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## **Human Resources Management Working Party**

### **PERFORMANCE-RELATED PAY POLICIES FOR GOVERNMENT EMPLOYEES: MAIN TRENDS IN OECD MEMBER COUNTRIES**

**HRM Working Party Meeting  
7-8 October 2004**

*This draft report aims to get comments from OECD member countries.*

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## FOREWORD

The goal of this report is to provide a comprehensive overview of the trends in performance-related pay (PRP) policies across civil services of OECD member countries and to draw some lessons from their experiences. It focuses on a “macro” level and aims to analyse various PRP designs and emerging trends. The report also aims to analyse the apparent impacts of PRP policy.

The report is based primarily on 12 country reports that were presented at an OECD expert meeting in October 2003.<sup>1</sup> These countries were Denmark, Finland, France, Germany, Hungary, Italy, Korea, Spain, Sweden, Switzerland and the United Kingdom, all OECD member countries and Chile, which is not. The Directorate of Public Governance and Territorial Development gratefully acknowledges OECD delegates’ contribution to this project and especially their preparation of the country reports. The other main sources for the report are the answers given to the 2003 OECD/GOV Survey on Strategic Human Resources Management (the HRM Survey)(OECD, 2003a)<sup>2</sup> and its analysis (OECD, 2004) and the research on performance-related pay conducted by Dr David Marsden of the Centre for Economic Performance at the London School of Economics (Marsden, D., 2000; Marsden, D., 2004).<sup>3</sup>

This report was prepared by Dorothée Landel from the OECD Secretariat, with substantial input provided by Dr David Marsden, Director of the Industrial Relations Department of the London School of Economics.

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1. Reports were prepared by delegates within the framework of guidelines set by the Secretariat. The guidelines were structured around four key points: i) background, scope and coverage of PRP policy. ii) design of PRP policy: performance appraisal, rating and payment systems; iii) implementation and assessment of the impact of PRP policy; iv) difficulties facing PRP policy, lessons learnt and prospects for the future.
  2. The Survey on Strategic Human Resources Management was answered by 29 OECD member countries (Turkey was not included). It was completed by ministries/departments in charge of human resources management in the public sector, and one official answer was provided by each country. This relies in particular on Sections 7 and 8 of the survey and the responses to them. The sections deal with performance management and pay determination systems.
  3. The results of this research are based on a series of attitudinal surveys of employees and line managers in several areas of the UK public service: the Inland Revenue, the Employment Service, NHS Trust Hospitals, and head teachers in primary and secondary schools.

## EXECUTIVE SUMMARY

### Introduction

1. Twenty years ago, nearly all civil servants in the central government of OECD member countries were paid according to service-incremental salary scales. This is not to say that civil servants previously lacked performance incentives. Promotions, and especially those into senior management, were rigorously controlled, serving partly as an incentive but partly also as an element to ensure both the independence of the public service with regard to the executive and its ability to serve governments of different political persuasions. However, socio-economic pressures have led to the need for other types of incentive than “promotion” to strengthen performance management. Remuneration has been seen as an alternative or a complementary incentive to promotion.

2. By the turn of the millennium, significant numbers of civil servants were covered by performance-related pay<sup>4</sup> (PRP) schemes of one kind or another in most OECD member countries, particularly senior managers, but increasingly also non-managerial employees. The introduction of performance pay policies occurred in the context of the economic and budgetary difficulties faced by OECD member countries from the mid-1970s. Reasons for introducing PRP are multiple, but focus essentially on improving the individual motivation and accountability of civil servants as a way to improve performance. PRP is seen as a signal of change for civil servants and as a way of indicating to citizens that performance is regularly assessed in public administration.

3. In this report, the terms “performance-related pay” and “performance pay” are used as synonyms to refer to a variety of systems linking pay to performance. Performance-related pay systems are based on the following assumptions: i) organisations can accurately measure individual, team/unit or organisation outputs,<sup>5</sup> ii) individual and team/unit outputs contribute to organisational performance; iii) pay can be administered in a way which capitalises on its expected incentive value for potential recipients.

4. The adoption of performance-related pay in the public sector reflects the influence of the private sector culture of incentives and individual accountability on public administration. Civil services have increasingly sought to manage service production tasks on similar lines to those in private sector. The introduction of PRP is one facet of a wider movement towards increased pay flexibility and individualisation in OECD public sectors stimulated by these influences. Another important change – especially at the managerial level – is the attempt to base individual salary on the specific difficulties of the

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4. Performance-related pay refers to the variable part of pay which is attributed each year (or on any other periodic basis) according to performance.

5. Outputs are the goods and services (usually the latter) which government organisations provide for citizens, business and/or other government bodies (an example of an output from a Ministry of Finance could be the delivery of monthly reports of government financial performance and of the annual financial statements).

Outcomes are the impacts on, or the consequences for, the community from the outputs or activities of government. They reflect the intended and unintended results of government actions and provide the rationale for government policies (an example of an outcome from a Ministry of Finance could be that government finances are sustainable, an example from a Ministry of Transport could be a decline in road accidents).

post or the level of responsibilities. In most countries, the salary policy for civil servants now consists of three key components: base pay, remuneration linked to the nature or duties of a post, and performance-related pay elements. The two elements of variable pay should not be confused. The first relies on an *ex ante* evaluation of performance (for example, by assessing the qualities needed for the particular duties associated with the position) while the other relies on an *ex post* evaluation. Variability of pay in almost all OECD member countries at the managerial level tends to depend more on prior job (*ex ante*) evaluation than on the *ex post* evaluation necessary for a PRP scheme.

5. Two-thirds of OECD member countries have implemented PRP or are in the process of doing so (OECD, 2004). However, there are wide variations in the degree to which PRP is actually applied throughout an entire civil service. In many cases, PRP concerns only managerial staff or specific departments/agencies. Very few OECD civil service systems can be considered to have an extensive, formalised PRP system. PRP is sometimes more rhetoric than reality, as some systems actually base the assessment of performance on inputs<sup>6</sup> – which cannot really be qualified as “performance-related”. In some cases as well, performance rewards are distributed without any formal assessment of individual performance. In fact, there is often a gap between the stated reasons for the introduction of PRP in a civil service and its method of implementation.

6. The goal of this report is to provide a comprehensive overview of the different trends in performance pay policies across the civil services of OECD member countries<sup>7</sup> and to draw some lessons from their experience. It focuses on a “macro” level and aims to analyse various PRP designs and emerging trends. The report also aims to analyse the apparent impacts of PRP policy.

7. The report is organised as follows: Chapter 1 sets performance-related pay policies in the wider management context; Chapter 2 analyses key trends in performance pay policies in OECD member countries; Chapter 3 assesses the impact of PRP policies and draws lessons from the experience of implementing them.

### **Performance-related pay in the wider management context**

8. PRP fits within the wider performance budgeting and management developments in vogue over the past two decades, which emerged against the background of the economic and budgetary difficulties in OECD member countries. These developments have been characterised by an attempt to systematically incorporate – at least formally – performance objectives and indicators into human resource management and budgeting processes and to move towards pay flexibility and individualisation in OECD public sectors. The introduction of PRP is only one facet of this wider movement towards an increased focus on defining and achieving organisational objectives.

9. The impact of the introduction of PRP has to be analysed according to the multiplicity of objectives for introducing it. The main argument put forward for implementing PRP, is that it acts as a motivator, by providing extrinsic rewards in the form of pay and intrinsic rewards through the recognition of effort and achievement. Overall, the types of objectives pursued with PRP vary across countries, with

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6. Inputs are the measures which a government or its agent have available to achieve an output or outcome. They can include employees, funding, equipment or facilities, supplies to hand, goods or services received, work processes or rules, or working hours for instance.

7. The scope of the report is limited to ministries/departments/agencies of the central/federal government level. For its purposes, a wide definition of civil service has been adopted, focusing on both core administration and service delivery departments in national civil services. The latter includes those working in local governments, public schools, health services, and social security, etc., where these are part of the central/federal government structure.

Nordic countries focusing more on the personnel development aspects, most Westminster countries<sup>8</sup> focusing more on the motivational aspect and others such as France or Italy, stressing the leadership and accountability of top civil servants.

10. There are large variations in the degree to which PRP is actually applied throughout an entire civil service. Less than one-third of OECD countries can be considered to have an extended, formalised PRP policy (Denmark; Finland; New Zealand; Switzerland; the United Kingdom; and the United States). 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.<sup>9</sup> This illustrates the importance of such delegation to the development of PRP. Traditionally, countries with a low degree of delegation – mainly career-based systems<sup>10</sup> – tend to focus primarily on promotion to motivate staff. However, this has started to change and PRP policies have now been introduced into some career-based systems in such a way as to increase flexibility and to promote individual accountability (Hungary; Korea and France, for instance).

### **Key trends in performance-related pay**

11. There is no single model of PRP across OECD member countries. Models are diverse and vary according to the nature of the civil service system, the pay determination system and the degree of centralisation or delegation in financial and human resources management. However, common trends are clearly emerging across groups of countries and across the OECD as a whole:

- PRP policies have been formally extended from management level to all categories of staff in the past 10 years.
- Among PRP policies, there has been some increase in the use of collective or group performance schemes, at the team/unit or organisational level.
- Long-running standardised PRP schemes have evolved into more decentralised systems, which facilitate delegation of managerial functions.
- There is an increased diversity of the criteria against which performance is assessed. Both career-based and position-based civil service systems tend to converge in the attention given to outputs, but also on competencies and social skills in general.
- Performance rating systems are less standardised, less formalised and less detailed than 10 years ago. Performance appraisals rely more on dialogue with line management than on strictly quantifiable indicators: more diverse criteria are now more flexibly applied. On the other hand,

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8. Westminster countries are those which have the system of parliamentary democracy used in countries such as Britain, Canada, Australia and New Zealand.

9. Position-based systems focus on selecting the best-suited candidate for each position, whether by external recruitment or internal promotion or mobility. Position-based systems allow more access to positions from external sources, and entry at a relatively high level of responsibility/mid-career is not uncommon.

10. In career-based systems, civil servants are usually mostly hired at the very beginning of their career and are expected to remain in the public service more or less throughout their working life. Initial entry is mostly based on academic credentials and/or a civil service entry examination. Promotion is based on a system of grades attached to the individual rather than to a specific position. This sort of system is characterised by limited possibilities for entering the civil service at mid-career and a strong emphasis on career development.

systems of rating performance which impose quotas on the numbers who can succeed under them, are more widespread across OECD member countries.

- The size of performance payments is generally a fairly modest percentage of the base salary, especially among non-managerial employees – in general less than 10% of the base salary. At the management level, performance payments are generally higher, around 20% of the base salary. PRP bonuses<sup>11</sup> tend to supplement not replace merit increments.<sup>12</sup>

### **Implementation and impact**

12. Performance pay is an appealing idea, but experience indicates that its implementation is complex and difficult. Previous OECD studies on the impact of performance pay at the managerial level concluded that many of the schemes had failed to satisfy key motivational requirements for effective performance pay, because of design and implementation problems, but also because performance assessment is inherently difficult in the public sector (OECD, 1993; OECD, 1997). Performance measurement in the public sector requires a large element of managerial judgement. The notion of performance itself is complex, owing to the difficulty of finding suitable quantitative indicators and because performance objectives often change with government policy. Many studies have concluded that the impact of PRP on performance is limited, and can in fact be negative.

13. Evidence cited in this report indicates that the impact of PRP on motivation is ambivalent: while it appears to motivate a minority of staff, it seems that a large majority often do not see PRP as an incentive. While base pay as it relates to the wider “market” is important, supplementary pay increases for performance are a second-rank incentive for most government employees, especially those in non-managerial roles. 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.

14. Despite such cautions, the interest in performance pay has continued unabated over the past two decades. The paradox comes from the fact that despite the overall consensus on the types of problems raised by performance pay, PRP policies continue to be introduced on a large scale in many OECD member countries. There are few examples of public organisations having withdrawn their PRP policy.<sup>13</sup> But the fact that organisations do not withdraw PRP is not necessarily a very good indication of effectiveness, because the costs of doing so are a deterrent. However, one of the key reasons why PRP continues to be introduced on such a large scale across civil service systems, appears to be its role in facilitating other organisational changes.

15. It seems that, in the right managerial framework,<sup>14</sup> 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. These include effective appraisal and goal setting processes, clarification of tasks, acquisition of skills, creation of improved employee-manager dialogue, more team work and increased flexibility in work performance. Introducing PRP can be the

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11. A bonus is a one-off payment which is not consolidated into basic pay, and has to be re-earned during each appraisal period.

12. A merit increment is a payment added to the base salary of the recipient and which becomes a permanent part of the basic pay.

13. The New Zealand police is one example.

14. The right managerial framework means the basics of sound management, that is transparency within the organisation, clear promotion mechanisms and trust in top management.

catalyst that allows these changes to occur and, at the same time, for there to be a renegotiation of the “effort bargain” thus assisting in recasting the culture at the workplace. These dynamics have positive impacts on work performance. It appears that it is not through the financial incentives it provides that PRP can contribute to improving performance, but rather through its secondary effects, that is the changes to work and management organisation needed to implement it.

