certain issues to ministries and agencies, allowing them more flexibility regarding staffing levels, recruitment, and some working conditions. Performance-related pay and performance appraisal systems have also been delegated to ministries and agencies in several countries, although overall responsibility for determining salary increase budgets remains centralised in a majority of countries. The imperative of cost control and the institutional structure of collective bargaining in member countries may partly explain these trends.

## Box 3.3. **The delegation of human resource management responsibilities**

### Why delegate?

Public managers are expected to improve the performance of their organisations and the outcome of their activities, and have to work with their staff to encourage, enable and support them in a continuous quest for quality, efficiency, productivity and propriety.

The traditional models for managing human resources in public administrations are the products of societies and dominant management paradigms that are more than a century old. They were designed for the exercise of public administrations in societies emerging from pre-democratic stages, and used centrally determined structures and procedures as a way to ensure a correct and equitable application of laws and regulations. They were also heavily influenced by hierarchical command-and-control models.

During the past decades, governments of OECD member countries wanting to strengthen the performance orientation of their public administration have found that these models hamper their efforts and make the development of new models for the provision of public services difficult. They have also come to realise that good management is essential for both improved performance and efficiency and for improved services to the citizen.

### What can be delegated?

The key motive for delegation is the need to empower public managers and enable them to adapt their human resource systems to the business needs of their organisations. Both the speed and extent of the reforms vary across countries due to differences in political, cultural and historical context. It is however possible to identify a number of functions that have been delegated in several OECD countries such as: arrangements for recruitment, certain pay decisions, and the handling of special performance-related pay elements.

All organisations must be able to motivate their employees. That includes an ability to reward them for good performances and behaviour, and to sanction misconduct and unsatisfactory behaviour. This can be done in many different ways, but some degree of delegated control over monetary rewards is probably indispensable.

### What are the challenges?

Delegation of authority is almost never uncontroversial or uncomplicated. The exact nature of the challenges depends (once again) however on the cultural, political and historical context. There are nonetheless a number of recurring challenges for which governments have to be prepared.

Box 3.3. **The delegation of human resource management responsibilities** (*cont.*)

One of these challenges is simply change itself. Many stakeholders – senior management, employees, trade unions – have adapted to the existing structure and may resist change. Some countries, including Ireland and the Scandinavian countries, have therefore opted for gradual changes supported by an appropriate social dialogue. Other countries, for instance Australia and New Zealand, have instead opted for cohesive reforms where the stakeholders can assess the outcome of the entire process.

Delegation entails a major cultural change. Stakeholders need to be convinced that modernisation of human resource management is both necessary and beneficial. Equally important, they need to be convinced that propriety and the public service ethos can be maintained even after the delegation of human resource management.

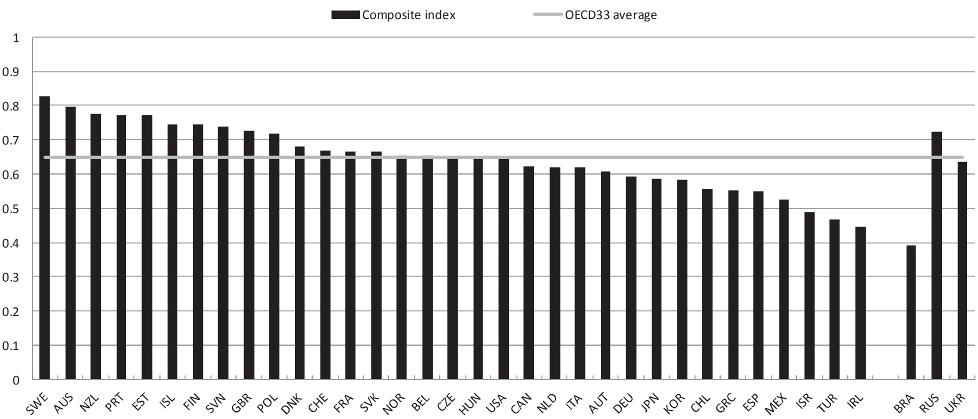
Another challenge is the need to develop and maintain sufficient managerial capacity and competence in the organisations that are authorised to handle their own human resources. The existing public managers normally lack training and experience in HR management, and the sub-central organisations normally lack professional human resource management units.

*Source:* OECD (2008), *The State of the Public Service*, OECD Publishing, Paris, DOI: 10.1787/9789264047990-en.

A common problem is that high-level leaders are reluctant to "let go". Delegated authority and responsibility represents a redefinition of the traditional role of front-line managers and necessitates a different management style. Training is essential but more importantly, managers need to be motivated to change their behaviour. The desired behaviours need to be reflected in the evaluation of their performance, and the best performer in this new role rewarded. They need to understand that their success as managers rides on their effectiveness in managing staff.

Management of compensation programmes involves two periodic decisions: i) the structure or schedule adjustments deemed necessary, and ii) individual employee decisions governing salary levels. The levels are initially specified when an employee is hired or promoted, and then adjusted annually. Managers can play a role in all employee decisions.

Figure 3.1. **Extent of delegation of human resource management practices to line ministries in central government (2010)**




*Note:* Data for Luxembourg are not available. The index is composed of the following variables: the existence of a central HRM body; the role of line ministries in determining the number and types of posts within organisations; the allocation of the budget envelope between payroll and other expenses; staff compensation levels; position classification, recruitment and dismissals; and conditions of employment.

*Source:* 2010 OECD Survey on Strategic Human Resource Management in Central /Federal Governments. Published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

Private sector employers delegate the responsibility for making those decisions, but limit a manager's discretion. The budget for increases is one control; another is the salary increase policy, which specifies the allowable increase at each performance rating level. That is to say, for example, that all employees rated as a "4" might receive the same percentage increase. Salaries are also controlled relative to prevailing market levels. In addition, many companies routinely monitor salaries for evidence of bias.

Government managers will initially require a basic education in salary management. They need "tools" to master this new role, such as easily accessible "just-in-time" e-learning modules to help address situations that arise (e.g. handling a poor performer). Employers are also now using technology to provide managers with information on market trends as well as pay levels for related jobs within the organisation. Technology also makes it possible for the HR staff to monitor salary adjustments for consistency with policy, and evidence of discrimination.

A basic concern is continued adherence to stated policies across government operations. For example, a core issue in the policy of virtually every country is that employees with similar if not identical jobs should be paid the same. That carries over to the relative importance of individual credentials (e.g. education and experience) as well as performance. In a delegated environment it can be very difficult to maintain consistency.

A new practice to minimise the problems related to inconsistency is the use of "calibration committees", composed of peer-level managers. These groups review performance plans at the beginning of the year as well as year-end ratings and recommended salary increases. Their purpose is to identify inflated or unjustified ratings, and possible cases of discrimination. If they have questions, they ask the rating manager to meet with them and justify the rating and/or proposed increase. The process increases the level of honesty and consistency, and provides assurance to employees that they will be treated fairly.

Another practice is the creation of small teams of high performers selected from the major job families, who are asked to identify the performance measures and competencies associated with successful job performance. The phrase "subject matter experts" (or SMEs) is often used to refer to individuals who are asked to address occupational issues. Use of SMEs reinforces the use of consistent measures and competencies for employees in the same occupations. It also focuses on contemporary issues that facilitate discussions between managers and their staff.

Those practices cannot prevent all problems, however. Public employers should consider the full range of controls and monitoring practices developed by the private sector. It is essential in delegating programme management responsibility that employees have reason to believe they will be treated fairly. An important step is the commitment to review the experience each year. That should include meetings with managers and employees, followed by well-publicised actions to address problems. Most important, however, is the commitment to move ineffective managers back to non-supervisory roles.

