

Paying for Performance: Policies for Government Employees

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Introduction

Over the past two decades, governments battling budget pressures and public perceptions of civil servants as under-worked and overpaid have been seeking ways to make the public service perform better. Alongside government re-organisation and privatisation of services such as telecommunications and water, governments have been modernising the management of their civil servants.

The question of how to reward civil servants has remained a thorny one, in a changing world where public service posts no longer necessarily offer a job for life and where the public employer is increasingly in competition with the private sector for the top performers.

One solution – widely used in some parts of the private sector – is to replace or complement the traditional civil service system of automatic salary increases based on length of service with financial reward for good performance, or performance-related pay (PRP). PRP refers to the variable part of pay, awarded – on an individual or on a team or group basis – depending on performance.

PRP is increasingly used in public administration of OECD countries. The results of such policies have in many ways been surprising. Staff are less motivated than might have been expected by the prospect of more money for working better. But performance-related pay can help improve performance when it is applied properly in the right managerial context, if not because of the financial rewards then indirectly through the changes in work and management organisation needed to implement it.

This *Policy Brief* looks at the trends in PRP across the civil service in OECD countries and the lessons that can be drawn from their experience. ■

Why reward performance?

Until about 20 years ago, nearly all civil servants in OECD countries were given pay increases based on length of service, regardless of how well they did their jobs. In the past two decades improving staff performance took on a new urgency in a context of economic difficulties and budget constraints. This does not mean that performance had not been a priority in earlier decades. However, the systematic attempt to incorporate performance objectives and indicators into human resource management and budgeting was clearly a new development. PRP was introduced in that context – along with an increased delegation of human resources management responsibilities.

There are a number of reasons why governments have turned to PRP:

- The main argument is that it can foster individual motivation, by recognizing effort and achievement and rewarding it in a concrete way. Before PRP was introduced, promotion was the only real way of getting an “extra” increase, but it could mean waiting virtually an entire career. For example, in the United Kingdom in the 1980s, a newly-promoted Senior Executive Officer could expect to wait, on average, over 20 years to be promoted to Principal, the first grade with significant managerial responsibilities.
- Introducing PRP, especially at managerial level, is seen as necessary to compete effectively with the private sector for the most talented employees. PRP may also help attract more dynamic and risk-taking people from the private sector.
- Concerns about the wage bill can also drive the introduction of PRP. Governments may see PRP as a way of containing salary costs by reducing automatic progression through salary levels, or on the contrary as a way of lifting an overall salary ceiling, with non-pensionable financial rewards. The increase of salary allowed by PRP may also be seen as compensating for the loss of security entailed in introducing fixed-term contracts, as in New Zealand.
- And there is an important political reason for introducing PRP: it refutes any idea that civil service employees are unaccountable and overpaid, by showing that their level of performance is monitored. ■

How widespread is PRP?

The first wave of PRP policies were put in place in OECD countries in the 1980s. The governments of Canada, Denmark, the Netherlands, New Zealand, Spain, Sweden, the United Kingdom and the United States were among the first to adopt PRP in one form or another. A second round started in the early 1990s, with the adoption of PRP policies in Australia, Finland, Ireland and Italy. Most recently, countries such as Germany, Korea, and Switzerland, as well as some in Eastern Europe (the Czech Republic, Hungary, Poland and the Slovak Republic), began to put PRP mechanisms in place. In 2004, France started experimenting with PRP for top level civil servants (director’s level) in six pilot ministries. More than two-thirds of OECD countries have now introduced performance-related pay for at least part of their civil service.

Mostly, countries which have developed the strongest links between performance appraisals and pay as employee incentives are those which have the highest delegation of responsibility for human resources and budget management – usually position-based systems. However, this has started to change and PRP policies have now been introduced into some career-based systems such as Hungary and Korea.

There are wide variations in the degree to which PRP is actually applied. In many cases, PRP concerns only managerial staff or specific ministries. Only a handful of member countries can be considered to have an extended, formalised PRP policy (Denmark; Finland; Korea; New Zealand; Switzerland; the United Kingdom). Elsewhere, the coverage of PRP varies greatly. In Canada, Ireland, Italy, and Norway, PRP is applied only at management level, Ireland, Norway and France, in pilot ministries, having it for the most senior officials. Sometimes, however, top managers are excluded from PRP (e.g. Finland). One reason is to avoid assessing the performance of those who are political appointees.