## **Recommendations**

16. ***The design of PRP is a trade-off*** between various options which have to take into account the background culture of each organisation/country. There is no “best” solution. When designing new schemes, management should consider what will prove acceptable to large numbers of the staff in its organisations. Management should also seriously consider team/unit PRP systems for employees, which can be introduced in a less disruptive way and appear to be able to produce more positive results than strictly individualised PRP.

17. ***The performance appraisal process is at the heart of the whole system.*** It should avoid rigidity, not be too detailed, and be based on clear criteria. Performance appraisal should act as a basis for ongoing dialogue throughout the year between the manager and the employee. Transparency in the whole process is the key factor of success. The success of PRP ultimately relies more on the effective measurement of performance than on the distribution of payment.

18. ***Implementation problems need to be anticipated.*** This implies primarily coordination with staff and unions on the implementation of PRP, the preparation of top and line management, clear anticipation of the budget and costs linked to PRP and of the time and work that the introduction and monitoring of the system requires.

19. ***Performance pay goes hand in hand with human resources management delegation.*** Some delegation of human resources and pay management is crucial for the effective implementation of performance pay. This is because of the close link between goal setting and performance pay. The more successful schemes appear to rely upon a close integration between these two functions, in contrast to more traditional models which tended to award PRP against standardised performance criteria. 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.

20. ***Evaluations need to be conducted regularly*** and a PRP system needs to be revised from time to time.

21. ***The significance and impact of PRP should not be overestimated.*** PRP is of secondary importance as a managerial tool for improving motivation. Criteria such as satisfying job content, promotion possibilities or flexibility in work organisation come far ahead of performance pay in motivating staff. The evidence points, therefore, to the need for a broad approach to better performance management as against a narrow preoccupation with performance related compensation.

22. ***PRP should be applied in an environment that maintains and supports a trust-based work relationship.*** In such an environment there is a balance between formal and informal processes, with on-going dialogue, information sharing, negotiation, mutual respect, and transparency being prioritised. It is also suggested that PRP requires a mature and well established civil service culture and a stable political and policy environment.

23. PRP should be used, above all, as a stimulus and a lever for the introduction of wider management and organisational change, rather than solely as a motivational tool for staff. The objectives of PRP should be set accordingly.



## CHAPTER 1

### PERFORMANCE PAY IN THE WIDER MANAGEMENT CONTEXT

24. This chapter describes the historical development of, and common trends in, PRP systems in OECD member countries, the links between the delegation of managerial functions and the development of PRP as well as examining the reasons for its growth in popularity. It finds that two-thirds of OECD member countries have introduced PRP or are in the process of doing so. However, it concludes that very few member countries' civil service systems have an extensive, formalised PRP system. It is usually those which have the highest delegation of human resource and budgetary management functions which have developed the most extensive performance pay schemes.

#### Introduction

25. The severe economic difficulties of the 1970s – as reflected in very weak growth and low productivity combined with high unemployment and inflation – triggered major adjustments in the public sectors of some OECD member countries. Limiting pay costs in the public sector became a priority, insofar as the public sector wage bill is the largest item in the budgets of many OECD countries. In this context, improving public sector performance and productivity (doing more with less staff) took on a new urgency. This does not mean that performance had not been a priority in earlier decades. However, the systematic attempt to incorporate – at least formally – performance objectives and indicators into human resource management and budgeting was clearly a new development.

26. “Performance is a deceptively simple idea. Simple because it is easy to express key concepts and objectives; deceptive because it is hard to apply these ideas in government” (OECD, 2003d). Performance can be defined as the ability of a government organisation or authority to acquire resources economically and use those resources efficiently (input<sup>15</sup>-output<sup>16</sup>) and effectively (output-outcome<sup>17</sup>) in achieving the output and outcome targets or goals.

27. The emphasis on performance within various national administrations took a number of forms, in many cases inspired directly by private sector management methods. These included structural reorganisations, commercialising and privatising government activities and devolving financial and personnel management, in exchange for more accountability for results. It was in that context that performance-related pay policies were first enacted, along with other civil service pay reforms such as simplification of salary scales and variable pay linked to job evaluation.

28. Before analysing the extension of PRP in the past two decades, it is worth clarifying the different concepts used in this report.

- **Performance-oriented management** involves linking the targets of the unit to the strategic goals of the organisation. Performance management systems are aimed at linking the management of people with institutional goals and strategies.

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15. Input: see the definition in footnote 6 of the Executive Summary.

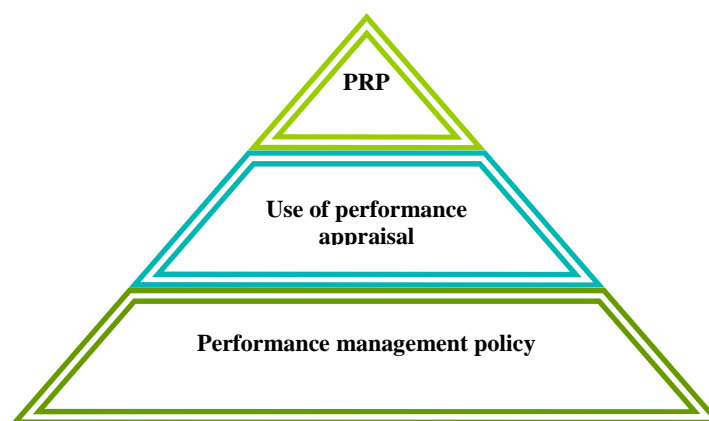
16. Output: see the definition in footnote 5 of the Executive Summary.

17. Outcome: see the definition in footnote 5 of the Executive Summary.

- The process of evaluating staff performance in a formal manner is often referred to as the “performance appraisal” system. **Performance appraisal** is a methodology and set of procedures for rating the work performance of individuals according to objective standards and criteria applied uniformly across one or several organisations.
- **Performance-related pay** refers to the variable part of pay which is awarded each year (or on any other periodic basis) depending on performance. The definition of PRP excludes: i) any automatic pay increase by, for example, grade promotion or service-based increments (not linked to performance); ii) various types of allowances which are attached to certain posts or certain working conditions (for example, overtime allowances, allowances for working in particular geographical areas).

29. The three concepts are interdependent, as a performance-related pay strategy should rely on a clear performance appraisal process, within the framework of a wider performance management strategy. However, performance appraisal is not necessarily linked to performance payments. Such appraisals have existed for some considerable time in many public service organisations without such a link. Where this is the case, performance appraisals are still only linked to promotion, formally or informally. However, over recent years they have increasingly been linked to pay. In some cases as well, PRP exists without any formal performance appraisal process, but this is a practice that should be discouraged.

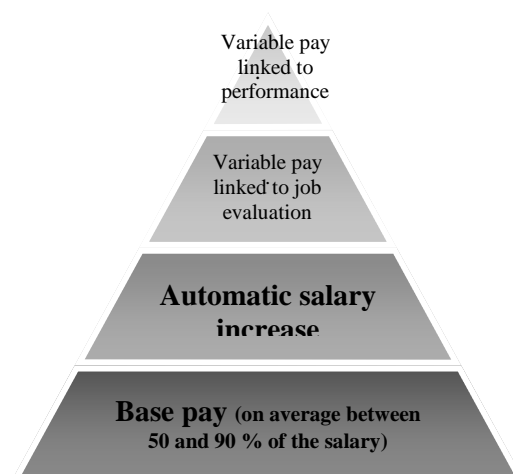
**Figure 1.1. PRP and performance management**



### ***1.1. The development of PRP over the past two decades***

30. The earliest examples of performance-related pay schemes pre-date the 1980s. In France, for example, the very first version of the civil service by-laws, adopted in 1946, stipulated that individual or group bonuses could be granted periodically to civil servants to reward exceptional performance. In Japan, a provision to grant public employees a “diligence allowance” has been in existence nationwide since the early 1950s. In Canada, an official system of merit increases for civil servants was introduced for the first time in 1964. The United States introduced a system of performance pay for managers (the Senior Executive Service) with the 1978 Civil Service Reform Act.

31. However, leaving the above examples aside, most other so-called merit increases available under many of the schemes in operation before the mid-1980s, could not be considered to be performance-related pay. This was because merit was defined so as to avoid penalties for non-performance; indeed, these increases were frequently allocated on a collective basis regardless of performance. They were effectively length of service or age-related increments.

**Figure 1.2. PRP in the overall pay structure**

32. The introduction of performance-related pay systems at the end of the 1980s and 1990s was a far more important trend than the early merit increases referred earlier. These more recent policies were introduced in a more systematic way and with mechanisms which consolidated performance-related pay increases into pay and pensions, having a long-term effect on them.

- The first wave of PRP policies were put in place in OECD member countries at the end of the 1980s. The central governments of Denmark, the Netherlands, New Zealand, Spain, Sweden, the United Kingdom and the United States<sup>18</sup> all adopted PRP in one form or another. Experimental policies were tested during the 1980s in certain organisations in Finland and in the German postal service.
- A second round of establishing PRP systems started in the early 1990s, with the adoption of PRP policies in Australia, Finland, Ireland and Italy.
- Most recently, in the late 1990s and early 2000s, 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 October 2003, France announced the introduction of a PRP system for top civil servants.

33. Examining the historical development of PRP, it seems evident that position-based systems, which grant a higher degree of delegation to managers, were the first to introduce PRP widely. The greater individualised accountability in these types of systems facilitated the introduction of individual performance pay. However, it is noticeable that some career-based systems like those in the Czech Republic, France or Korea, have recently acted to implement PRP to some extent. This constitutes quite a radical change in these civil services which are traditionally oriented to collectivism and based on promotion.

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18. The United States already had a PRP system in place for senior officials in 1978, which was extended to mid-level managers in 1981. The system was revised in 1984 and became the Performance Management and Recognition System. It was abolished in 1993. Since then, many US government departments and agencies have introduced performance pay, usually at the management level, following guidelines issued about its implementation from the Office of Personnel Management. In February 2004, the Department of Homeland Security adopted a PRP policy, which covers 220 000 employees.

**Table 1.1. Milestones in the development of PRP policy**

*1<sup>st</sup> introduction of PRP*

Canada (1964)	United States (1978)	Spain (1984)	Denmark (1987) Netherlands (1989) New Zealand (1988) United Kingdom (1985 and 1987; Inland Revenue Scheme, 1988) Sweden (1989)	Finland (1992) Italy (1993) Ireland (1995)	Australia (1997) Germany (1997) Korea (1999)	Ireland (2002) France (2004) Hungary (2002) Switzerland (2000)
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*Revision of schemes / implementation of more operational ones*

		United States (1984)		Sweden (1994) United Kingdom (1996) United States (1994)	Denmark (1997-2002)	United States (2004)
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34. Performance pay systems are not static. Aspects of their design may prove unsuited to the environment in which they are implemented and, like all pay systems, they are likely to go through a life-cycle. Belfield and Marsden (2003) found that, although many British private firms adopted PRP during the 1990s, large numbers also abandoned it. One reason for this was that it proved unsuited to their needs. There have also been some examples of public sector organisations moving away from PRP, for example, for managers in some parts of the British National Health Service. Pay systems often go through a life-cycle. They may start with clear principles, but over time they have to be adapted on an *ad hoc* basis to changing organisational demands and labour market pressures, leading to a gradual loss of their initial logic. As a result, from time to time, they need to be fundamentally reformed or replaced. There is no reason to believe that PRP schemes are any different from their predecessors.

**1.2. An overview of the current state of play in performance management**

35. The results of the OECD Survey on Strategic Human Resources Management (the HRM Survey) (OECD, 2004) conducted by the OECD in 2003 in 29 OECD member countries indicate that:

- Most OECD member countries report having a formal performance appraisal system for employees. The exceptions are Greece, Iceland, Luxembourg, and Spain.
- Most performance appraisal systems are based on an individual assessment of performance, which in turn rely largely on job objectives as defined in an employee/management performance agreement, rather than on standard, generalised criteria for a given job (that is a job description established by management irrespective of the aims for the position at a given point in time).
- Most OECD member countries (18) have tried to implement a wider performance management strategy, linking, at least formally, individual objectives and performance to institutional ones.
- One-third of OECD member countries have developed a different performance management system for senior managers (including Canada, Denmark, Italy, Korea, Norway, and the United Kingdom). This usually occurs in position-based civil services,<sup>19</sup> although France is an exception here. There is a trend across the OECD to focus special HRM policies on managers, which was traditionally not the case before the 1990s (OECD, 2003a).