## The highest hurdle – transitioning successfully to performance-related pay

If there is one trend that dominates the literature on the management of pay in public organisations, it is performance-related pay.

The OECD (2005) notes that, "Two-thirds of OECD member countries have implemented PRP [performance-related pay] or are in the process of doing so. However, there are wide variations in the degree to which PRP is actually applied throughout an entire civil service" (OECD, 2005). The practice ranges from a centralised approach in Luxembourg to policies delegating its management to "departments, agencies or work units" in Australia, New Zealand, Sweden and the United Kingdom. More recent reports show performance is an important factor in determining salaries in Chile, Finland, Germany, Norway, Portugal, Slovenia and Ukraine.

OECD reports show that the delegation of human resources and budgetary management is related to the introduction of performance-related pay. The countries "which have developed the strongest links between performance appraisals and pay are the countries which retain the highest delegation in human resources and budgetary management. Countries with a rather low degree of delegation tend to focus on promotion to motivate staff and introduce the remuneration incentive only for specific categories or for those at management level."

Performance assessment and the linkage to staff rewards remains a challenging issue in many OECD countries. Performance incentives include career opportunities (such as promotions) and pay. Performance-related pay (PRP) in the form of bonuses or merit increases to basic pay has been used more frequently in recent years. PRP can vary in terms of the range of staff positions to which it applies; whether the targets and the incentives apply to individuals or to groups; the extent to which rankings are used; and the size of awards. There is relatively small variance among countries reporting the use of performance-related pay, with the United Kingdom, Switzerland and the Czech Republic applying PRP more extensively than other countries and New Zealand, Austria and the Netherlands applying it the least (Figure 3.2). Six OECD countries (Belgium, Greece, Iceland, Mexico, Poland and Turkey) report not using performance-related pay at all.

Table 3.1. **Factors that determine base salary at different hierarchical levels**

**Top management**

| | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience |
|---|---|---|---|---|---|---|---|
| Australia | ○ | | | | ○ | | |
| Austria | ○ | ● | ○ | ○ | ○ | | ○ |
| Belgium | | ● | ○ | ○ | ○ | ○ | ● |
| Canada | ○ | ● | ○ | | ○ | | |
| Czech Republic | ● | ● | ● | | | | |
| Denmark | | ● | | | ○ | | |
| Estonia | | ● | | | ○ | | |
| Finland | ○ | ● | ○ | | ○ | ○ | |
| France | ● | ● | ○ | | | | |
| Germany | ● | | ○ | ● | ○ | ○ | ● |
| Hungary | ○ | | ○ | | ○ | ○ | ○ |

**Middle management**

| | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience |
|---|---|---|---|---|---|---|---|
| Australia | ○ | ● | ○ | | ○ | | |
| Austria | ● | ● | ○ | ○ | ○ | ● | ○ |
| Belgium | ● | ● | | ○ | ○ | | |
| Canada | | ● | ○ | | ○ | | |
| Czech Republic | ● | ● | ● | | | | |
| Denmark | | ● | | | ○ | | |
| Estonia | | ● | | | ○ | | |
| Finland | ○ | ● | ○ | ● | ○ | ○ | |
| France | ● | | | | | | |
| Germany | ● | | ○ | ● | ○ | ○ | ● |
| Hungary | ○ | | ○ | | ● | | ○ |

**Professionals**

| | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience |
|---|---|---|---|---|---|---|---|
| Australia | ○ | ● | ○ | | ○ | | |
| Austria | | ● | ○ | ○ | ○ | ● | |
| Belgium | ● | ● | | ○ | ○ | | |
| Canada | ● | ● | ○ | | ○ | | |
| Czech Republic | ● | ● | ● | | | | |
| Denmark | ● | ● | ○ | | ○ | | |
| Estonia | ● | ● | | | ○ | | |
| Finland | | ● | ○ | ● | ○ | ○ | |
| France | ● | | | | ○ | | |
| Germany | ● | | ○ | ● | ○ | | ● |
| Hungary | ● | | ○ | | ● | | ○ |

**Secretarial level**

| | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience |
|---|---|---|---|---|---|---|---|
| Australia | ○ | | ○ | | ○ | | |
| Austria | ● | ● | ○ | ○ | ○ | ● | ○ |
| Belgium | | | ○ | ○ | ○ | ○ | |
| Canada | ○ | | ○ | | ○ | | |
| Czech Republic | | | | | | | |
| Denmark | ● | ● | ○ | | ○ | | |
| Estonia | | | | | ○ | | |
| Finland | | ● | ○ | ● | ○ | ○ | |
| France | | | | | ○ | | |
| Germany | | | ○ | ● | ○ | | ● |
| Hungary | ● | ○ | ○ | ○ | ● | ○ | ○ |

**Technical support**

| | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience |
|---|---|---|---|---|---|---|---|
| Australia | ○ | ○ | ○ | ○ | ○ | ○ | ○ |
| Austria | ● | ● | ○ | ○ | ○ | ● | |
| Belgium | | | | ○ | ○ | ○ | |
| Canada | ○ | | ○ | | ○ | | |
| Czech Republic | ○ | | | | | | |
| Denmark | ● | ● | ○ | | ○ | | |
| Estonia | ● | | | | ○ | ○ | ● |
| Finland | | ● | ○ | ● | ○ | ○ | |
| France | | | | | ○ | | |
| Germany | | | ○ | ● | ○ | | ● |
| Hungary | ● | ○ | ○ | ○ | ● | ○ | ○ |

● Of key importance  . Somewhat important  ○ Not at all important

Table 3.1. **Factors that determine base salary at different hierarchical levels** (*cont.*)

| | Top management | | | | | | | Middle management | | | | | | | Professionals | | | | | | | Secretarial level | | | | | | | Technical support | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience |
| Iceland | | ● | | ○ | ○ | | | | ● | | | | | | ● | ● | | | ○ | | | | | | | ○ | ○ | | | | | | ○ | | |
| Ireland | ● | ● | | | ○ | | ● | | ● | ○ | | ○ | | ● | ● | ● | ○ | | ○ | | ● | | ● | ○ | | ○ | ○ | | | ○ | ○ | | ○ | | ● |
| Israel | ● | ○ | ○ | | ○ | | ○ | ● | ○ | | ○ | ○ | ● | | ● | | | ○ | ○ | | | | ● | | ○ | ○ | ● | | ● | | | | ○ | ● | ● |
| Italy | ● | | | | ○ | ○ | ○ | ● | ● | ○ | | ○ | ○ | ○ | ● | | ○ | | ○ | ○ | ○ | | ○ | ○ | | ○ | ○ | ○ | | ○ | ○ | | ○ | ○ | ○ |
| Korea | ○ | ○ | ○ | | ○ | ● | ○ | ○ | ○ | ○ | | ○ | ● | ○ | ○ | ○ | ○ | | ○ | ● | ○ | ○ | ○ | ○ | | ○ | ● | ○ | ○ | | ○ | ○ | ○ | ○ | |
| Mexico | ● | ● | | | | ○ | ● | ● | ● | | | | ○ | ● | ● | ● | | | | ○ | ● | ● | ● | | | | ○ | ● | ● | ● | | | | ● | ● |
| Netherlands | ○ | ● | ○ | ○ | ○ | ● | ● | ○ | ● | ○ | ○ | ○ | ● | ● | | ● | ○ | ○ | ○ | ● | | ○ | ● | ○ | ○ | ○ | ● | | | ● | ○ | ○ | ○ | ● | |
| New Zealand | | | ○ | | ○ | | ● | | | ○ | | ○ | | ● | ● | | ○ | | ○ | | ● | ○ | | ○ | | ○ | | ● | | | ○ | | ○ | | ● |
| Norway | | ● | | ● | ○ | ○ | ● | ● | ● | | | ○ | | | ● | ● | | ● | ○ | | | | | | | ○ | ● | | ● | ○ | | | ○ | ● | ● |
| Poland | ● | ● | ● | | ○ | | | ● | ● | ● | | ○ | | | ● | ● | ● | | ○ | | | | ● | ● | | ○ | | | ○ | ○ | ○ | ○ | ○ | ○ | ○ |
| Portugal | ● | ● | ○ | ○ | ○ | ○ | | ● | ● | ○ | ○ | ○ | ○ | | ● | ● | ○ | ● | ○ | ○ | | ● | ● | ○ | ● | ○ | ○ | | ● | ● | ○ | ● | ○ | ○ | |
| Slovak Republic | | | ○ | ○ | ○ | | | ● | ● | ○ | ○ | ○ | | | ● | ● | ○ | ○ | ○ | | | ● | ● | ○ | ○ | ○ | | | ● | ● | ○ | ○ | ○ | | |