Also, many government organisations claim to have PRP, but in practice there is often a gap between the existence of a so-called “performance-related pay scheme” and its concrete functioning, which may be barely linked to performance.

Although PRP systems have become increasingly common in OECD countries, their design and application varies considerably. Nevertheless, some common trends are emerging:

- Long-running standardised PRP schemes have evolved into more decentralised systems. This is the case for instance in Denmark, Italy, New Zealand, the United Kingdom and the United States.
- A notable development in recent years has been the extension of PRP from senior management to non-managerial staff.
- Several countries have strongly encouraged the move to a more collective approach to PRP over the past five years. In the United Kingdom a number of departments made the transition from individual to team-based systems in 2004. In Finland, results-based rewards are applied at the team level. In Korea, as of 2002, four areas (defence, police, security such as the Presidential Security Service, and railways) use a departmental base for PRP. ■

What rewards for what performance?

A key issue is whether performance payments are given as permanent additions to the recipient's basic pay (merit increments), or one-off payments which have to be re-earned during each appraisal period (bonuses). In recent years, the use of bonuses has increased, at the expense of merit increments, because bonuses are managed with greater flexibility and do not add to fixed payroll costs.

The size of payments varies greatly across OECD countries, but it is generally a fairly modest percentage of the base salary, especially among non-managerial employees. Merit increments tend to be smaller than one-off bonuses; they

are in general below a maximum of 5% of the base salary. PRP bonuses tend to be higher – but overall, maximum rewards usually represent less than 10% of the base salary for civil servants. For managers, the size of performance payments is bigger and represents, on average, 20% of the base salary for maximum rewards.

The process of performance management is usually an annual cycle, where the line manager identifies key objectives for the year with his/her employee(s), and at the end of the period the manager assesses the employee’s performance. Performance rating systems are less standardized and less detailed than ten years ago. They rely more on assessing pre-identified objectives and on dialogue with line management than on strictly quantifiable indicators or standard criteria for a job.

Overall, the most important criteria for assessing civil servants’ performance are the following: outputs achieved which include the pre-identified objectives; competencies and technical skills; interpersonal skills and teamwork; leadership and management skills. Other criteria mentioned by individual countries include for instance ethics (Canada) and innovation (Denmark). ■

Why is PRP difficult?

Monitoring and measuring performance – especially the conduct of staff performance appraisals – is a difficult process. Experience indicates that the attempt to introduce highly formalised and detailed rating systems in public organisations was not successful, as it is very difficult to distinguish the average performance of the majority of employees who are working satisfactorily, no matter how complex and formal the criteria might be. For example, in the United States, in most PRP schemes in use in the 1980s, more than 95% of managers were rated as “fully satisfactory or better”. Considering these limitations, there have been two notable trends:

- There has been a move to less detailed rating systems, focusing on the distinction between top and bad performers – as performance can be more easily assessed for the extremes – based on a three-point scale rather than on five, ten or twenty points.
- Another response has been the increasing use of quota systems and forced ranking systems, to specify the proportion of employees placed in the higher categories of the rating scale (for instance in Canada, Germany, Korea, Switzerland, United Kingdom, United States).

Performance assessment is inherently difficult in the public sector, owing to the difficulty of finding suitable quantitative indicators. The performance

Table 1.
EXAMPLES OF MAXIMUM SIZE OF PRP PAYMENTS

	Merit increments	Bonuses
Canada	• Progression of 5% per year, up to 3 years.	• 10-25% bonus lump sum (managerial level).
Ireland		• Bonuses for assistant secretaries of up to 20% of salary.
Korea	• For senior civil servants, up to 7% of the base salary for those rated excellent.	• Bonuses vary in size from 100% to 40% of the monthly base salary.
Switzerland	• Merit increments: 4.1-6% for outstanding performance (ranked A++). Increase of 3% if assessment is A (good performance).	• Bonuses: can reach 12% of salary for outstanding performance.

appraisal process requires a large element of managerial judgement. Whether PRP will have a positive impact on staff is strongly dependent on how well the appraisal process is carried out, and, in particular, on how well individual and team objectives are identified and to what extent they are based on performance rather than standard job criteria. Certain conditions, such as transparency, clear promotion mechanisms and trust of top and middle management are essential before introducing a performance-oriented culture. PRP policies are counterproductive in an inadequate management framework, and may in such situations increase problems linked to trust and even lead to corruption and patronage.