19. Position-based systems: see the definition in footnote nine of the Executive Summary.

- Few countries have developed systematic policies to address underperformance. Traditionally career civil service systems<sup>20</sup> have certain procedures, but these are generally for misconduct rather than attempts to impact positively on underperformers.<sup>21</sup> It is clear, however, that the increased use of term contracts in OECD civil services has an influence on possible sanctions (OECD, 2004).
- OECD member countries focus on incentives to promote good performance rather than on sanctions for bad performance. Overall, career-based systems focus on incentives linked to promotion (and in limited cases they introduce one-off performance payments) while position-based systems focus on monetary incentives such as merit increments and bonuses.
- Two-thirds of OECD member countries have, to some degree, tried to link performance appraisal to pay formally. These include Australia, Austria, Canada, Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Korea, Netherlands, New Zealand, Poland, Slovak Republic, Spain, Sweden, Switzerland, the United Kingdom and the United States.
- Less than one-third of OECD member countries can be considered as having an extended, formalised PRP policy (Denmark, Finland, New Zealand, Switzerland, the United Kingdom and the United States).

### ***1.3. Why have governments introduced PRP?***

36. The reasons given for introducing PRP and extending its coverage within public services in OECD member countries are varied, as illustrated by the country reports and the academic literature. Individual countries often have multiple objectives for their PRP schemes. The main reason given for introducing PRP is that it motivates, by providing extrinsic rewards in the form of pay and intrinsic rewards through the recognition of effort and achievement.

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20. Career-based systems: see the definition in footnote 10 of the Executive Summary.

21. In many countries it may well be that failure to get a performance payment would be seen as a punishment. This, however, would appear to punish all those who deliver normal productivity and who may not receive therefore bonuses, as well as the underachievers.

**Box 1.1. What does the literature say about PRP?**

- It is common to analyse the workings of PRP through the lenses of three main theories: expectancy, agency, and goal setting to illuminate the PRP incentive and appraisal processes.
- The psychological theory of expectancy, pioneered by writers such as Lawler (Lawler, 1971), and Vroom (Vroom, 1964), proposes a simple relationship between the value of the reward for performance to the employee and the likelihood of obtaining it if they provide the necessary effort, resulting in improved motivation and thus performance.
- “Agency theory” applies a strongly economic perspective to the analysis of incentives. It argues that performance incentives are needed when the principal (the employer) cannot easily monitor the agent’s (the employee’s) work effort. In its pure form, it assumes a low degree of trust between management and employees, and that both act primarily out of self-interest. Therefore, unless management can either monitor work effort or reward performance, employees will put in as little effort as they can get away with. It also highlights the importance of matching incentive systems to employees’ degree of risk aversion. For example, if public employment attracts risk averse employees, these may resent the uncertainty attaching to variable pay linked to performance (see for example, Lazear, 1998).
- A third analytical approach is provided by “goal setting” theory (see for example: Latham and Locke, 2002). Goal setting theory emphasises the link between the quality of the goal setting process and increased employee performance. Its most important contribution is to the understanding of the value of the goal setting process. The way employees’ goals are set (in particular, how closely they are involved with choosing them) has been found to influence how hard they will seek to achieve those goals.
- Although the three approaches differ in emphasis, they point to the same key issues for the analysis of PRP systems: reward and motivation on the one hand, and goal definition and evaluation on the other. There is not much literature on PRP as a tool for improving management processes rather than motivating staff. The research led by David Marsden at the Centre for Economic Performance (the CEP) of the London School of Economics is leading the way in examining this (Marsden, 2003; Marsden, 2004).

*1.3.1. Improving motivation*

37. To understand why PRP schemes are thought to improve motivation, the shortcomings of the incentive systems they are used to supplement or replace, must be considered. The incentives in earlier pay schemes comprised a mixture of advancement up the pay scales for each grade, with some opportunities for promotion into the next grade above. Although salary progression within grades may not have been intended to be automatic, in practice this was often the case, as highlighted in Britain by the Megaw report (Megaw, 1982) and in France by the Guilhamon report (Guilhamon, 1988). Provisions for withholding increments were rarely if ever invoked.

**Box 1.2. Rationales for service-incremental pay scales**

There are two common rationales for service-incremental pay scales. They reflect the average improvement in employees’ productivity as they learn the skills required for their grade. They represent a form of deferred income designed to discourage labour turnover and to enable employees to signal their commitment to the organisation. Both rationales are based on the idea that performance differences among individual employees tend to be small, as in the concept of the “neutral competent” (Bettors, 1931). It is hard to test how far these rationales really explain the observed patterns of service-incremental pay scales in the public services. It is possible that their very survival in so many countries demonstrates their effectiveness, but unlike private firms, there is no market test of competitiveness. Inertia and tradition could be just as good an explanation (Kahn, 1962).

38. Promotion has severe limitations as a generalised incentive. Even where there is scope for promotion, it may be slow because of the generally stable employment in public services. This has been intensified by a “delaying” of levels of management in many organisations which has reduced previously existing promotion opportunities. The ageing of the workforce and the fact that, since 1990, the age groups “50-59 years” and “60 years and more” have seen their share of the civil service workforce increase

(OECD, 2002c)<sup>22</sup> have limited the opportunities for promotion in the past decade. As a result, large numbers have stayed at the same rate of pay or within narrow pay bands, and management has had little to offer by way of further financial inducements. For example, in the United Kingdom civil service administrative group, 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. When examining police pay in the United Kingdom in the 1990s, the Sheehy Inquiry (Sheehy, 1993) found that a very large percentage of all ranks (42%) “did not expect to be promoted” (Touche Ross, 1993). The introduction of PRP is thus seen as an alternative method of motivating staff.

### 1.3.2. *Attracting and retaining talented and dynamic employees*

39. Data compiled by the OECD in the 1990s showed that, in a number of OECD member countries, the pay levels of senior civil service managers had slipped to between 30-50% below those of the private sector during the 1980s (OECD, 1993). Introducing performance-related pay policies, especially at managerial level, is therefore seen as necessary to compete effectively with the private sector for the most talented employees.

40. The other key role of PRP in recruitment concerns the type of person it attracts. Government organisations may often appeal to employees who, although competent, are somewhat risk averse. Pay scales with service-related increments may reinforce that perception of public service jobs, whereas performance pay may well attract more dynamic and risk-taking people.<sup>23</sup> Particularly for jobs which require risky decisions, as in senior management, it is possible that PRP has a role in recruitment. To attract people from the private sector with the right kind of expertise, it is seen as necessary not just to match pay levels, but to adopt similar kinds of incentive systems.

### 1.3.3. *Facilitating management changes*

41. PRP can also be seen as a way to facilitate management changes at times when new priorities are emerging. In particular, three points were mentioned by countries:

- PRP as an incentive for improved staff development. For instance, it can be a requirement for receiving a PRP bonus that a training course has been completed. This was mentioned by Hungary, Italy and the Nordic countries as a key objective for the introduction of PRP.
- PRP has been mentioned by several countries (Finland, Hungary and Italy) as a way to introduce new methods of work and to reorganise work in order to introduce more flexibility and to provide a more responsive service to the public.
- PRP is sometimes seen as a lever for improving leadership by encouraging innovation and risk taking. This was given special mention by Canada, Denmark, France and Germany.

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22. More than half of civil servants are over 50 years old in OECD countries.

23. In his Safelite study, Lazear (Lazear, 1998) estimated that a high proportion of the increased productivity associated with the introduction of output-based pay (the case concerned fitting windshields on cars) could be explained by differences between the firm’s recent recruits and long established employees.

*1.3.4. Will PRP control the pay bill?*

42. The introduction of PRP can have differing aims regarding pay:

- Government may consider the introduction of PRP as a way to contain salary costs by reducing the incidence of automatic progression through salary levels.
- On the other hand, the introduction of PRP may be a politically saleable means of lifting an overall salary ceiling when salary levels compared to the private sector are considered to be low.
- The increase of salary allowed by PRP may be seen in some cases as compensating for the loss of security entailed in term contracts, as in New Zealand for instance.
- The introduction of PRP may be also seen as an attractive way to increase salaries without impacting on pensions or long-term pay, in the case of one-off non-pensionable bonuses. Wage increases in the public sector are extremely expensive, particularly in a climate of low inflation, and a PRP scheme offers one mechanism for controlling these and thus allaying the fears of the taxpayer.

*1.3.5. Making accountability visible*

- An important reason for introducing PRP is political as it is a signal that individual civil servants, especially managers, are accountable and that their level of performance is monitored. It is important in combating ideas that civil service employees are unaccountable and overpaid.
- In career-based systems, PRP may also be a way to bridge the gaps that exist between the public and private sectors, where the public sector is seen as the world of security in which people have a job for life and automatic salary increases, unlike the private sector. The introduction of PRP in the public sector is a popular reform in most countries. This is a major reason for implementing it or not going back to previous systems of salary increases based on seniority.

***1.4. PRP and the delegation of human resource and budgetary responsibilities***

43. Overall, countries which have introduced performance-related pay policies are those which have the most devolved budgetary frameworks. These provide essential underpinning for the delegation of central controls over key HRM aspects such as staff numbers, classification, grading and pay, itself critical to the implementation of PRP.

44. Analysis of the HRM Survey (OECD, 2004) shows that there are two noticeable trends in human resources management in the past decade, although the scope and pace of these trends vary greatly from one country to another:

- increased delegation of human resources and budgetary management responsibilities to individual ministries/departments and onwards to line managers;
- and increased individualisation of human resources management that is, management of employees as individuals not just by grade classification.

45. While traditionally, career-based systems tend to create little individualisation and delegation of human resources practices, whereas position-based systems have more individualised and flexible human resources practices, many countries now fall in between the two systems as regards delegation and

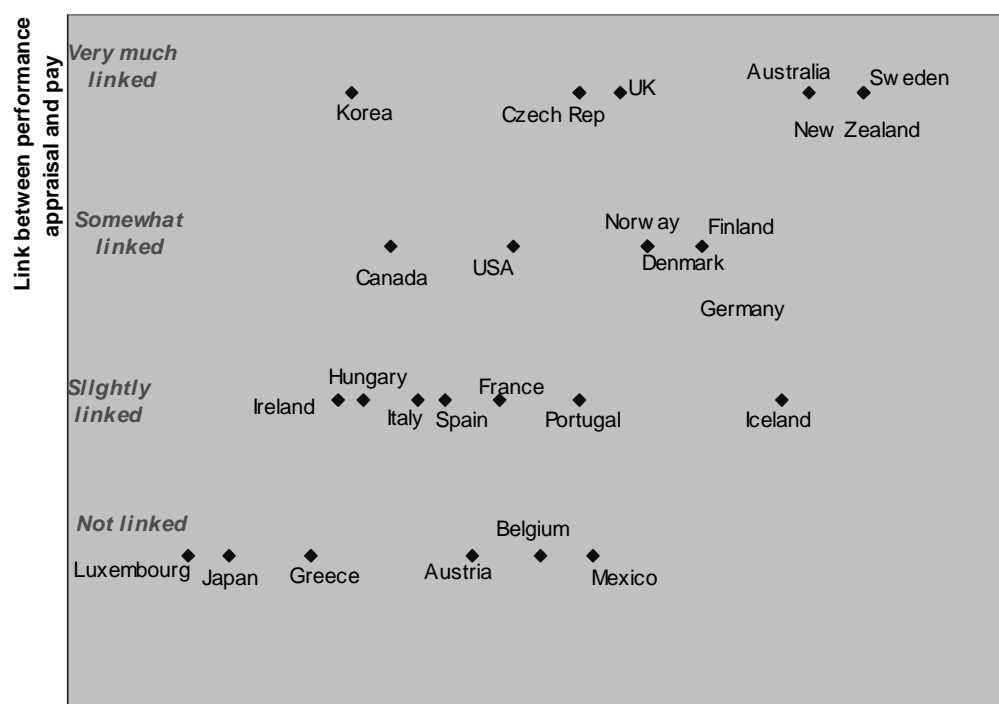


individualisation (OECD, 2004). These trends to managerial delegation and individualisation are, however, essential if PRP is to be effectively implemented. For example, budgetary delegation provides the essential underpinning for the delegation of central controls over key HRM aspects such as staff numbers, classification, conduct of performance assessments, grading and pay. All of these are critical to the effective implementation of PRP.

46. It must, however, be stressed that, even when human resources and pay management are substantially delegated, finance ministries tend to keep tight control over pay budgets. Flexibility for local management is confined to issues such as measurement of performance and distribution of the limited amount of money available for performance-related pay. The design of the scheme, that is how to go about measuring performance for example, may or may not be decentralised/delegated and that issue is dealt with below in Chapter 2.1.2.

47. Graph 1.1 below shows the relationship between the level of delegation and the existence of a formal link between performance appraisal and pay. It is based on an index of delegation developed on the basis of the HRM Survey (OECD, 2004, also covering the methodology of Graph 1.1).<sup>24</sup> Overall, it shows that the greater the HRM and pay delegation, the stronger the link between performance appraisal and pay.

**Graph 1.1. Relationship between delegation and link between performance appraisal and pay in OECD member countries**



Source: OECD, 2004.