● Of key importance  . Somewhat important  ○ Not at all important

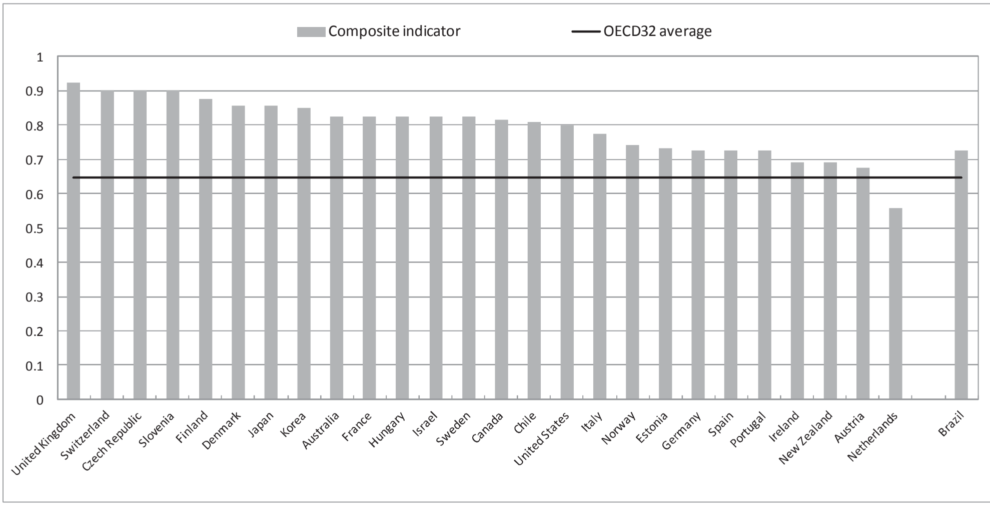
Table 3.1. **Factors that determine base salary at different hierarchical levels** (*cont.*)

| | Top management | | | | | | | Middle management | | | | | | | Professionals | | | | | | | Secretarial level | | | | | | | Technical support | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience | Educational qualification | Job content | Ministry | Performance | Age | Seniority in the position | Relevant experience |
| Slovenia | ○ | | ○ | ● | ○ | | ○ | ○ | ○ | ○ | ● | ○ | | | | ○ | ○ | ● | ○ | | | ● | | ○ | ● | ○ | | | ● | | ○ | ● | ○ | | |
| Spain | ● | ○ | ○ | ○ | | ○ | ○ | ● | ○ | ○ | ○ | | ○ | ○ | ● | ○ | ○ | ○ | | ○ | ○ | ● | ○ | ○ | ○ | | ○ | ○ | ● | ○ | ○ | ○ | | ○ | ○ |
| Sweden | | | | | ○ | | ● | | ● | | ● | ○ | ● | ● | | ● | ○ | ● | ○ | | ● | | | ○ | ● | ○ | ○ | | | ● | ○ | ● | ○ | ○ | ● |
| Switzerland | ○ | ● | | | ○ | | | ○ | ● | ○ | | ○ | | | ○ | ● | ○ | | ○ | | | ○ | ● | ○ | | ○ | | | ○ | ● | ○ | | ○ | | |
| Turkey | | | | | ○ | | | | | | | ○ | | | | | | | ○ | | | | | | | ○ | | | | | | | ○ | | |
| United Kingdom | | | ● | | | | ● | | | ● | | | | ● | | | ● | | | | ● | | | ● | | | | ● | | | ● | | | | ● |
| United states | | ● | ○ | | ○ | ○ | | ○ | ● | ○ | ○ | ○ | ● | | ○ | ● | ○ | ○ | ○ | ● | | ○ | ● | ○ | ○ | ○ | ● | | ○ | ● | ○ | ○ | ○ | ● | |
| Russian Federation | ○ | ● | ○ | ● | ○ | ● | ● | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ | ○ |
| Ukraine | ○ | ○ | ○ | ● | ● | ● | ○ | ○ | ○ | ○ | ● | ● | ● | ○ | ○ | ○ | ○ | ● | ● | ● | ○ | ○ | ○ | ○ | ● | ● | ● | ○ | ○ | ○ | ○ | ● | ● | ● | ○ |

● Of key importance  . Somewhat important  ○ Not at all important

Notes: No information available for Brazil, Chile, Greece or Japan.
*Source*: 2010 Survey on Strategic Human Resources Management in Central/Federal Governments of OECD Countries.

Figure 3.2. **Extent of use of performance-related pay in central government (2010)**




*Note:* The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law. Data for Luxembourg and the Slovak Republic are not available. The average for OECD countries includes the six countries that have reported not having a PRP system: Belgium, Greece, Iceland, Mexico, Poland and Turkey. In addition, Ukraine reported that it does not use PRP and is therefore not included in the index.

*Source*: 2010 OECD Survey on Strategic Human Resource Management in Central/Federal Governments, published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

It was reported that performance-related pay is seen "as a way of increasing flexibility in working practices and managerial discretion over pay and individual accountability. Other reasons … include increasing staff motivation, attracting more dynamic employees and facilitating managerial changes." A widely used phrase among consultants is that performance-related pay motivates employees "to work smarter, not harder" – but that assumes the increases are linked to the achievement of goals (OECD, 2005).

OECD reports also make the point that member countries "focus on incentives to promote good performance rather than on sanctions for bad performance". That is consistent with the typical philosophy in the private sector: it promotes a positive view of the policy. In contrast, past efforts to reduce pay levels and the argument voiced by government critics that performance-related pay should be adopted to deny increases to poor performers often feeds a negative, sceptical view of any change in the pay programme.

Although not discussed in other OECD reports, there is evidence that the adoption of performance pay by government is related to the importance of the policy in the private sector. In some regions it is virtually a universal business practice. Few if any employers in the private sector would choose a pay policy that guarantees annual increases. They also would not choose policies that link pay increases to indices, such as inflation rates, that are unrelated to their business goals. They may accept those policies as part of a labour agreement but their business preference would be a system that has the flexibility to recognise and reward those employees who are the most valuable to the company.

There are no surveys on the preference of government leaders, but scattered evidence suggests most would agree with the philosophy behind performance-related pay. No one in a leadership position, it seems, contends that rigid salary systems based on step increases are the best answer. Progress has been slow but as OECD reports document, there has been an ongoing transition at all levels of government over the past 20 years to performance pay policies in many OECD countries.