Setting individual objectives for employees is not an easy task. The objectives must not be too easy to achieve, nor too complex or unrealistic. They should not focus on small details of the job without ever addressing the heart of the task. Setting clear organisational objectives is also important for implementing PRP effectively at all levels of the organisation. It is especially important for middle management who must have a clear perception of what they need to achieve in order to effectively apply a performance evaluation process for their own staff.

Performance-related pay is costly to implement in terms of both time and money. Time is required to plan, introduce and run the scheme, for example undertaking staff appraisals and, critically, training managers in its operation. The financial costs of PRP are often underestimated, thus undermining its effective implementation.

A requirement that performance-related pay should be cost-neutral may be imposed. This can be achieved by, for example, decreasing the salaries of the worst-performing staff. Switzerland is an example of country which has conducted such policies: for a public employee rated B (partially satisfies requirements), the wage is reduced to 94% of the pay band ceiling after a two-year period.

A number of countries have also experimented with sharing cost savings with employees, despite the difficult-to-measure productivity in the public sector. In Finland, it is required that one-third of any improvement in results should be devoted to staff rewards. ■

Does PRP work?

While performance-related pay appears to motivate a minority of staff in the public sector, a large majority just do not see it as an incentive to work better. Extensive staff surveys, conducted notably in the United Kingdom and the United States, showed that despite broad support for the principle of linking pay to performance, only a small percentage of employees thought their existing performance pay schemes provided them with an incentive to work beyond job requirements and in many cases they found it divisive.

Most government workers, particularly those in non-managerial roles, consider basic pay and how it compares to the wider job market as far more important than supplementary pay increases for performance. This is because performance rewards are often limited in the public sector, but also

because job content and career development prospects have been found to be the strongest incentives for public employees. PRP is unlikely to motivate a substantial majority of staff, irrespective of the design.

Despite these important limitations, PRP appears to be a window of opportunity for wider management and organisational changes. In other words, introducing PRP may not in itself improve motivation and performance, but the changes required to introduce PRP might.

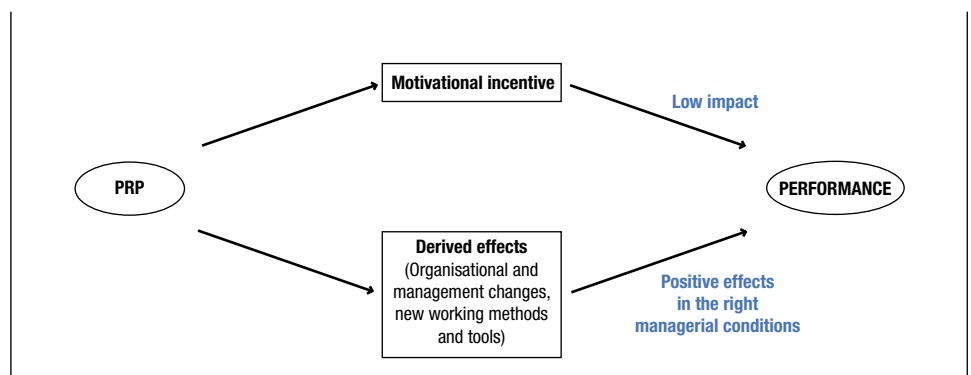
PRP gives managers an added incentive to manage effectively and stimulates them to fully endorse a goal-setting approach. Goal-setting and appraisal provide the motivation for the kind of one-to-one contact between employees and their line managers in which the manner of working can be discussed and explained. Goal-setting works well when accompanied by more interaction between manager and staff member so that any reduction of formal controls is substituted by informal control. Another level at which the performance appraisal element of PRP has emerged as critical lies in the scope it offers to link broader organisational objectives to those of individual employees.

PRP can also act as a window of opportunity for introducing significant managerial changes. This is especially true for public service delivery – tax, social security – where work organisation can be more directly linked to outputs or citizen demands than core administration. PRP may facilitate wide-ranging organisational changes by linking pay bonuses to new objectives at the individual and the departmental levels. PRP may be used as a lever to:

- introduce more flexible working methods (working hours for instance);
- encourage team working – through collective bonuses or credit given for co-operation in the performance appraisal;
- reinforce the information and communication technology (ICT) focus;
- focus on training policies.