24. Please note that Graph 1.1 excludes the Netherlands, Poland, the Slovak Republic, Switzerland and Turkey in the absence of sufficient data.

48. Overall, one can distinguish four groups of countries:

- The first group of countries (Australia, Denmark, Finland, New Zealand, Sweden and the United Kingdom) has developed strong links between performance appraisal and pay. They are position-based systems and have in common a very high degree of HR delegation.
- The second group of countries (Canada, Germany, Hungary, and the United States) has their performance appraisal system somewhat linked to pay. They have a lower level of delegation.
- The third group of countries (Austria, France, Ireland, Italy, Poland, Spain) has introduced very limited links between performance appraisal and pay. They focus more on non-monetary incentives such as promotion.
- The fourth group of countries (Greece, Japan, Luxembourg, the Slovak Republic) has not developed any formal links between performance systems and pay. They have in common a very low degree of human resources delegation.

49. Some exceptions to this typology are noticeable. The Czech Republic and Korea for instance, have a low degree of delegation and have developed strong links between performance appraisal and pay. Iceland has a very high degree of delegation and a weak link between performance and pay. Belgium and Portugal have no performance pay system but have a higher degree of delegation than the fourth group.

50. The trend appears to be that countries which have moved towards more delegation have introduced PRP systems. This is not surprising given that performance-related pay requires enhanced discretion to manage. Regardless of the extent of the introduction of PRP, some delegation of management responsibilities is a key pre-condition for its effective implementation.

51. However, reinforcement of accountability mechanisms is needed to counterbalance equity problems raised by this increasing delegation, an issue addressed below in Chapter 2.

### **1.5. Conclusions**

52. Two-thirds of OECD member countries have introduced some links between performance appraisal and pay in their civil services although less than one-third of OECD member countries can be considered to have an extended, formalised PRP system. 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.

53. Previously limited to position-based systems, the introduction of PRP policies is now being extended to some department-based and career-based systems as a way of increasing flexibility and managerial discretion over pay and to promote individual accountability. Other reasons for introducing PRP include increasing staff motivation, attracting more dynamic employees and facilitating managerial changes.

54. The impact of the introduction of PRP has to be analysed according to the multiplicity of objectives given for introducing it. The types of objectives which its implementation is hoped to realise, vary across countries. Nordic countries focus more on the personnel development aspects, Westminster countries focus more on the motivational aspect and others like France or Italy stress the accountability of top civil servants.

## CHAPTER 2

### KEY TRENDS IN PERFORMANCE-RELATED PAY IN OECD COUNTRIES

55. This chapter outlines how, although PRP systems have become increasingly common in OECD member countries, their design and application varies considerably. Nevertheless, some common trends are emerging and these are reviewed under three headings. Firstly, the overall design of PRP demonstrates that there is no single method for designing or implementing it. Secondly, the evolution of performance appraisal systems, using more diverse criteria and rating systems so as to be able to identify more clearly excellence amongst employees, is described. Finally, detailed information is provided about the form and size of performance-related payments in a number of OECD member countries.

#### 2.1. *General trends in the overall design of PRP systems*

##### 2.1.1. *How and how far has PRP been introduced?*

56. Across OECD member countries, there is a great deal of variation in the manner in which PRP schemes have been introduced, ranging from its imposition by central government to introduction by consultation and collective bargaining. PRP was introduced by means of collective bargaining in Denmark and Finland, whereas it was introduced by law in many other European countries and in the United States. In New Zealand and the United Kingdom, PRP was introduced rather differently by negotiations between the State Services Commission (New Zealand) and the Cabinet Office (United Kingdom) and their respective public service departments and agencies. Broadly speaking, methods of introducing PRP reflect the established methods for determining public pay. Where the move to PRP has been negotiated, change has been more gradual than where it has been imposed.

**Table 2.1. Methods of introduction of PRP**

Method of introduction of PRP	Countries
<b>Law</b>	Germany; Hungary; Italy; Spain; Switzerland; United States
<b>Collective agreement</b>	Denmark; Finland; <sup>25</sup> ; Sweden
<b>Other methods</b>	Canada (policy advice) <sup>26</sup> New Zealand (bargaining parameter) <sup>27</sup> United Kingdom (Negotiations with Cabinet Office and HM Treasury)

57. Introducing PRP gradually can be a very slow process. From the examples of Denmark and Finland, it seems that a minimum of eight to 10 years will be required for these governments to attain their objective of full coverage of PRP. In Denmark, implementation started in 1997, and will continue until 2005. In Finland, in 2002, about 35-50% of the civil service has successfully implemented the new pay system launched in 1992. The rest of the civil service will implement it at the beginning of 2005 at the latest.

25. The State Employer's Salary and Wage Policy Programme.

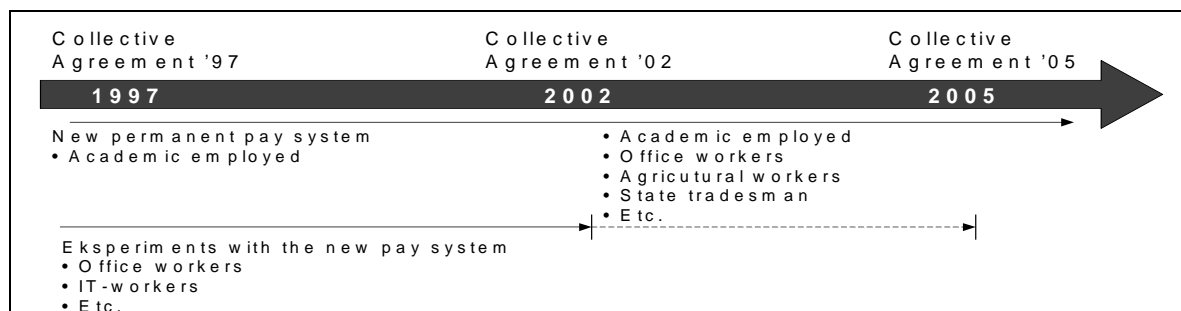
26. The approach to performance-related pay in Canada is a policy that was accepted by the government upon recommendation by an advisory committee responsible for reviewing and monitoring the compensation of executives and heads of departments and organizations.

27. The purpose of the bargaining parameters is to establish government policies and expectations for collective bargaining and employment relations generally in the public service, so that departments can act in accordance with these.

**Box 2.1. Introducing PRP: the Danish case**

The new PRP system in the Danish public sector, introduced in 1997 by collective agreement, began slowly. It was effective from the beginning of 1998 for university graduates employed under collective agreements, but most of the unions were not then prepared to accept an individual performance-related pay system. Thus, in the sectors controlled by the Danish Central Federation of State Employees' Organisations (*Centralorganisationernes Fællesudvalg* – CFU) a framework agreement was concluded on trialling the new pay system between January 1998 and March 2001. Subsequently, in the 2002 collective agreement, most of the unions entered the new pay system.

**Figure 2.1. Milestones in the development of the new pay system**



In Denmark, communication and education about the new pay system was put in the hands of a special unit in the Ministry of Finance called *Lønreformenheten*. This unit was responsible for all information about the new pay system, for instance development and distribution of a dynamic guide to the new pay system (updated half yearly) which was produced and distributed in consultation with the relevant social partners, as was most PRP information. The unit was also responsible for the education of HR personnel in the state institutions and for running conferences and courses on the new pay system (including for managers on implementing it). The responsibility for the information on the new pay system was transferred in 1999 to different divisions in the Ministry of Finance and integrated into the daily work in these divisions.

58. However, gradual implementation allows the new system to be piloted on a limited number of employees, and for it to be improved drawing on the lessons from such experiments. It also contributes to a smoother implementation process with unions and greater acceptance from employees. Partial or gradual change processes are more akin to learning and adaptation – crucial with PRP – rather than “reform”.

**Box 2.2. The case of the Department of Work and Pensions (DWP) in the United Kingdom**

An incremental approach in the DWP has helped to make the task of introducing team bonuses into a large organisation more manageable. It has also had the added advantage of enabling lessons to be learnt as the scheme is rolled out area by area. The earliest areas to run schemes will now be entering their third year of operation and this experience has valuable lessons for newer areas.

This gradual approach also allowed the DWP to select or avoid areas of the organisation. For example, the DWP did not introduce PRP into areas operating under legacy arrangements or organisations which were due for modernisation e.g. much of the Pension Service. Instead team bonuses were introduced to motivate those in areas undergoing modernisation (e.g. to the Jobcentre Plus Pathfinders and to the Pension Service Empower) where PRP will be a key part of the performance management culture.

A further advantage of the incremental approach was that early progress could be demonstrated, which was vital for securing pump priming funding from the UK Treasury.

59. On the other hand, taking a radical approach to the introduction of PRP, as has been done in some OECD member countries, may allow a rapid adoption of the new system, which can facilitate cultural change and the adoption of wider management changes. But this approach may cause its own particular problems, see Chapter 3.

60. If PRP policies have been implemented to some degree in two-thirds of OECD member countries, only a minority (less than one-third) of them have applied PRP systematically throughout their entire civil service. Denmark, Finland, New Zealand, Switzerland, the United Kingdom and the United States seem to have advanced the furthest in establishing PRP, at least in formal terms.

61. The coverage of PRP varies greatly. In Canada, Ireland, Italy, and Norway, PRP is applied at management level only, with Ireland and Norway (and soon France) having it for the most senior officials only. Sometimes, however, top managers are excluded from PRP (*e.g.* Finland and Italy). One reason for this is to avoid assessing the performance of those who are political appointees. But most OECD member countries with PRP have extended it to all their staff.

62. The extent of coverage of PRP within the civil service reflects, in part, the degree to which management is centralised or devolved within the public service. In centralised countries, PRP tends to be standardised and applied to the whole core administration of the government. In decentralised countries, there is greater diversity as to which departments and units use it.

63. Overall, however, it is noteworthy that 10 years ago, it was common for PRP schemes to apply to senior managers only. Today, in most countries, the design of PRP includes all categories of staff or plans are under way for its extension to include them. A notable development in recent years has been the extension of PRP from senior management to non-managerial staff. The hypothesis for that extension is that PRP is often introduced as a lever for wider management changes in organisations, which implies that all staff should be included in the PRP scheme, not just managers.

#### *2.1.2. Decentralisation of the design of PRP policies*

64. The methods by which different countries have introduced elements of performance-related pay in their public services broadly reflect the established methods for determining public pay. However, when the pay system is centralised, it is noticeable that some countries have introduced PRP as a way to introduce more decentralisation into the overall pay system. Some centralised pay systems can thus be combined with a decentralised PRP approach – this is the case in Denmark for instance.

65. Long-running schemes of the 1980s have evolved from centralised to much more decentralised systems in the past 10 years, where individual departments/ministries are responsible for designing and managing their PRP schemes. This is the case for instance in Denmark, New Zealand, the United Kingdom and the United States.

66. In addition, the degree of centralisation of PRP policies – *i.e.* the degree to which their design is elaborated at the central government level and standardised across all government organisations – varies according to the group of employees concerned. Often, a decentralised approach to PRP at the employee level is combined with a centralised approach for senior civil service management. This is the case for instance in New Zealand, the United Kingdom, and the United States. PRP design is established at the central level in detail for senior management, while it remains very much decentralised for employees. Even where design is centralised, rating policy may be left to local management or to ministries.

**Table 2.2. Degree of centralisation of design of PRP policies**

	<b>Senior management</b>	<b>Employees</b>
<b>PRP highly centralised<sup>28</sup></b>	Australia; Canada; Ireland; New Zealand; United Kingdom; United States	Germany; Hungary; Korea; Switzerland
<b>PRP partially decentralised<sup>29</sup></b>	Finland; Italy;	Australia; Finland; Spain; United Kingdom; United States
<b>PRP highly decentralised<sup>30</sup></b>	Denmark; Sweden	Denmark; New Zealand; Sweden

67. New Zealand and Sweden constitute probably the most decentralised systems in terms both of the design of the PRP scheme and managerial delegation. In Sweden, agencies are almost completely autonomous in employer policy related matters. Each agency recruits its personnel and negotiates pay within the limits set by its budgetary appropriations. The only requirement of agencies is that they should have the skills required to accomplish the outcomes demanded by the government. Each agency decides autonomously on pay, promotion, hiring and firing, etc.

*2.1.3. The equity implications of decentralisation and delegation of PRP arrangements*

68. Decentralisation of PRP and delegation of human resource and budgetary management raises issues related to equity which are created by the application of different policies across departments/ministries. A special focus has to be put on accountability/control mechanisms in order to counter any possible unfairness in pay systems within organisations. Some countries, such as Denmark, have developed new tools to monitor wages or have reinforced formal contractual arrangements between managers and top management, as a way to strengthen accountability.