Setbacks have slowed the transition. Most notable among these recently was the 2010 termination by the US government of the National Security Personnel System (NSPS) authorised for the Department of Defense in 2004. A review of NSPS was completed at the request of the US Congress, and the conclusion was that the system and the performance pay policy should be modified but continued. Nonetheless, a decision was made by the political party then in control to terminate it. That system covered 226 000 workers and was in its 5th year of implementation.

The NSPS experience highlights several of the reasons performance pay policies can fail. The most obvious is that the policy needs vocal advocacy from top management; it cannot be seen as "another HR project". Second, it is impractical to mandate the use of the same performance systems and performance criteria over a diverse workforce. Third, employees need to know what to expect. NSPS relied on committees to decide increases in closed meetings. Training for managers is of course important, but far more important is their commitment to making the policy a success.

The NSPS experience also suggests that the prospects for success are higher when managers and employees play an active role in the planning and implementation. In this situation the Department of Defense held "town hall" meetings where employees heard presentations and could ask questions, but the new system and associated regulations were developed "behind closed doors". It was never publicly acknowledged but the unions believed the goal in planning NSPS was to reduce their influence.

Despite setbacks, the pressure continues to make the transition. In the United States for example, despite the NSPS termination, there have been repeated recommendations to end the now-60-year-old General Schedule (GS) salary system covering most white collar employees, and replace it with a market-sensitive, pay for performance system. The failure of NSPS did not deter those recommendations.

The OECD concluded in 2005 that:

- "The adoption of performance-related pay in the public sector reflects the influence of the private sector culture…"
- "Civil services have increasingly sought to manage service production tasks on similar lines to those in the private sector."
- "Many studies have concluded that the impact of PRP on performance is limited, and can in fact be negative."
- "It seems that, in the right managerial framework, the processes that accompany PRP have made such changes both possible and positive. When performance pay is introduced, there is a window of opportunity for wider management and organisational changes."

The wider management and organisational changes include: a revision of the appraisal and goal-setting processes, clarification of tasks, acquisition of skills, creation of improved employee-manager dialogue, more teamwork, and increased flexibility in work performance.

The point related to private sector culture is central and important to understand as background for planning the transition. Business leaders generally have a strong focus on building a successful company. Performance data are widely communicated and there is pressure to perform better than the prior month, year, etc. Performance measurement systems monitor, and the information they generate impacts, every aspect of the business. Often at the executive level, over half of the total compensation package depends on company financial results. Career success at all levels rides on performance. Every employee understands the need for continued profitability. Companies also benefit from the competition in their product/service markets. The desire to be successful is no doubt a core human desire.

In the typical company, day-to-day management of employee performance and the annual appraisal rating are part of a panoply of practices used to communicate performance results. Moreover, PRP makes identification and management of the "star" performers a priority. They are commonly recipients of incentive awards and, in some companies, stock ownership opportunities that dwarf the annual salary increase.

The work culture in public organisations can be very different. The pace is generally slower and it is not clear that employees have a similar commitment or understanding of the goals of their employer. There is less emphasis on identifying or rewarding high performers. The cultural focus on performance can be reinforced by adopting organisational performance management practices such as a Balanced Scorecard.

In both the public and private sectors the prospect of a salary increase is intended as an incentive, but it is impossible to isolate the impact of the policy from other practices influencing performance such as work/life balance, and training. It is not accurate to argue that the prospect’s impact is limited; it is more accurate to state that its true impact cannot be confirmed. At the very least, the policy sends the message that management considers employee performance to be important.

### Box 3.4. **United Kingdom: Lessons learned from the experience with performance-related pay – Hutton Review**

Today there is greater recognition of the subtleties of running performance pay in the public sector, allowing that the future could present a very different picture**.** It is noteworthy – though perhaps no coincidence – that opposition to performance pay has been softening, and that there is now a greater consensus on what works. For example:

- It is recognised that performance is better measured in terms of outcomes over time rather than against peers. For instance, the value added by a school is better gauged by tracking the performance of the same pupil over time rather than by "pitting" pupils against one another in comparisons. This acknowledges that each pupil has a different level of achievement and ability that reflects differences in parental investment, socioeconomic background and other personal characteristics – factors that are beyond the school's control.

- The pitfalls of strictly quantifiable measures are also increasingly understood, not least where they are used to rank every individual and organisation in painstaking attention to detail. It is recognised that positions on such ranks may jump around chaotically in response to the choice of performance measures. However, objective measures can be a powerful way of starting a conversation in which staff have to account for their performance and undergo more finely tuned judgemental assessments, including 360-degree and stakeholder reviews. Where necessary, there should be a move away from specific targets to the use of more general success criteria, such as benchmarks, milestones and directions of travel– which are harder to manipulate.

- There is an understanding that the performance appraisal process is the backbone of the whole system, without which pay decisions become arbitrary. A high priority should be attached to consultation with employees as well as to simple and regular communication, so that different goals are recognised and objectives are transparent. One study found that perceptions of pay fairness were a 25-times stronger predictor of employee commitment than pay satisfaction. It also found that overall pay fairness is influenced most strongly by pay process fairness.

Box 3.4. **United Kingdom: Lessons learned from the experience with performance-related pay – Hutton Review** (*cont.*)

- Where feasible, performance indicators should be based on alternative, independent and manipulation-proof information sources such as general household surveys and ratings. The distribution of rewards should be controlled and co-ordinated by independent committees. These tasks have been made easier by advances in technology that allow for the rapid collection and processing of information.

- It is clearer that rating systems should avoid forced rankings – relative assessments can do more harm than good and create divisiveness among employees. If it is necessary to use ranking systems, they should be used more to check the distribution than as a rigid quota.

- Finally, objectives should be relatively stable over time and to the extent possible be protected from political interference. Performance assessments should involve defining medium-term measures of success and placing considerable weight on them. In part this can be done by requiring that the choice of short-term performance measures correlate empirically and theoretically with positive long-term outcomes.

*Source*: United Kingdom Government (2011), "Hutton Review of Fair Pay in the Public Sector". HM Treasury, *www.hm-treasury.gov.uk/d/hutton_fairpay_review.pdf*.

At the same time, policies that base increases on seniority or job tenure send a clear message that downplays the importance of employee performance. Too often managers are inclined to ignore problem employees – it is a far easier strategy – and from everyone's perspective that should not be the case.

The public is also a stakeholder and in most countries, citizens are now expressing their concern about government, the quality of public service, and the accountability of leaders. Performance pay sends an important message to the public as well.

It is perhaps unreasonable, however, to expect the added compensation to be a powerful incentive. The difference in the annual increase, even with an aggressive performance pay policy, is not large. Prior to the recession a typical salary increase budget provided for average increases of 3-4% and possibly 6-8% for the best performers. With required withholding for taxes and benefit contributions, and the net take-home increase spread over a year, the difference is not going to change the employee's lifestyle in any important way.

However, performance-related pay is more than an annual increase. Consistently higher performers of course see, with compounding, faster growth in their salary level. Perhaps equally important, PRP is also a form of recognition; the ratings are or can be linked to other organisational rewards. This is consistent with widely understood psychological theories employed throughout all societies (that includes success in school, parenting, product marketing – the applications are many).

In an organisation there are many other ways to recognise and reward employee contributions. No other formal practice, however, is applicable to all employees. Informal reward practices are too often not used consistently across an organisation.

Cash bonuses and incentives are considered to be a more effective reward when well managed. The amounts are generally larger, the ties to results more explicit, and the potential differential between good and bad performance greater. The practice has never gained acceptance in government but is widely used in industry. Perhaps when performance metrics are more fully developed, cash awards will be accepted in the public sector, especially for executives.