It appears that PRP can also act as a recruitment incentive. This positive effect on recruitment was mentioned by Denmark, Finland and Sweden in particular. In Denmark, for 57% of managers, PRP leads to better opportunities for recruitment. Similar experiences occurred in attracting and retaining top quality school teachers in England and Wales.

Figure 1.
THE OVERALL IMPACT OF
PERFORMANCE-RELATED
PAY ON PERFORMANCE



Empirical studies as well as a preliminary reading of the situation in some OECD countries provide some evidence of the beneficial effects of team rewards. Finland considers that “a group-based reward system is the most effective method of reward allocation”. The experience of Spain with collective PRP in the National Institute of Social Security is also reported to be highly positive: the average time for any procedures related to social security benefits have moved from six months at the end of the 1980s to less than seven days in 2000, due to management changes linked to PRP and improved ICT.

The United Kingdom has recently moved to a more collective approach to performance pay, and preliminary results of this new policy encouraged the government to promote the extension of collective PRP systems. ■

What lessons for the future?

- **The design of PRP has to take into account the background culture of each organisation/country.** PRP should not be introduced to the detriment of the base salary, as the base salary has the more decisive incentive impact. On the other hand, performance rewards must not be too limited – Makinson in the United Kingdom recommends not below 5% of the base salary – and should be well above the level of inflation. The balance of individual and team PRP is a key design issue. Team/unit PRP systems for employees can be introduced in a less disruptive way and appear to produce more positive results than strictly individualised PRP.
- **The performance appraisal process is at the heart of the whole system.** The success of PRP ultimately relies more on the quality of the performance measurement process than on the level of payment.
- **Implementation problems need to be anticipated.** This implies primarily: coordination with staff and unions on implementing PRP, preparing top and line management; and clearly anticipating the budget and costs linked to PRP and of the ways to fund it, and the time and work that introducing and monitoring the system requires.
- **Performance pay goes hand in hand with delegating human resources management.** It is easier to articulate individual employees’ objectives and those of their organisation in a meaningful way if the local management has a degree of autonomy to adapt the scheme to its own needs.
- **The significance and impact of PRP should not be overestimated.** PRP is of secondary importance as a managerial tool for improving motivation. The evidence points, therefore, to the need for a broad approach to better performance management as against a narrow preoccupation with performance-related compensation.
- **PRP should be applied in an environment that maintains and supports a trust-based work relationship.** PRP requires a mature and well-established civil service culture and a stable political and policy environment.
- **PRP should be used, above all, as a stimulus and a lever for introducing wider management and organisational change,** rather than solely as a motivational tool for staff. Pay for performance should be viewed essentially as a management tool. The objectives of PRP should be set accordingly. ■



For further information

For more information on the OECD's work on performance-related pay, contact Dorothee Landel, tel.: (33) 1 45 24 82 43, e-mail dorothee.landel@oecd.org; or Elsa Pilichowski, tel.: (33) 1 45 24 76 12, e-mail elsa.pilichowski@oecd.org. ■

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Where to contact us?

OECD HEADQUARTERS

2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: (33) 01 45 24 81 67
Fax: (33) 01 45 24 19 50
E-mail: sales@oecd.org
Internet: www.oecd.org

GERMANY

OECD Berlin Centre
Schumannstrasse 10
D-10117 BERLIN
Tel.: (49-30) 288 8353
Fax: (49-30) 288 83545
E-mail:
berlin.contact@oecd.org
Internet:
www.oecd.org/deutschland

JAPAN

OECD Tokyo Centre
Nippon Press Center Bldg
2-2-1 Uchisaiwaicho,
Chiyoda-ku
TOKYO 100-0011
Tel.: (81-3) 5532 0021
Fax: (81-3) 5532 0035
E-mail: center@oecdtokyo.org
Internet: www.oecdtokyo.org

MEXICO

OECD Mexico Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560 MEXICO, D.F.
Tel.: (00.52.55) 9138 6233
Fax: (00.52.55) 5280 0480
E-mail:
mexico.contact@oecd.org
Internet:
www.rtn.net.mx/ocde

UNITED STATES

OECD Washington Center
2001 L Street N.W., Suite 650
WASHINGTON DC. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: www.oecdwash.org
Toll free: (1-800) 456 6323

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