**Box 2.3. How to monitor the highly decentralised pay system in Denmark and Sweden**

In Denmark, decentralisation is counterbalanced by the comprehensive centralised control of each institution/agency using the new pay system. In order to monitor the wage level trends, the State Employer's Authority of the Ministry of Finance has developed a special statistical tool - accessible from the Internet – called *ISOLA*. This database has been extremely important for the State Employer's Authority in order to run, monitor and control the highly decentralised pay system. But the system is also of vital importance for assisting local institutions to use of the new pay system properly. The system allows a local institution to compare its salary level to that of other institutions.

Since 1997, the government in Sweden monitors agencies' employment policies by using a system with annual reporting of staff planning, salary level and development, gender distribution, age structure and staff turnover.

69. In most countries, the line manager is now in charge of an employee's performance assessment. In certain cases, assessment has to be done in coordination with top managers, as in Finland, or with unions, as in Denmark.

70. The influence of unions on the operation of the performance appraisal system is very diverse among OECD member countries, as demonstrated in Table 2.3.

28. PRP is usually defined in detail in the law: performance appraisal and the nature of the awards are centrally designed.

29. PRP is defined in the law in broad terms, and guidelines for performance appraisals and payments are issued. Within this general framework, individual departments have significant flexibility in areas such as the approach to performance appraisal and the distribution of rewards.

30. Individual departments have considerable flexibility in the design of performance appraisal, size of rewards, form and distribution of payments, etc. The PRP system is not defined in the law and PRP policies vary considerably from one organisation to another.

**Table 2.3. Influence of unions on the operation of the performance appraisal system**

Strong		Relatively weak		Very weak	
-	Denmark	-	Austria	-	Australia
-	Korea	-	Belgium	-	Canada
-	Norway	-	Czech Republic	-	Finland
-	United States	-	France	-	Hungary
		-	Germany	-	Iceland
		-	Ireland	-	New Zealand
		-	Italy	-	Poland
		-	Portugal	-	Slovak Republic
		-	Sweden	-	Switzerland

Source: OECD, 2004.

71. When the appraisal system is linked to pay, the system is often accompanied by the creation of special committees to coordinate and control ratings and the distribution of rewards, organisation-wide or government-wide, thus reinforcing any formal guarantees provided by existing procedural justice mechanisms.

#### **Box 2.4. Committees to control evaluation criteria and ratings**

France – Joint technical committees (*comités techniques paritaires*) are consulted on “allocation criteria for performance bonuses”; there is accordingly social dialogue in this area, but it is confined to performance bonuses which are far from comprising the majority of allowances.

Italy – In accordance with Law No 286/1999, a central unit for assessing policy and programme effectiveness has been established at the Prime Minister’s Office. The committee is composed of six members who are expert in evaluation methodology, economy, law, sociology, statistics and political studies respectively. Each member is appointed for six years. The mission of this technical-scientific committee on evaluation and strategic control is, amongst other things, to examine the appraisal systems of public managers which are set up in each ministry and to give advice on of their implementation.

United Kingdom – Departmental pay committees consist of a representative group of the most senior managers in each department and include some independent element such as non-executive directors from departmental management boards. The judgements required of a pay committee are based on a broad assessment of an employee’s contribution compared to other individuals operating at the same level. The introduction of the pay committee makes judgements previously made on an *ad hoc* basis more transparent, rigorous and equitable.

#### **2.1.4. PRP: the shift from the individual to the collective approach**

72. Whilst individual PRP is the principal form used across countries, especially for management, change in this aspect of PRP design is noticeable, as an increased interest in the use of group and team-based schemes has occurred over the past five years. The experience of the limitations of individual PRP schemes (for example with regard to measuring individual performance) have led some public organisations to consider more collective approaches, often in addition to individualised PRP systems. The combination of individual and collective PRP is more common than 10 years ago. A collective system can, for example, be applied at the departmental or team/unit level, and be combined with an individual approach, to reward exceptional performance. The introduction of collective PRP is more than an emerging idea now, and seems to be a significant trend across OECD countries.

73. Several countries have strongly encouraged the move to a more collective approach to PRP within individual ministries. This is the case in the United Kingdom, where a number of departments are making the transition from individual to team-based systems during 2004, implementing the recommendations of the government’s Makinson report (Makinson, 2000). In Finland, results-based rewards are applied at the team level within an organisation. In Spain, the productivity bonus is also

essentially applied at the team level, when productivity is used for remunerating special performance. In Germany, managers can allocate a bonus at the team level. There, it has been decided, on the basis of a report in 2003 on the performance pay system, to strengthen the collective approach to PRP. In the United States, many public sector agencies, such as the Federal Aviation Agency, have introduced collective PRP systems, where bonuses are allocated at the team level on the basis of team objectives.

74. Other countries such as Hungary and Korea have mentioned their intention to move to a more collective form of performance pay. Italy states that “the concept of team results connected to a bonus represents a new operative modality in a new general context” (Lefebvre and Raspino, 2002). It is striking to see that all types of civil service systems, both career-based and position-based, are showing some movement towards collective forms of performance pay.

## **2.2. Performance appraisal systems: highlighting the trends**

75. Performance appraisal is commonly based on job objectives. 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), generally in line with organisational goals. After a period of time (the “appraisal period”) generally one year, the employee’s performance is assessed by their manager. The evaluation can be based on a detailed grid or list of criteria or can be much more informal. Where PRP is in place, which is generally more the exception than the rule, this appraisal then becomes a key element in the performance pay decision.

76. Some countries also define the standard elements of a job which cover its more important areas of work and which are common to a particular range of managerial or non-managerial jobs. This is the case in Australia, the United Kingdom, and the United States, for instance. In the United States, they are referred to as “critical elements”. The proper development of performance assessment criteria requires extensive job analyses for the family of jobs they are to cover.

### *2.2.1. Increased use of performance appraisal based on job objectives*

77. There are two main types of performance agreement (OECD, 1999):

- Organisational performance agreements: negotiated agreements between the minister and chief executive or between the chief executive and senior managers within the department or agency, which break down overall strategic goals into programme elements, setting specific, often detailed, operational, procedural and output oriented targets.
- Individual performance agreements: these may take the form of a non-legal written agreement as part of an annual performance appraisal and goal setting, or be part of an employment contract process, regarding the work to be carried out over the coming year. Regardless of the format, performance agreements are generally evaluated and negotiated on an annual basis.

78. Objectives are usually set in a “top-down” manner, with government setting the priorities for ministries and government objectives being disseminated within each organisation and each level of organisation by top managers and line managers. There are generally four main kinds of targets used in performance measurement. They include:

- policy priorities directed to achieving long-term outcomes;
- strategic goals, intermediate outcomes or high level outputs;



- measures or standards of service quality, often as part of organisational performance agreements, or as stand alone performance contracts for individuals;
- annual targets, including specification of outputs, processes, management targets (staffing, training, IT), financial targets, efficiency and productivity targets, and possibly customer service targets.

79. Some countries have developed formal contractual relationships between the most senior officials and ministries in order to reinforce accountability but also to bridge the political/administrative interface. This has occurred in some position-based systems and in countries with a long agency tradition, like Australia, Denmark, New Zealand, Norway or Sweden. More recently, some long standing career-based systems have moved in that direction for top managers, for example, Korea or plan to do so, for example, France.

80. Setting clear organisational objectives is important for the effective implementation of PRP at all levels of the organisation. It facilitates goal setting by creating a “cascade” effect throughout the whole department/agency. It is especially important for middle management which has to apply a performance evaluation process for its own staff: if middle management has a clear perception of what they must achieve, then it is much easier to set the goals for, and to evaluate the performance of, their own staff. Goals are also more likely to be achieved where local management has a degree of independence so it can adapt a PRP system to local requirements.

81. At the employee level, the identification of objectives is generally done through a discussion with the line manager, within the framework of organisational objectives. The degree of formality varies regarding the agreement of objectives – in most cases it is done in writing but sometimes it is done informally (in Sweden for instance). The discussion of the objectives can be the opportunity to assess the employee’s development needs (*e.g.* training, career or mobility, support from the manager). In some countries, personnel organisations or unions have to sign the objectives, as in Denmark. The agreed job objectives then become the criteria against which performance is appraised at the end of the appraisal period.

82. Involvement of employees in the identification of their own objectives is important. Employees are generally better informed about the technical aspects of their work than are their managers, and managers are more oriented towards general strategy. Both benefit from this active dialogue. Achieving objectives becomes one of the criteria against which performance is measured.

#### 2.2.2. *What are currently used performance criteria?*

83. In most cases, some kind of criteria to assess the individual’s performance is developed. Overall, the most important criteria highlighted in country reports are the following: outputs<sup>31</sup> achieved which include the specified objectives described above; competencies and technical skills; interpersonal skills and teamwork; leadership and management skills; and inputs.<sup>32</sup> Other criteria mentioned by individual countries include for instance ethics (Canada) and innovation (Denmark) (OECD 2003x; OECD, 2003y).

84. Figure 2.2 provides an indication of criteria used for assessing the performance of government employees across OECD member countries. It is based on answers to an open question in the HRM Survey (OECD, 2002a; OECD, 2004) about the key criteria used for evaluation. Countries which use an individual performance appraisal system without linking it to pay have also been included in the chart. On the vertical

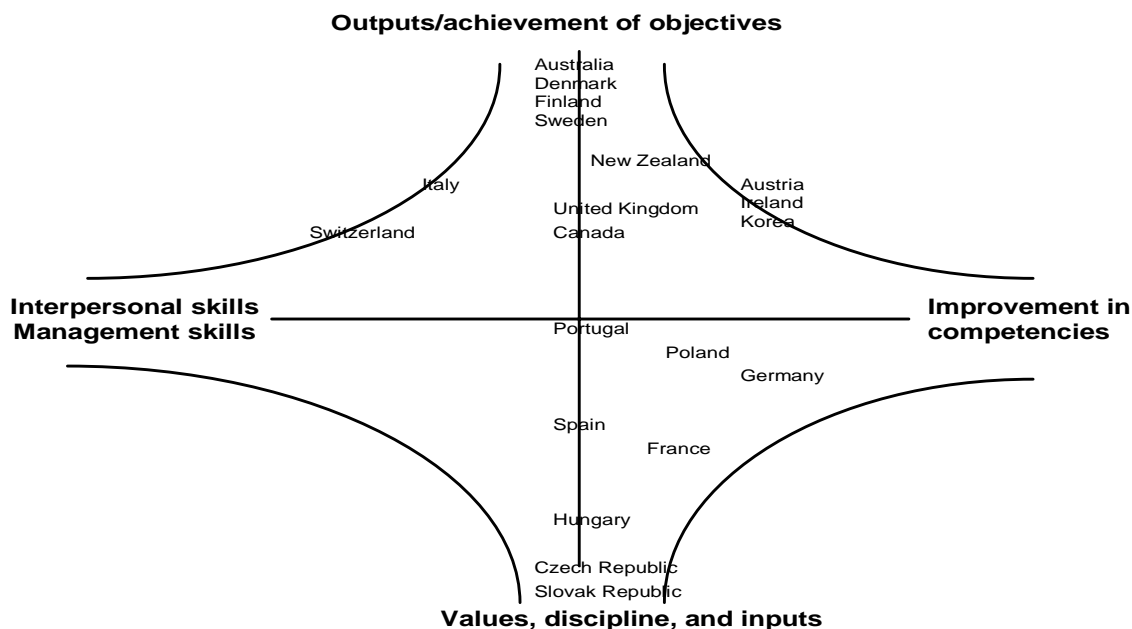
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31. Outputs: see footnote 5 of the Executive Summary for a definition.

32. Inputs: see footnote 6 of the Executive Summary for a definition.

axis there is a distinction between inputs and outputs and on the horizontal axis there is a distinction between attention granted to formal competencies and interpersonal/managerial skills. More countries focus on outputs as their first criteria for assessing performance rather than on inputs.

**Figure 2.2. Criteria for assessing performance across OECD countries**



So

urce: OECD, 2004.

85. The criterion specifying improvement in competencies has also become increasingly important. Partly this is because this criterion is a way to encourage the development of the key skills required of staff. But it is also, in some respects, easier to agree and codify what constitutes technical competence than to assess what outputs have been achieved. This route can avoid some of the problems of divisiveness associated with PRP based on appraised performance outputs.

86. Nevertheless, interpersonal skills have grown in importance with the spread of more flexible, team-based, working practices and the need to be more responsive to individual citizens' requirements. Associated with these are leadership and management skills. They have a special relevance to managerial staff, but with measures to devolve more decision-making and responsibility to lower levels, these skills become more relevant also to staff lower in the organisation.

87. Of course, with the other criteria described above are also not immune from the assessment problems encountered by PRP based on outputs achieved. It is very hard for instance to measure competencies in the absence of formal certification as they are difficult to define in a way that is acceptable to both staff and management (Wolf). Relying simply on a manager's subjective judgement as to whether an employee has acquired a particular competence can be as difficult as deciding whether an employee has achieved a certain level of output. Hence, the common attachment to relying on the perceived objectivity of certified skills.