### Box 3.5. **The potential value of group or team incentives**

Discussions of bonuses in previous OECD reports have focused on two key points: i) there is recognition that these plans can be more effective than the typical salary increase policy, but ii) they have rarely been adopted.

There is scattered evidence that group or team incentives have become increasingly important in the business world over the past two decades. The literature and the surveys tend to focus on larger companies, so the actual extent of use is unclear.

An element of the confusion is that the common executive and management incentive plan is in fact a group incentive. Those plans were first adopted with the economic expansion following World War II, as owner-managers were replaced by "professional managers". The early plans were effectively profit-sharing arrangements by which all executives shared in the payouts, and that philosophy is still a core consideration.

Corporations with stock traded on an exchange generally have an added group incentive in the form of stock options (or similar arrangements). With these plans, all participants benefit when the stock price appreciates.

### Box 3.5. **The potential value of group or team incentives** (*cont.*)

In combination, those plans -profit sharing & stock options- are generally far more powerful incentives than the prospect of a salary increase. In some corporations the plans have been extended down to senior professionals or below. The plans make it very clear: it is to everyone's benefit to make the company successful.

Profit-sharing arrangements in which *all* employees participate are also an alternative. These plans have declined in use in larger companies, as employers realise that relatively few employees can truly see how their work efforts contribute to company profitability. They are of course not feasible in government organisations.

The alternative, which clearly can be adopted by government employers, is now referred to as "goal-sharing plans". The message to participants is simple: "When we achieve our performance goals, everyone can expect a cash payout." There is no standard model for these plans, but they all reflect the same basic philosophy.

The predecessor concept was a "gain-sharing plan", conceived in the 1930s by a union leader, whereby payouts are based on improved performance over a base period. These plans are still mentioned in the literature, although it may be that the phrase is used but the plans have been changed. A problem is that the potential for improvement is limited and performance plateaus after a period, which means payouts decline.

Goal-sharing plans can be designed to fit any work group with measureable or verifiable group or team performance goals. The general recommendation is to focus on a few key indicators that in combination would be considered successful performance. In a hospital setting, for example, patient satisfaction is a frequently used measure.

Payouts typically start when performance reaches a threshold of 80% or 90% of the goal(s), and progressively increases to a planned payout for achieving the goal(s). With the typical plan the planned payout might be 5% of salary; at the threshold the payout might be 2.5% of base salary. Most of these plans reward participants for exceeding the goal, with maximum payouts of possibly 7.5% of salary. The argument is that the potential swing in the payout – in the illustration it can swing from 2.5% to 7.5% – provides the incentive (Risher, 2002).

The payouts are controlled by defined performance scales. The threshold performance notion is found in most corporate incentives, and reflects the reality that planned performance is never precise. Too often in government, payouts are strictly linked to actually achieving a goal or goals. There is no payout if the goal is not reached. And there is often no benefit in exceeding the goal. In a business, payouts typically continue to increase for performance above the threshold. That reflects the profit-sharing philosophy. The message is straightforward – "The better the team performs, the more everyone can expect to earn."

Box 3.5. **The potential value of group or team incentives** (*cont.*)

All participants typically share equally in the payout, usually as a percentage of salary. The percentage is often referred to as a "target" or "guideline" award and is the amount paid for meeting the goals.

There is an argument that employees could refrain from a full effort and essentially be "free riders", but they will usually feel the brunt of group pressure to perform. Experience suggests that employees like the sense that they are working as a team and do not want to "let the team down." That may be a more powerful incentive than the prospective cash payout.

Three problems need to be avoided. First, the group can be too large and too removed from the goals to feel a sense of commitment. Second, the performance goals can be too soft and subjective. When awards are subjective, it sometimes becomes difficult to deny payouts and that leads to a sense of entitlement. Perhaps most importantly, when all employees are not logically a member of a group and do not participate in a plan, it means their compensation is lower.

*Source*: Risher, H. (2002), "Improving Agency Performance Through Incentive Payouts" *The Public Manager*, Vol. 31, No, 4. Pp.23-27.

For government, performance-related pay requires a commitment to effective performance management along with a review process to provide the assurance that employees will be treated fairly and the policy managed consistently. There are solid success stories. In most cultures the best performers want to be recognised so the philosophy gains acceptance. Perhaps the most imposing barrier is that it represents a significant organisational change, and the implementation needs to be planned and managed as a change initiative.

One of the issues with delegation is the relevance of inter-agency comparisons of salaries for jobs at the same organisation level. The policy question relates to the fairness of disparate salaries for similar work. It can be argued that the same job, in terms of its content, might have a different "value" in different agencies. It also may be that the staffing strategy calls for highly qualified specialists and salaries are commensurate. However, explanations to justify the differentials may not be convincing.

Too often the Human Resource office is solely responsible for planning and implementing new pay policies. This fails to recognize that HR specialists have little involvement in the day-to-day management of employee performance – that of course is the responsibility of managers. For individualised pay to be truly accepted, it is important to have the "buy-in" of managers. It is correctly seen as a tool to help managers achieve performance goals.

The importance of buy-in cannot be overstated. The transition to performance-related pay is perhaps the most complex organisational change any employer can undertake. The following list of questions is intended to provide guidance and highlight key considerations. The list, however, is not intended as a roadmap, since each situation involves different dynamics. There is a proverbial train leaving the station and the goal is get everyone on board.

Box 3.6. **Issues to consider in moving to performance-related pay**

- How is the existing salary programme perceived by managers and supervisors? Employees? Elected officials? Union leaders? Other stakeholders? The public? Were their concerns documented?
- Have senior leaders made it clear that making the new system a success is an organisational priority? Have they agreed to act as "champions" of the new system?
- Is there a communications campaign to keep managers and employees aware of the plans for a new programme? Do employees know what to expect?
- Did the planning and implementation reflect adequate concern for transparency?
- Was there an effort to understand the "best practices" in other countries?
- Was the new programme negotiated? Were all labour organisations involved? Consulted?
- Were other stakeholders asked to provide feedback? Professional associations? Prominent critics of government?
- Were market data assembled and made available to negotiators (or the programme planners)?
- Were specific workforce concerns addressed in planning salary levels? Locality pay differentials? Occupational differentials? Mission-critical skills differentials?

Box 3.6. **Issues to consider in moving to performance-related pay** (*cont.*)

- Do managers and employees understand what factors will determine their salary? Internal job value? Career stage? Education? Experience? Performance? Competence?
- Are the logic and process for assigning jobs to grades (or bands) accepted?
- Were managers involved in planning the new programme? Would they agree it reflects their concerns?
- Are managers "ready" for their role in managing staff salaries? Has their training been adequate? Is refresher training included in the plan? Are managers rewarded for performance? Are employees asked to comment on their supervisor's skills?
- Were employees trained in the performance management process as well as in performance planning and measurement?
- Is the performance management system reliable? Are ratings viewed as "fair"? If rating inflation is seen as a problem, is there a strategy to bring ratings down to more credible levels?
- Has "Meets Expectations" (or satisfactory) performance been defined in terms understood by managers and employees? Do employees understand what they need to demonstrate to be rated as "Outstanding"? Has "Unacceptable" performance been defined using credible performance criteria?
- Is there a process to review ratings (beyond a "one-up") manager? Is the grievance process available to employees who are convinced their rating and/or salary increase is unfair?
- Does the plan create or continue a methodology to identify possible cases of discrimination?
- Does the plan provide for a regular review of programme effectiveness and agree to modify it as necessary to address recognised problems?

## The new importance of the market factor in retaining talent

Conceptually, individualised pay reflects an employee's performance along with the market expression of his or her value. The best-qualified and best performers can normally command a higher salary if they test the market. This is both an internal salary management issue as well as a market and salary survey issue.