**Box 2.5. Performance criteria and rating systems – Country examples**

Denmark – All allowances are decided on the basis of individual appraisal, based on a dialogue between the employee and the line manager. This dialogue – called *the salary discussion* – is normally integrated into the yearly “*performance interview*”. The agreements have to be agreed and signed by the manager and the union representative/union liaison. In some institutions a “scorecard” is used for this appraisal, but normally the rating is more informal and the salary discussion is “only” based on the local salary policy.

Finland – In every organisation there is a set of criteria for assessing individual performance. Ordinarily three to five main criteria are agreed upon in the collective agreement, and a network of sub-criteria as well as their weights are specified when the new pay system is implemented. A very typical set of criteria would be a variation of “*competence, effectiveness, and cooperation*”. For management there is often a specific criterion “management skills”, which can also be an alternative for “cooperation skills” for non-management jobs. These sub-criteria and criteria are assessed, often giving points for them, and the sum is the individual's result. The collective agreement includes a table defining the pay for the various performances as percentages of the base salary (which is based on the demands of individual jobs).

Korea – Performance and competencies of employees in grade five and below are assessed twice a year (January and July), while performance of managers is assessed in January. Performance of civil servants is evaluated by: performance outcomes (60%), job-related competencies (30%), job-related attitude (10%). After completing appraisals, managers are recommended to communicate the results to employees, focusing on counseling and development.

88. In summary, there is an increased diversity in the criteria against which to assess performance. Even if the traditional schema remain in place, career-based systems focusing more on inputs and position-based systems on outputs, both systems tend to converge in the attention given to results and competencies and social skills in general.

89. Systems which rely almost entirely on assessing performance appraisal through consideration of inputs cannot fully qualify as performance-related, nor can they qualify as true performance-related pay systems even where their performance appraisal is linked to pay. To be truly performance-related, the assessment needs to be based at least partially on outputs.

*2.2.3. Flexible or quota based rating systems: identifying the outstanding performers*

90. Ten years ago the priority was to develop quantifiable indicators. Today it is well-established theoretically, as well as being the everyday experience of managers, that if rewards are tied to one element in employee performance, then over time, employee efforts will be diverted towards it at the expense of other elements. It is often argued that focusing too much on easy to measure quantitative targets, for example, will drive out harder to measure qualitative aspects of performance. Non-quantifiable aspects of jobs are extremely important, and evaluation by line management can provide a more flexible and accurate appraisal system than quantifiable indicators.

91. Performance can be more easily assessed for the extremes – the very good performers and the very bad ones. For the majority of staff, it is very difficult to differentiate between performance. This explains the limitations of highly detailed rating systems or scales, where most staff end up being rated in the same category. The lack of discrimination in ratings was reported as one of the major limitations of PRP schemes used in the 1980s which tended to be highly formalised and detailed.

92. Given these inherent limitations, two differing responses have been apparent from many civil services. Some have moved to a more flexible and less detailed system of rating, where each ministry is responsible for developing its rating policy and more emphasis has been given to verbal assessment and qualitative methods. Some countries have even suppressed the rigid grid of rating used for the evaluation. The United Kingdom, for example, has moved to a more informal system of rating for senior civil servants. There, the removal of explicit and numerical performance markings is seen as “a new departure” (OECD, 2002b). A more flexible approach is seen as a better way of identifying excellence and differentiating average performance.

93. Another response intended to prevent the lack of differentiation in ratings awarded has been the increasing use of quota systems, to specify the proportion of employees placed in the higher categories of the rating scale. This has occurred, for example, in Canada, Germany,<sup>33</sup> Korea, many departments of the United Kingdom, and the United States.<sup>34</sup> Forced ranking systems go even further as they specify the proportion of staff to be placed at each rating level. Such systems are based on the assumption that the actual distribution of performance outcomes matches the theoretical distribution which is being applied. This occurs in Switzerland where the *Gauss Curb* has been used to develop the design of PRP.<sup>35</sup> The rating distribution is controlled at central level.

94. The introduction of quotas is an acknowledgement of the difficulty of differentiating between individuals' performance and a way of formally insisting it take place. But it introduces rigidity into a system which is trying to move away from that constraint. It has, however, another important purpose: facilitating the budgetary control of PRP scheme.

#### 2.2.4. *Performance assessment as dialogue rather than control tool*

95. A performance assessment is generally reported through an oral discussion with the line manager, and also in a written report. This is compulsory for instance in Canada, France, Hungary and Switzerland. In Sweden, the system is much more informal and performance appraisal can be done though an oral discussion only. Generally evaluation occurs once a year – in some countries twice per year (*e.g.* Korea and New Zealand). In many cases informal discussion takes place during the year to prepare for the final appraisal. In Ireland, there are an interim review and an annual review to ensure that feedback is given at least twice a year. In the United Kingdom, there is a mid-year development review. In most countries employees have the right to question their appraisal and to submit the decision to unions or employee organisations.

96. The final evaluation discussion tends to be conducted along the lines of a dialogue rather than of a control tool. In this regard, there is a noticeable trend toward the so-called 360-degree feedback system where performance appraisal is made not only by superiors, but also by peers, and/or subordinates. Norway, for instance, has developed an interactive evaluation system, where the employee is required to assess himself before the performance dialogue – and to assess the manager.<sup>36</sup> Two-thirds of OECD countries have initiated a move in the direction of 360-degree feedback in assessing individual performance, in most cases still as a pilot experience (OECD, 2004). This is notably the case in Australia, Austria, Canada, Denmark, Finland, France, Germany,<sup>37</sup> Korea, Mexico, New Zealand, Norway, Sweden, Switzerland, the United Kingdom and the United States (OECD, 2004). It is noticeable that these countries are almost the same as those which have introduced PRP.

97. When there is a link between performance appraisal and pay, the link varies greatly across countries, with some countries developing a formal and detailed link between appraisal and pay, and others having no requirement to link performance pay awards to formal appraisal. When the link is formalised,

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33. In Germany, the limit on the proportion of staff who can receive performance pay (15% of staff) is considered demotivating.

34. In the United States, no more than 1% of the career SES may receive a distinguished executive award each year; no more than 5% of the career SES may receive a meritorious executive award each year.

35. The 2002 rankings were: maximum of 5 % of staff to be rated A ++, maximum of 25 % of staff to be rated A+, 65-75 % of staff to be rated A, 5-15 % to be rated B and maximum 3 % of staff to be rated C.

36. The employee is supposed to evaluate himself and his manager in several ways. Usually there is a formula that can be filled in, one about the employee himself and one for how the employee evaluates the manager.

37. In the Federal Ministry of Interior.

there are different ways to determine the size of performance-related payments. The first is a simple scaling of awards based on performance rating levels. The second approach employs a matrix formula in which the size of the performance pay award is determined by both an employee's performance rating and his or her position in the salary range. Awards may be either stated as a fixed cash amount or calculated as a percentage of base salary.

### **2.3. *Performance payments: form and size of payments***

#### **2.3.1. *Merit increments or lump-sum bonuses?***

98. A key issue in the design of performance pay schemes is whether payments are to be in the form of **merit increments** (added to the base salary of the recipient and which becomes a permanent part of the basic pay) or lump-sum **bonuses** (one-off payments which are not consolidated into basic pay, and have to be re-earned during each appraisal period). Both forms of performance payments may be expressed in either cash terms or as a percentage of the basic pay and they can be distributed independently of the level of salary.

99. A common system across OECD member countries is the combination of merit increments and bonus systems. Merit increments tend to have been introduced in position-based systems, but pure merit increment systems are rare. More common are countries which rely on bonuses only. This is the case in France, Italy, Spain and the United States (for the Senior Executive Service). It is notable that Korea has a merit increment system for senior civil servants and lump-sum bonuses for other employees.

100. Lump-sum bonuses offer several advantages over merit increments. They highlight better the performance-related nature of the reward. Because they do not become an ongoing part of the base salary, bonuses do not add to fixed payroll costs, notably pensions. Also, because they are variable costs, they are managed with greater flexibility.

101. On the other hand merit increments offer the advantage of being integrated into the base salary and of being a better incentive on a longer term basis. However many problems are attached to this form of payment, such as the lack of flexibility in its management, the greater cost in the long term, the slow progression within the pay range, and the lack of incentives for performers who are at the top of the pay range.

102. In recent years, many countries have developed non-consolidated bonuses at the expense of merit increments. Finland, Germany and the United Kingdom have mentioned the more positive impact of one-off bonuses compared to merit increments.

103. Table 2.4 summarises the advantages and drawbacks attached to each form of payment and regarding size of payment:

**Table 2.4. Advantages and problems linked to different forms of performance payments**

	<b>Advantages</b>	<b>Disadvantages</b>
<b>Merit increments</b>	<ul style="list-style-type: none"> <li>▪ Long-term incentive</li> </ul>	<ul style="list-style-type: none"> <li>▪ Tends to become an automatic annual payment</li> <li>▪ Less visible than bonus</li> <li>▪ More costly in the long term (impact on long term pay bill and pensions)</li> </ul>
<b>Bonuses</b>	<ul style="list-style-type: none"> <li>▪ More clearly related to performance, more visible</li> <li>▪ More flexible and easily manageable</li> <li>▪ Less costly, do not add to fixed payroll costs (pensions)</li> <li>▪ Does not tend to become an automatic annual payment</li> </ul>	<ul style="list-style-type: none"> <li>▪ Short-term incentive</li> <li>▪ Not included in the base salary: less motivating for the long term</li> </ul>
<b>Large size of performance payments</b>	<ul style="list-style-type: none"> <li>▪ Positive and immediate impact on motivation</li> </ul>	<ul style="list-style-type: none"> <li>▪ More limited distribution of rewards : risk of demotivating the majority who do not receive rewards</li> <li>▪ Risk of focusing on their award at the expense of base pay.</li> <li>▪ Any problems linked to procedural justice of the appraisal more serious</li> </ul>
<b>Small size of performance payments</b>	<ul style="list-style-type: none"> <li>▪ Opportunity to distribute them to a greater number of staff</li> <li>▪ Opportunity of associating them with wider organisational or management changes</li> </ul>	<ul style="list-style-type: none"> <li>▪ Limited impact on motivation</li> <li>▪ Lack of differentiation between staff</li> </ul>
<b>Quotas</b>	<ul style="list-style-type: none"> <li>▪ Clear system for performance differentiation: facilitates budget control of the scheme</li> </ul>	<ul style="list-style-type: none"> <li>▪ Artificial way of differentiating performance: risks undermining the credibility and impact of the whole PRP scheme</li> <li>▪ Demotivating for the majority of staff who do not receive rewards</li> </ul>

### 2.3.2. *PRP: a small part of total salary*

104. The size of payments across OECD member countries varies greatly. Merit increments vary from a maximum of 3% of the salary in the United States, to a maximum of 50% for top performers in Finland. Bonuses are in general higher than merit increments, due to their neutral impact on the long-term pay bill. Maximum size of bonuses can be as high as 40-50 % of the base salary. However, these indicate the maximum rewards that can be allocated. On the whole, “low powered” forms of PRP are used, with performance rewards being a fairly modest percentage of base salary, especially among non-managerial employees. Generally, performance payments for government employees are less than 10% of the base salary. For managers, the size of performance payments is bigger and represents, on average, 20% of the base salary.

105. Whether there is special funding provided for the PRP or not is an important factor in the management of the scheme. Evidence from the HRM Survey (OECD, 2004) indicates that in many countries, for example, Australia, Denmark, Hungary, and the United States, there is no special fund for the PRP. Rather, all pay increases must be funded from within agency budgets. Canada, Finland, Ireland, Korea, and Spain are exceptional in that they have provided a special budget for PRP.

106. Table 2.5 provides some indication of the maximum size of performance payments across OECD countries.

Table 2.5. Form and maximum size of individual PRP payments

Country	Merit increments	Bonuses
<b>Australia</b>		<ul style="list-style-type: none"> <li>▪ Secretaries and executive agency heads are eligible for annual performance bonuses</li> </ul>
<b>Canada</b>	<ul style="list-style-type: none"> <li>▪ Progression of 5% per year, up to 3 years</li> </ul>	<ul style="list-style-type: none"> <li>▪ 10-25% bonus lump sum</li> </ul>
<b>Czech Republic</b>	<ul style="list-style-type: none"> <li>▪ There are 12 pay grades, each containing five increments</li> </ul>	<ul style="list-style-type: none"> <li>▪ Bonuses can be up to 100% for grades 9-12 and 40% for grades 1-8. Average bonuses are about 25% of take-home pay but each public institution will vary. The criteria by which these increases are determined do not have to be disclosed and they are granted at the discretion of the Minister or organisation heads (OECD, 2003c).</li> </ul>
<b>Denmark</b>	<ul style="list-style-type: none"> <li>▪ Decided at the local level by institutions/agencies.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Not centrally determined</li> </ul>
<b>Finland</b>	<ul style="list-style-type: none"> <li>▪ Merit increments: the maximum pay (for ultra-performance) has been agreed at between 25% and 50% of the basic salary.</li> <li>▪ The average of individual performance pay in relation to individual total pay varies between 13-20%, whereas the maximum varied between 30-50%.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Bonuses: results based rewards (RBR) allocated on a team basis. The average amount of RBR was 1.7 % in relation to individual total pay in 2002. The range between the agencies was 1-8.3%.</li> </ul>
<b>France</b>		<ul style="list-style-type: none"> <li>▪ Indemnities represent about 17% of the remuneration of civil servants, but this number varies greatly by Ministry, sector and level of qualifications of staff.</li> <li>▪ Senior civil servants perceive higher bonuses than other categories of staff (about 40% of their remuneration depends on these bonuses). Indemnities are not included in basic salary.</li> </ul>
<b>Germany</b>	<ul style="list-style-type: none"> <li>▪ Merit increments (performance steps). The number of performance steps granted by the employer within one calendar year must not be awarded to more than 15% of the civil servants and military personnel in employment with this employer under remuneration scheme A, who have not yet reached the final basic salary.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Performance bonus and performance allowances for outstanding special services by civil servants and military personnel in pay grades of remuneration scheme A. Up to 15% of staff can get performance bonuses and allowances.</li> <li>▪ Performance bonuses shall not exceed the initial base salary of the respective pay grade of the civil servant or member of the military.</li> <li>▪ Performance allowances shall not exceed 7% of the initial basic salary.</li> </ul>
<b>Hungary</b>	<ul style="list-style-type: none"> <li>▪ Merit increments of up to 20% of the salary</li> </ul>	
<b>Ireland</b>		<ul style="list-style-type: none"> <li>▪ Bonuses for assistant secretaries of up to 20% of salary. The pool for performance-related awards for assistant secretaries is 10% of the pay bill for the grade on a service-wide basis, i.e. the cost limit applies to all assistant secretaries across departments and not on a departmental basis.</li> </ul>
<b>Italy</b>		<ul style="list-style-type: none"> <li>▪ Bonuses for senior managers. The annual performance-related pay cannot be less than 20% of the annual value of the award for the particular post, within the limits of available resources.</li> </ul>

<b>Korea</b>	<ul style="list-style-type: none"> <li>• Merit increments are added to the annual salary of a higher level government employee and linked to his/her performance ratings. Up to 7% of the performance standard amount (nearly the equivalent of half of an annual salary) for those rated 'excellent.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Bonuses are paid to government employees annually and designed for mid- and lower level employees. Lump sum bonuses vary in size from 100% to 40% of the monthly base salary per year.</li> <li>▪ Performance bonuses can be provided in various ways: on an individual basis, on a departmental basis, and on a combination of individual or departmental bases.</li> </ul>
<b>Netherlands</b>	<ul style="list-style-type: none"> <li>▪ Unsatisfactory performers will not receive an annual salary increase. Staff members deemed to be more than satisfactory performers may be considered for an additional increment. A salary from the next scale may be awarded for excellent performance by a staff member who has reached the top of his/her current scale.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Year-end bonus (one-off supplements). It is not possible to indicate the range because such payments are not regulated or capped. The average award in 2000 was €1 120.60.</li> </ul>
<b>New Zealand</b>	<ul style="list-style-type: none"> <li>▪ Merit increments (decided by individual departments within the pay range set out in voluntary agreements).</li> </ul>	<ul style="list-style-type: none"> <li>▪ Bonuses (decided by individual departments)</li> </ul>
<b>Slovak Republic</b>		<ul style="list-style-type: none"> <li>▪ Personal bonus for extraordinary results: 30-70% of the salary of the highest salary category of the salary class within which the civil servant is paid.</li> </ul>
<b>Spain</b>		<ul style="list-style-type: none"> <li>▪ Productivity bonus at the individual or team level. In 2000, the productivity bonus cost represented approximately 9.7% of staff remuneration as a whole.</li> <li>▪ In the Spanish social security civil service, the productivity bonus represents on average 22.1% of the salary.</li> </ul>
<b>Sweden</b>	<ul style="list-style-type: none"> <li>▪ Under the individual salary systems, each official gets the general wage increase but there is no guarantee of a merit increase. Each individual is placed within a salary range and movement within that range is based on performance assessments.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Less than 10% of agencies use bonus payments, but where applicable, bonus payments are more directly linked to efficiency measures and cost savings.</li> </ul>
<b>Switzerland</b>	<ul style="list-style-type: none"> <li>▪ Merit increments: from 4.1-6% for outstanding performance (ranked A++).</li> <li>▪ Increase of 3% if assessment is A (good performance).</li> </ul>	<ul style="list-style-type: none"> <li>▪ Bonuses: can reach 12% of salary for outstanding performance. If bad performance, no bonus and after two years decrease of the salary to 94% in the range of salary.</li> </ul>
<b>United Kingdom</b>	<ul style="list-style-type: none"> <li>▪ Merit increments</li> </ul>	<ul style="list-style-type: none"> <li>▪ Non-consolidated bonuses – now being used as one of the main vehicles for delivering performance-related pay to those staff performing above a satisfactory level.</li> <li>▪ Bonus levels vary in different organisations and can be substantial in some and much less substantial in others.</li> </ul>
<b>United States</b>	<ul style="list-style-type: none"> <li>▪ In the General Schedule base pay system, an agency may advance an employee who meets a high performance bar – outstanding performance, to the next step of a grade (approximately a 3% increase). Merit increments are based on the manager's annual performance rating and current position in the pay range. A full merit increment is equal to approximately 3% of the average pay rate for that grade. Managers who are rated "unacceptable" receive no general increase.</li> </ul>	<ul style="list-style-type: none"> <li>▪ An agency may grant a cash performance bonus for above-average performance. These bonuses are typically 1-2% of salary. Funding for both the QSI and bonuses is provided out of the regular budget for salaries and expenses. This scheme applies to about one million employees.</li> <li>▪ Cash bonuses of up to 10% of base pay can also be paid to managers. In the case of unusually outstanding performance, a department head may pay an individual a larger bonus, but not more than 20% of base pay.</li> </ul>

Source: OECD, 2003a-h; OECD, 2004.



## 2.4. *Conclusions*

107. PRP schemes have been increasingly adopted and have also been formally extended to all categories of staff in the past decade. There has been some increase in the use of collective or group performance schemes, at the team/unit or organisational level.

108. Long-running standardised PRP schemes have evolved into more decentralised ones, designed at the organisational/ministry level and in some cases permitting flexibility in local application, rather than one design covering an entire civil service.

109. There is an increased diversity of the criteria against which to assess performance. If the traditional schema remains in place, that is, career-based systems focusing more on inputs and position-based systems on outputs, both systems tend to converge in the attention given to results and competencies, as well as (but to a lesser extent) to general social skills.

110. Performance rating systems are less standardised, less formalised and less detailed than 10 years ago. They tend to rely more on dialogue with line management than on strictly quantifiable indicators and seek to do better at distinguishing excellent performance. However, quota systems of ratings, as an alternative way of doing this, are becoming more widespread across OECD member countries. In practice, they tend to counteract the trend to less formality,

111. The size of performance payments is rather small (less than 10% of the base salary in many cases at the employees' level, around 20% of the base salary at the managerial level). Bonuses are tending to supplement and even replace merit increments.

## **CHAPTER 3 IMPLEMENTATION AND IMPACT OF PRP**

112. This chapter analyses the lessons which may be learnt from the implementation of performance-related pay schemes to date. It sets out recommendations to improve the design and implementation of such schemes notably in relation to the performance appraisal framework and the need to anticipate the financial costs associated with PRP. It also assesses the impact of PRP and concludes that the incentive effect of the financial aspects of PRP has been overestimated. However, it concludes that PRP has been an effective lever for change at the workplace both by shifting attitudes to work and in relation to work organisation. Finally, it notes that initial research on the impact of collective performance pay systems is positive.

### **Introduction**

113. Few organisations have conducted systematic evaluations of the impact of PRP policies. This is due partly to the difficulty of measuring performance outcomes in the public sector and possibly also because negative results may compromise management's position in pay negotiations. Even in the private sector, where quantitative evaluation of performance is easier, there are few studies on the impact of performance-related pay policies. The material upon which this evaluation is based is on the research referred to earlier in this report. Below, the impacts of PRP are described both in relation to the reasons for which governments introduced it, and also in relation to its unintended consequences.

114. Certain preconditions are essential before introducing a performance-oriented culture, pay related or otherwise, without which implementing performance management will run into serious problems. These preconditions are: transparency within the organisation, clear promotion mechanisms and trust in top management, that is, the basics of sound management. In addition, sufficient delegation of responsibility for the management of human resources and, in particular, in relation to staff performance appraisal policies should have occurred.

### **3.1. *The implementation of PRP: lessons to be learnt***

#### **3.1.1. *Towards an improved design of PRP schemes***

115. **Consultation with staff** on the design of performance pay schemes is strongly recommended as a way of minimising two common problems in drawing up such schemes. The first can occur where design is “top-down”: that is, based on information from managers alone (see Chapter 2.2.1.). This can result in essential information from staff about their work and their attitudes to it, not being taken into consideration in preparing a PRP scheme. This approach can adversely affect how well a PRP policy works as well as set the scene for staff to resist it. Secondly, a major problem all PRP schemes face is that they involve both “winners” and “losers”. However, procedural justice theory predicts that staff are more likely to accept changes, even those which are disadvantageous to them, if they feel they have been able to express their views about their work and any proposed changes, and feel that these views have been taken into account fairly. Adequate consultation can tackle both these potential problems.

116. Developing a **simple performance appraisal framework**, with no detailed differentiation in the ratings for “average” performers is advisable.<sup>38</sup> The focus should be on the distinction between the very good and the bad performers. Highly detailed and inflexible performance criteria and rating frameworks, though they can be reassuring to managers and managed alike, are often detrimental to the smooth running of a PRP scheme. Firstly, listing performance criteria cannot cover all the factors affecting performance and may have the perverse effect of encouraging employees to focus on the performance criteria set out as “creditworthy”. Secondly, it is much easier to evaluate extremes of performance (excellent or poor) than the performance of the majority of employees who are working satisfactorily, however complex and formal the performance criteria devised are. PRP schemes should be explicitly directed to achieving this. The opportunity should also be taken to link individual and organisational objectives. Chapter 2.2.3 describes the varying responses to the identification of these problems in early PRP systems. It was increasingly felt that detailed criteria had led to an inappropriate focus on the process of performance evaluation not on what the evaluation was meant to achieve in terms of improved performance.

117. For example, in most PRP schemes in use in the 1980s, more than 95% of managers were rated as “fully satisfactory or better” (OECD, 1993). In the United States, surveys from the 1990s have concluded that the five-level summary rating was too rigid, too complex and demotivated staff, as “better performance [did] not lead to more pay” for top performers as opposed to “average” ones, as they were effectively lumped together. Consequently there has been a move towards more flexible and less detailed criteria in many countries, which appears to be the advisable course to take.

118. Another type of response to the lack of differentiation possible under detailed performance criteria, was to move to the use of **quotas and forced ranking performance pay systems**. However, where they are in operation, consideration should be given to moving away from them (see Chapter 2.2.3). Although they may be effective for budgetary control purposes and control an upward drift in appraisal scores, they are disliked by employees as arbitrary limits on performance grading that take no account of actual performance. Moreover, forced ranking does not make differentiation between staff easier. Some managers, when compelled to undertake forced ranking, rotate the good ratings amongst their staff. In Switzerland, the strict application of the ‘*Gauss curb*’<sup>39</sup> is seen as one of the major problems in operating the PRP scheme there, as it creates a rigid system where line managers are forced to differentiate amongst staff, even in small teams of three or four people

119. Consideration should also be given to introducing a **collective/team-based PRP**, or a combination of a collective and an individual one. If outputs are more collective than individual, group schemes can have a number attractions. They stress the need for cooperative working, and can harness peer motivation. They avoid the problem of sometimes invidious interpersonal comparisons that line managers find difficult to make, and find the consequences even more difficult to live with. They can also enable management to place more focus on objective indicators, which are easier to measure and rely less on personal judgement. Whereas an individualised performance pay scheme might be divisive and undermine team working, the introduction of collective incentives, or a combination of the collective and the individual approach, may reinforce it. As identified in Chapter 2.1.4, they are becoming increasingly used.

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38. Not that it is easy to get even simple performance appraisal criteria right. But detailed criteria have been criticised as being too focused on targets which can be easily specified such as inputs or processes, too easy to be achieved or too complex, or too numerous and lacking in focus; as not being regularly updated or else being added to on an *ad hoc* basis without clear consideration of their overall purpose (indicative of a poorly functioning scheme) or generating too much information to be effectively processed. All of which can lead to disenchantment with a scheme.