Many private sector employers are now deciding to adopt policies to attract and retain better-qualified employees as part of their compensation strategy. That translates into paying above-average salaries. The typical policy identifies those occupations and jobs that are seen as keys to success, and selectively assigns the jobs to higher grades. Few employers can afford to pay all or most of their employees above market salaries.

A common assumption in interpreting market survey data is that worker qualifications and experience are reflected in the distribution of pay around the average. It is assumed that the better-qualified workers are paid higher in the distribution. Based on that assumption employers might, for example, decide to pay engineers at the 75$^{th}$ percentile level. That salary level is then the basis for assigning these jobs to a grade.

This logic can be adopted and used informally to manage individual salaries. Organisations that find they have a truly outstanding performer or someone who is believed to have that potential can simply pay them more. In current workforce planning jargon, these employees are referred to as "A Players". The concern of course is the need in a government organisation to be able to justify the decisions. An element of the justification is that the best-qualified are most likely to have job opportunities in the private sector.

## Compensating public managers effectively

One of the earliest of the executive pay programmes in government was the creation by the US Congress of the Senior Executive Service in 1978. The SES provides for performance-related salary increases along with bonus awards for the roughly 7 000 members of the SES. It is important to note that every few years there are proposals to revamp the programme; the most recent was in August 2011. This is to a large extent due to fact that 95% of employees covered by the SES are rated at the highest two levels. It is clearly not functioning as expected, although the problems have not been publicly stated.

The United Kingdom is experiencing similar concerns with its Senior Civil Service (SCS) system. Dating from 1994, it is not as old and the cadre of SCS executives is naturally smaller. Its handling of performance ratings is based on a forced distribution policy, with a limit of 25% in the highest rating and 5%-10% in the lowest of three rating levels.

But it also is not seen as effective. Soon after the new administration took office in May 2010, the government commissioned a study on SCS pay and pensions. The report, titled the "Hutton Review of Fair Pay in the Public Sector" (United Kingdom Government, 2011, and see Box 3.4), gives renewed emphasis to performance-related pay and concludes that public employers should be much better, in keeping with the importance of transparency, at communicating to the public the explanations for executive compensation practices.

It seems executive compensation is always contentious. Government executives earn far less than their counterparts in large companies, but their income is considerably higher than the average citizen. A common focus of critics is the use of bonuses to reward performance. The awards are smaller than those common in industry, but still appear large to the public.

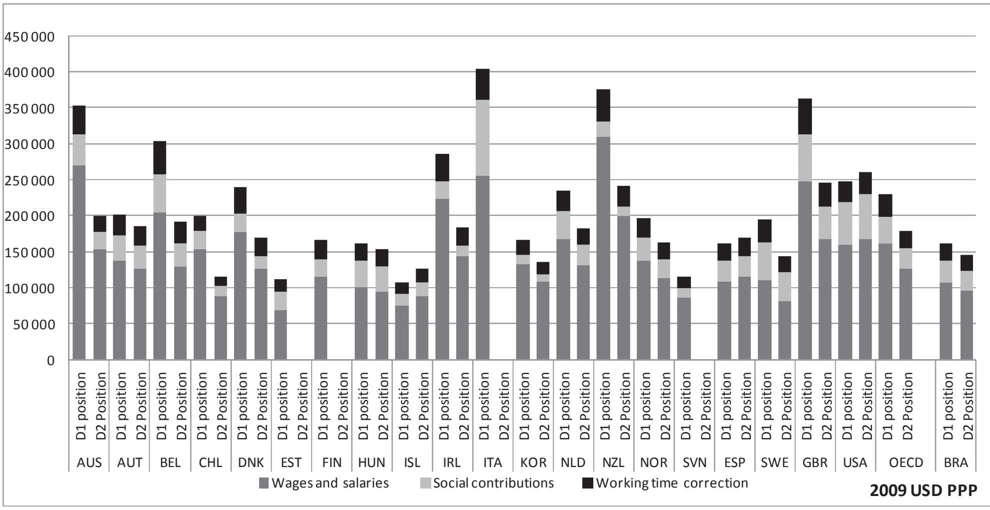
Figure 3.3 suggests that the yearly compensation of senior managers (excluding political levels) varies significantly across countries and between D1 (top public servants below the minister or secretary of state) and D2 (usually just below D1) levels. On average, in countries responding to the OECD 2010 Compensation of Employees in Central/Federal Governments Survey, D1-level senior managers' total compensation amounts to just under USD 235 000 PPP (fully adjusted for employers' social contribution and holidays), and to about USD 165 000 PPP in wages and salaries. D2-level managers' total compensation nearly reaches USD 185 000 PPP (fully adjusted for social contributions and holidays), and to USD 130 000 PPP in wages and salaries in the same year.

Due to their smaller numbers, the total compensation costs of senior management are relatively small in the context of total government spending. Their levels of compensation are nevertheless considered crucial for attracting and keeping talent for positions involving high levels of responsibility in government. Compensation for these positions has important symbolic value, as they are usually at the top salary scales and involve staff whose appointment tends to be more discretionary.

A basic problem is that the customary analyses based on so-called benchmark jobs and surveys of current pay levels are not feasible. Government executive jobs are simply not comparable to those in industry. Different strategies have been tried and rejected. The Hutton Review sets forth a new idea, tying executive pay by fixed ratios to the pay of non-executive civil servants.

Figure 3.3. **Average annual compensation of central government senior managers, 2009**

Adjusted for differences in holidays




*Note:* Data for the Czech Republic, France, Germany, Greece, Israel, Japan, Luxembourg, Mexico, Poland, Portugal, the Slovak Republic, Switzerland and Turkey are missing. Canada withdrew its data. Compensation data for D2 positions are missing or mixed with D1 positions in Estonia, Finland, Italy and Slovenia. Austria: Value is median rather than average. Brazil: Source of social contribution: IBGE; source of PPP: World Bank. Data include career salary + 60% of *Direção e Assessoramento Superiores* (a sort of senior civil service) Chile: Data exclude bonus for critical functions. This affects across-country comparison by one to two percentage points depending on occupational group, but may be much higher for top-ranking positions. Ireland: Data take into account the decrease in salaries following the Financial Emergency Measures in the Public Interest Act 2009. Social contribution rates are for staff hired after 1995 and exclude unfunded pension schemes through the pay-as-you-go system. Italy: Public managers' compensation is comprehensive in that it rewards "all functions, tasks, and assignments performed in relation to their office" and also includes social contributions paid by the manager (11% of gross salary). Government introduced cuts in 2011 to the wages of all public managers with a total gross remuneration above EUR 90 000. Reductions amount to 5% for the share of gross remuneration between EUR 90 000 and EUR 150 000, and 10% to the part exceeding EUR 150 000. Korea: Civil servants are entitled to 3-21 days of annual leave per year depending on the length of service. New Zealand: Data do not include all social payments, including sick leave and other unfunded leave payments, made by the employers. The D1 and D2 managers' compensation of the particular organisations surveyed are among the highest of all the New Zealand public service departments. Spain: Major reductions in compensation introduced in May 2010 are not reflected. United Kingdom: Data exclude additional payments. Compensation levels are calculated by averaging the compensation of staff in place (it is not the middle point between the minimum and maximum salary).

*Source:* 2010 OECD Survey on Compensation of Employees in Central/Federal Governments, OECD STAN Database. Published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

However defined, executive pay levels involve political decisions and inevitably it seems general pay levels are restricted. That leads to pay compression, which is defined by reduced differences in pay between management levels. Severe compression cascades down and can limit the pay of several levels in the hierarchy.

Korea reports that overall compensation levels for senor officials are low relative to levels in neighbouring countries such as Japan, Hong Kong and Singapore. In response to OECD survey questions, the Korean respondent reported that the situation generates general discontent among civil service employees. Although not stated, the level of compensation for public officials is often an indicator of their stature in society. The respondent also reported that "human resource management for high-level positions… is not…well developed", which is possibly an indication that these positions are not a priority.

The use of bonus payments is another controversial practice. In many countries, large payments to government officials are frequently highlighted in media reports. A number of countries state that they make bonus awards to executives and in some cases to middle managers. The descriptions suggest that the awards are subjectively determined. (Several countries reported cancelling bonuses for a year or two in response to the recession.)

The common model for awarding bonuses or incentives in industry differs in several respects from the way awards are determined in government:

- In industry, awards under a "management incentive plan" are planned and budgeted. The awards at each level of management are defined as a percentage of salary. The amounts might start at 10% of salary at the lowest level and increase progressively to 50%, 60% or higher. The words "guideline" and "target" are used to refer to the percentages.
- All awards in part reflect organisation performance, which follows from the profit-sharing heritage. It means that all participants benefit when the company is successful. That also makes the typical award plan a team reward system. This is an important distinction.
- The awards are typically based on goals that are weighted for importance. That makes it possible to calculate the awards using a formula logic. There is virtually no subjectivity.
- Actual awards can go up or down around the target award level. If the company is successful and the individual exceeds their goals, they can earn more than the target. If the company performs poorly

or the individual fails to meet one or more goals, the individual might simply get no monetary award.

- Finally, all plan participants (except poor performers) can expect to earn an award. The target amounts are treated as an integral element of the "total compensation" package, not an extra year-end add-on. The total cash amount is planned based on survey data. Everyone has their payout depending on how well the organisation performs. This is an important philosophical difference from government.

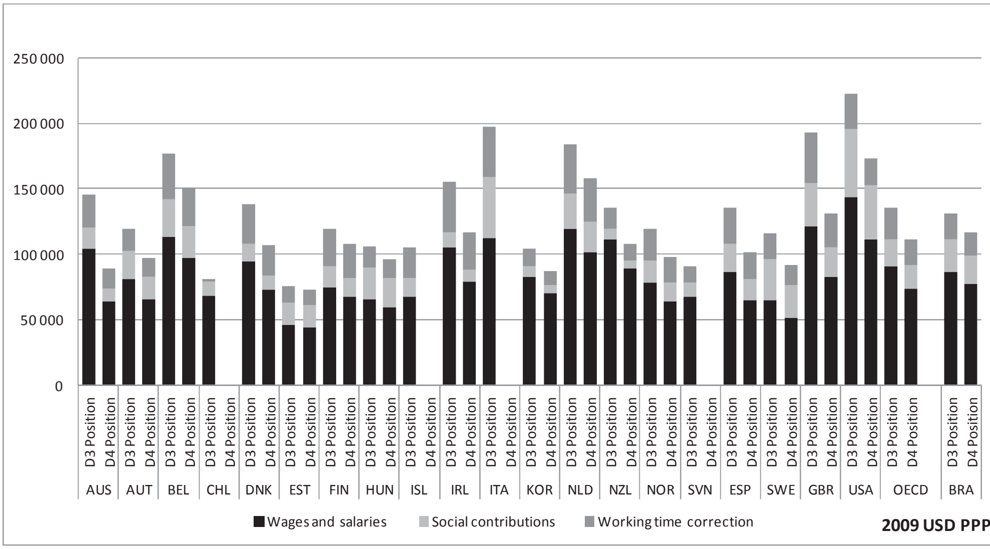
Those points define the distinction between a bonus, which is normally based on subjective factors decided ex post facto, and an incentive, which is based on largely quantitative measures and has a method for calculating awards that is spelled out early in the year. With incentives, participants can track their performance progress and estimate payout at any point in the year. Bonus awards are much more likely to create distress, since the rationale for awards is often vague or unstated.

Private sector employers also commonly include middle managers as participants in management compensation programmes, avoiding the artificial distinction between executives and managers. This is not always the case in the public sector, where there is a tendency in a number of OECD countries to further separate management of senior managers from that of senior experts. In a knowledge-based economy, senior experts may become more valuable to public organisations, and thus should be highly valued and rewarded.

Middle managers are located between senior management and professionals in the central government workforce hierarchy. D4 managers are directly below the D3 level. As Figure 3.4 shows, there are significant differences in the amount of compensation between the two levels of middle managers. In the OECD countries that responded to the 2010 Survey on the Compensation of Public Employees in Central/Federal Governments, the higher level of middle managers' (D3) total compensation amounts to on average about USD 135 000 PPP annually, including wages and salaries, employers' social contributions, and the value of all working time adjustments. In contrast, the average annual compensation of lower-level middle managers (D4) amounts to around USD 112 000 PPP. Compensation of middle managers is significantly lower than that of senior managers. For example, middle managers in D3 positions only earn 59% of what senior managers in D1 positions earn, and 76% of what managers in D2 positions earn (see Figures 3.3 and 3.4).

Figure 3.4. **Average annual compensation of middle managers in central government, 2009**

Adjusted for differences in working hours and holidays




*Note:* Data for the Czech Republic, France, Germany, Greece, Israel, Japan, Luxembourg, Mexico, Poland, Portugal, the Slovak Republic, Switzerland and Turkey are missing. Canada withdrew its data. Compensation data for D4 positions are missing or mixed with D3 positions in Chile, Iceland, Italy and Slovenia. Austria: Value is median rather than average. Brazil: Source of social contribution: IBGE; source of PPP: World Bank. Data include career salary + 60% of *Direção e Assessoramento Superiores.* Chile: Data exclude bonuses for critical functions. This affects across-country comparison by one to two percentage points depending on occupational group, but may be much higher for top-ranking positions. Estonia: Data for managers in policy-making/basic units of ministries have been presented under D3 and data for managers in support units of the ministries (budgeting, personnel, IT, etc.) have been presented under D4. Ireland: Data take into account the decrease in salaries following the Financial Emergency Measures in the Public Interest Act 2009. Social contributions rates are for staff hired after 1995 and exclude unfunded pension schemes through the pay-as-you-go system. Italy: Public managers' compensation is comprehensive in that it rewards "all functions, tasks, and assignments performed in relation to their office" and also includes social contributions paid by the manager (11% of gross salary). Government introduced cuts in 2011 to the wages of all public managers with a total gross remuneration above EUR 90 000. Reductions amount to 5% for the share of gross remuneration between EUR 90 000 and EUR 150 000, and 10% to the part exceeding EUR 150 000. Korea: Civil servants are entitled to 3-21 days of annual leave per year depending on the length of service. New Zealand: Data do not include all social payments, including sick leave and other unfunded leave payments, made by the employers. Spain: Major reductions in compensation introduced in May 2010 are not reflected. The United Kingdom: Data exclude additional payments.

*Source*: 2010 OECD Survey on Compensation of Public Employees in Central/Federal Governments, OECD STAN Database. Published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

The level of compensation of middle managers varies much less across OECD countries than that of senior managers.Figure 3.4 shows that middle managers in the United States earn the most relative to other OECD countries; their annual compensation exceeds just over USD 220 000 PPP for D3 levels and USD 170 000 for D4 levels. The division of total remuneration between wages and salaries and employers' social contributions varies across countries. In Sweden, the United States, Italy, Hungary and Estonia, employers' social contributions constitute a relatively large share of total remuneration of middle managers, while they tend to represent less in other countries. It should be considered that differences in the remuneration levels across countries can be the result of differences in national labour markets, particularly remuneration in the private sector for comparable positions.

## Pay and gender equity

The phrases "comparable worth" and "pay equity" first surfaced in the late 1970s as a central issue of improving the relative pay of women in the labour market. Back then it was common to find women and men working in single-sex occupations and female-dominated jobs were commonly paid less. In many countries women were routinely denied opportunities to work in higher-paying occupations, and in school they were channelled into traditional female fields.

The occupational outlook for women has broadened dramatically since then. They now have successful careers in virtually every occupation, and leadership roles at the national level are frequently held by women.

In compensation management, demands for gender equity spawned an intense effort through the 1980s to develop non-discriminatory job evaluation systems. The system model that eventually gained acceptance was developed for Bausch & Lomb in 1980. It was based on data from structured scaled-response job analysis questionnaires; this data was used to develop multiple regression statistical models that predicted the salary based on job data. The model had the advantage that the incumbent's gender was specifically excluded from the data. By the middle of the decade, similar systems were marketed by each of the major consulting firms.

Problems surfaced quickly, however. Perhaps the most important was that relatively few people understand multi-variate statistical analyses.[2] The new systems were viewed by managers and employees as "black boxes" that generated poorly understood results. Even the responsible compensation managers were often unable to explain the analyses.

Interest in systems based on statistical models, as well as in other formal job evaluation systems, fell off dramatically with the onset of the 1990 recession. Employers acted to eliminate all practices seen as overly bureaucratic and costly. The prevalence of formal systems has continued to decline over time.

Fortunately, women were steadily gaining a foothold in male-dominated occupations. The generation of women that entered the workforce in the 1980s and later had every expectation they would be successful in any field. Employment patterns changed significantly. Laws supporting gender equity have been passed in a number of countries.

For the most part, OECD countries do not provide preferential treatment for women. Only the Czech Republic and Germany reported to provide women preferential rights for promotions. Austria, Finland, France, Hungary, Japan and Switzerland have targets for promoting women. Belgium, Finland, France, Germany, Italy, Japan, Korea, Sweden and the United States provide coaching and information sessions to support women's career advancement.

The earnings gap between men and women is still significant, however. Reliable data are not always available, but a gap is consistently evident. The primary cause is still choice of occupation and career patterns. Within at least the larger employers, women and men in similar jobs are now generally paid similar salaries, although individual discrimination is always possible. Many employers, public and private, routinely conduct analyses to identify and correct where necessary patterns of discrimination.

In Finland for instance, women are well represented in the civil service, but their average monthly earnings are 80% of those of men. One of the reasons is segregation in the labour market, as the majority of women work in the fields of social care, health, education and culture, while men are more likely to work in the higher-paying fields of technology, agriculture and security. New Zealand has a similar situation: the gender pay gap in public service has been steady over recent years despite a focus on gender equity.

Table 3.2. **Gender pay gap in the New Zealand public service**

| | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **Labour force (2008)** |
|---|---|---|---|---|---|---|---|
| Gender pay gap (%) | 15.8 | 17.0 | 16.4 | 16.1 | 16.0 | 15.4 | 14.9 |

*Source*: New Zealand Government, Human Resource Capability Survey of Public Service Departments as at 30 June 2008, State Services Commission.

The International Labour Office – the permanent secretariat of the International Labour Organization – has noted that in spite of continuous positive advances in anti-discrimination legislation, the global economic and social crisis has led to a higher risk of discrimination against certain groups. One of the key findings of the ILO Global Report on “Equality at Work 2011” is that although significant progress has been made in recent decades in advancing gender equality in the world of work, the gender pay gap remains a challenge. Women’s wages are on average 70-90% of men’s.

The United Nations Population Fund has declared that women have a right to equality. “Gender equity” is one of the goals of the United Nations Millennium Project to end world poverty by 2015; the project claims, “Every single goal is directly related to women’s rights, and societies where women are not afforded equal rights ... can never achieve development in a sustainable manner.” A number of UN organisations have made similar pronouncements.

In 2010, the European Union opened the European Institute for Gender Equality (EIGE) to promote gender equality and to fight sex discrimination. The International Labour Organization has also made gender equity a goal.

The World Economic Forum first published its Global Gender Gap Report in 2005. The 2008 report covers 130 major and emerging economies. For the most part OECD countries rank high in the index used to quantify the status of women. The highest scores were earned by Iceland, Norway, Sweden and Finland. The lowest scores of OECD countries are still high relative to countries in Africa and the Middle East.

Gender equity is a priority in the HR offices of OECD countries. Gender-neutral job evaluation systems can be developed, and statistical analyses can be applied to identify situations involving possible discrimination. However, the problems related to the recession and the budget crises have largely superseded the issue in recent literature on government and business practices.

Clearly, discrimination still occurs. While systemic discrimination is less today than it was 30 years ago, the trend of delegating responsibility for compensation management provides increased opportunities to discriminate. It is incumbent on employers to monitor pay levels and pay adjustments to identify and assess suspicious patterns.

## Conclusion

The fiscal crisis, together with the consolidation measures aimed at reducing operational expenditure, is forcing rapid changes in the public sector compensation management. As mentioned above, governments are restructuring in an effort to balance budgets – and restructuring generally involves reducing staffing and compensation levels. However, governments now need to determine appropriate salary levels and the performance expectations for all affected jobs in the new organisation structure. To perform this task, they require adequate HR staff capacity.

The environment in which governments operate is also changing, prompting shifting priorities and posing new challenges. Countries are now exploring new approaches to compensation management, such as salary bands. A number of countries have moved to delegating responsibility for compensation management in an effort to make managers accountable for their work group, but delegation is not without its problems. Leaders are generally reluctant to "let go". Training in salary management for line managers is essential.

Moving towards performance-related pay (PRP) has been the hardest challenge for OECD countries. The reported lack of or limited success of PRP is due to: i) the absence of top management advocacy, as the system is seen as just another HR project; ii) the use of the same performance system (i.e. PRP) and performance criteria over a diverse workforce; and iii) employees' general lack of awareness of what it is expected of them. Training managers in PRP is important, but experience shows that success depends on the managers' commitment to make the policy a success. A possible way of overcoming this situation and reinforcing the performance focus is to adopt organisational performance management practices such as balance scorecards.

Apart from commitment, performance-related pay schemes are going to require a review process, to provide the assurance that employees will be treated fairly. PRP is more than a pay increase; it is a form of recognition. This cannot be seen as a task for the HR departments, as they have little involvement in the day-to-day management of the employees. It is the managers who have the largest responsibility.

Compensation of public managers is a contentious issue. Compensation programmes should look for ways of attracting and retaining management talent, but also ways of offering salaries that are socially acceptable – or even above, considering the current economic crisis. One way of approaching this issue is by improving transparency and communication and explaining the decisions regarding executive compensation practices. A starting point is to acknowledge that government executive jobs are simply not comparable to executive jobs in the private sector.

## Notes

1 For further information visit: *www.opm.gov/oca/12tables/locdef.asp*.

2 Multi-variate statistical analysis is a form of statistics encompassing the simultaneous observation and analysis of more than one statistical variable. It is used in studies that involve more than one dependent variable (also known as the outcome or phenomenon of interest), more than one independent variable (also known as a predictor), or both. This type of analysis is desirable because researchers often hypothesise that a given outcome of interest is affected by more than one thing.

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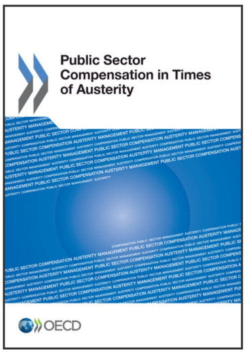


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