39. See Chapter 2.2.3 for a description of the *Gauss Curb*.

120. The **type of financial incentive** selected will also have an effect on the impact of PRP policies. It is advisable that merit increments do not become automatic allowances. This potential distortion has prompted a number of countries to prefer a bonus system to a merit increment one (see Chapter 2.3.2, Table 2.5). As Denmark mentioned in one of its answers to the HRM survey, “the bonus should be paid only for exceptional and improved results. The inherent risk of automatically paid bonuses for ordinary results may undermine the intention of introducing performance-related pay”.

121. To a lesser extent, the **size of the financial incentive** also plays a role in the impact of PRP. Evidence from attitude surveys, notably from the CEP surveys, suggests that many staff are not motivated to work harder by their performance related pay (this issue is addressed in detail in Chapter 3.2.1). Partly, this is because they consider the current size of payments to be too small to create an incentive. In contrast, awards for managers have tended to be larger, and it is possible that their larger awards account for the greater success of PRP in managerial grades. However, increasing performance rewards is subject to two caveats. First, it is often easier to identify the individual contribution of managers than it is to identify that of individual non-managerial employees. The second caveat is that greater rewards may bring greater tensions in the workplace around the operation of PRP scheme.

122. In his report, Makinson suggested that rewards be a minimum of 5% of the base salary (Makinson, 2000). Basically, a choice has to be made between distributing higher payments to a small number of staff (as was the case for American nurses and British teachers) or distributing low rewards to a high number of staff. Both options have their advantages and drawbacks (see Chapter 2, Table 2.4). It is worth noting that distributing lower payments to a high number of staff might facilitate the use of PRP as a lever for organisational or management change and that this may, in fact, be the most important impact of introducing PRP (see Chapter 3.2.3). The money involved in awards is not necessarily a great incentive in itself but it can validate change.

### 3.1.2. *Implementation issues*

123. As in designing a PRP scheme, **involvement of staff/unions**, in running it assists in the optimal operation of a PRP scheme. Staff cooperation can be obtained by consultation and regular communication regarding how the system is operating. It is notable that the Scandinavian countries and the Department of Work and Pensions in the United Kingdom, all of which introduced PRP gradually (and in the Scandinavian countries by means of collective agreements) appeared very positive about the effects of their schemes.

124. It is advisable to define the budget policy prior to the introduction of a performance pay scheme as **the financial costs of PRP are** often underestimated, thus undermining its effective implementation. Implementing and administering a PRP policy is costly. Where evaluations have been conducted in various civil service organisations, they suggest that the average cost of PRP is between 1-5% of the total pay bill. In theory, it is arguable that increases in salary costs produced by PRP schemes can be funded by increased productivity, as happens in some industries in the private sector. However, it is very difficult to measure productivity in the public service. A number of countries have experimented with sharing cost savings with employees, thereby creating an incentive for efficiency improvements. Alternatively, a requirement that performance-related pay should be cost-neutral may be imposed. This can be achieved by, for example, replacing service increments with those linked to performance, or through decreasing the salaries of the worst performing staff. But if PRP is not adequately funded, the disappointed expectations of employees who have been promised money for improved performance and then find it is funded by means of smaller increases in base pay, must be anticipated – together with the likely demotivating effects.

125. Linked to the above, is the need to make adequate provision to meet the **management costs of PRP** which are significant. The time-consuming nature of the work needed to implement performance pay is often underestimated. Time is required to plan and then introduce the scheme, to run it, for example undertaking staff appraisals and, critically, for training managers in its operation. A survey from Denmark conducted in 2001 on the effects of PRP, indicates that 56% of union representatives and 70% of managers stated that the most negative effect of PRP was that there was “too much administration related to it”.<sup>40</sup> Reviewing its operation regularly is also an added essential cost.

**Box 3.1. Negative effects of PRP mentioned in the Danish survey (2001)**

In Denmark, in 2001, the State Employer's Authority and the Danish Federation of State Employees' Organisations conducted an evaluation of the impact of the new pay system. This survey included 111 government institutions.

The most negative effects of PRP mentioned in the results were (for 60% of union representatives and 51% of managers) that PRP creates uncertainty amongst employees. It is also surprising that 28% of union representatives considered that PRP makes line managers uncertain of their role (whereas only 16% of managers mention this as a problem). For 39% of managers and 23% of union representatives, PRP leads to a greater focus on results. Only 16% of union representatives and 15% of managers considered that it led to increased satisfaction among employees. And for 32% of union representatives and for 11% of managers, PRP actually “decreases satisfaction among the employees”.

*3.1.3 How well is the performance appraisal managed?*

126. Whether PRP will have a positive impact on staff is strongly related to how well the appraisal process is carried out. It appears more influential than the financial rewards on offer in motivating staff, if done appropriately. So it is of concern that the evaluation process itself is the source of the greatest number of problems and criticisms. The first major problem is the difficulty in differentiating between the relative performance of employees, due to inadequately designed performance criteria. This results in problems distinguishing excellent staff from the adequate. The second is the reluctance of line managers to differentiate between their staff succumbing, for example, to pressure from them to be lenient with work assignments and over-generous with performance rewards.

127. It appears that the skilful execution of performance appraisals depends principally on four factors. How well it is designed (see above), how appropriately rewards granted under the PRP scheme relate to the performance appraisals and appear to relate to them (that is the system is transparent and feedback to employees is given), how well managers are trained in operating it, and that it is carried out by an employee's line manager. These factors will assist in creating ongoing employee/manager dialogue throughout the year, increasing the likelihood of positive results.

Specific recommendations on the design and operation of performance pay schemes

128. The following recommendations are made:

- Consult unions/employees' organisations from early on in the preparation of a PRP policy and during its implementation and operation, to ensure that the purpose of the scheme and how it is functioning, is communicated to them.
- Develop a simple performance appraisal framework, with no detailed differentiation of ratings for “average” performers. A small number of realistic but not too modest performance objectives should be set.

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40. Please refer to Annex 1 in the Denmark country report (OECD 2003x) for more information on this survey.

- Consider introducing a collective or team-based PRP system or a combination of this and an individual scheme, at the employees' level.
- Managers – including senior ones – should be included in the PRP policy, in order to set an example to employees.<sup>41</sup>
- Careful consideration should be given to both the type of performance awards made and their size.
- Define the budget policy prior the introduction of PRP.
- Be prepared to devote sufficient management resources to running the system.
- Seek to ensure that the performance appraisal process is transparent and focused on dialogue with staff, providing them with clear feedback as well as the opportunity to have its results reviewed.
- Ensure line managers are at the centre of the system as performance appraisal should be undertaken by the nearest management level.

**Box 3.2. The case of France: the conclusions of the committee of enquiry into the cost and efficiency of public services (April 2004)**

In April 2004 the committee of enquiry into the cost and efficiency of public services – a body connected to the Audit Office and attached to the Office of the Prime Minister – published a report reviewing the state of the bonus policy applied in the civil service and proposing specific reforms aimed at taking merit more fully into account in awarding these.

The report outlines the weaknesses of the appraisal process in France. “The adjustments made are not all based on an objective appraisal process. Individual appraisals with systematic annual interviews are by no means the rule. The opacity of the bonus system and the lack of rigour in the methods for individual and collective staff appraisal, [which are not] based on explicit criteria, lessen the legitimacy of bonus adjustments”.

The lack of transparency and the complexity of the bonus management system are also generally criticised as being obstacles to genuine merit-based adjustments. Clearly, the present methods of bonus adjustment are not being developed in an environment likely to make them a genuine management tool.

The report recommends strengthening the “appraisal” aspect above all. “An indisputable appraisal system is a vital prerequisite for the acceptance of any [pay] adjustment”. The report therefore suggests that both managers and staff be trained in appraisal techniques. It also pleads for more transparency and social dialogue on compensation policy. In addition, it recommends that the reform of the bonus system as a whole be continued.

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41. Politically appointed managers may be excluded from PRP in order to avoid possible conflicts of interest.

**Box 3.3. The introduction of PRP in developing countries**

Building a performance culture step-by-step by focusing on performance-related promotion systems is recommended for transitional and developing countries. This can help move civil service values towards standards of competence and merit, and is to be preferred to introducing performance-related pay elements.

A temptation in developing or transitional countries can be to develop performance pay in order to boost public sector performance in a rapid way – or to potentially reduce the size of base salaries. Certain transitional countries have instituted PRP as a large proportion of the base salary – more than 50% or 60% in some cases. Such policies are counterproductive in an inadequate management framework. PRP may, in such situations, increase problems linked to trust and lead to corruption and patronage. It might also lead to widespread dissatisfaction among staff and discourage competent employees from entering the public sector.

In addition, where the level of political appointments is high, “procedural justice” mechanisms may be harder to set. When such mechanisms are limited, the demotivating impact of performance pay is increased.

### **3.2. *The impact of PRP: incentive for change?***

#### **3.2.1. *PRP and its operation as an incentive***

129. The factors outlined above describe obstacles to the effective functioning of PRP, which can be partly overcome by strenuous efforts on the part of management. However, some limitations of PRP systems are structural and these have to be taken into account in order to avoid overestimating what PRP policies can do by themselves.

130. Improved staff motivation was one of the main reasons for introducing PRP, yet most country reports do not mention it as one of the positive achievements of such schemes once up and running. This is consistent with most of the academic research conducted on PRP. Nearly all of the United Kingdom research on employee attitudes<sup>42</sup> using self-reports of the factors which motivated them, indicate that only a small minority of staff are positively motivated by their PRP scheme.

131. Research conducted by the United Kingdom CEP provides an example of the attitudinal surveys conducted about PRP. It conducted major staff attitudes surveys in the United Kingdom on PRP in 1998 in the National Health Service, in secondary schools and in the Inland Revenue (Marsden, 2000; Marsden, 2004). Overall, 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 or to show greater initiative (32% in the NHS, 18% of staff in the Inland Revenue, and 8% of school staff considered PRP was an incentive to work beyond job requirements). Of even more concern to top public management, was the evidence that the performance pay schemes in place were seen by staff to be divisive and to undermine cooperation among staff (86% of staff in the Inland Revenue, 61% in the NHS and 58% in schools). However, a quite substantial minority of line managers reported that PRP had caused many of the staff to work harder (52% in the NHS, 42% of managers in the Inland Revenue and 28% in the Employment Service and considered that PRP had increased the quantity of work done). For managers, the picture on motivation has been less negative than for non-managerial employees.

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42. Most of the research on motivation has been undertaken in the United Kingdom, and to a lesser extent in the United States. Although there is a considerable body of research which suggests that performance incentives can raise employee performance, as reviewed by Prendergast, much of it focuses on occupational groups for which individual output is relatively easily determined, and by objective measures. Examples include sales staff paid on commission, CEOs, and professional sports players. The research referred to here is that described in the following paragraph.

132. In the United States, a 2002 survey by the Office of Personnel Management found that many federal workers are unhappy with the bonus system. Only 47% of workers said awards depended on how well employees did their jobs. Less than a third said their organisation's award programme gave them an incentive to perform their best.

133. The impact of PRP on motivation is thus ambivalent. While it does motivate a minority, it seems that a large majority of staff do not see PRP as an incentive. There is no automatic correlation between the introduction of PRP, increased motivation and improved performance. It seems that the motivational value of PRP has been overestimated and its adverse impacts underestimated. Summarising this, the Makinson report in the United Kingdom concluded that the existing public service PRP schemes, which were mostly based on individual reward for individual performance, had failed to motivate, and had left many employees disenchanted (Makinson, 2000).

134. How can this limited impact on staff motivation be explained? It seems that while base pay according to the "market" is important, marginal pay is a secondary incentive for government employees. Many studies and staff surveys indicate that satisfying job content and career development prospects have been found to be the best incentives for public employees. In a previous study the OECD concluded that "PRP was the least or second least preferred item on a list of work characteristics that included degree of challenge in the job, base salary, job security, training and development opportunities and recognition for work achievements" (OECD, 1997). PRP is unlikely to motivate a substantial majority, irrespective of the design, as performance-related pay is only a secondary motivating factor. Performance management strategies that focus on the pay incentive risk missing the most important ways to motivate staff which are satisfying job content and clear prospects of career progression. The pay incentive must thus be integrated into a much wider performance management strategy.

### 3.2.2. *PRP and recruitment*

135. In contrast, at least in the Scandinavian and the United Kingdom contexts, it appears that PRP can act as a recruitment incentive. It does this by attracting a different type of person to the public service, those – possibly the more dynamic – who feel they will obtain the better pay available in a more competitive pay environment. In this way PRP can encourage a different attitude towards innovation and risk-taking by recruiting staff with a positive attitude towards such issues in the work environment. This positive effect on recruitment was mentioned by Denmark, Finland and Sweden in particular. In Denmark, for 57% of managers and 48% of union representatives, PRP leads to better opportunities for recruitment.

136. In addition, PRP may also lead to better retention of high-quality staff, apart from its positive effect on recruitment. This was demonstrated by the Danish survey, where 54% of managers and 55% of union representatives took this view. The CEP research shows that similar experiences occurred in the limited field of attracting and retaining top quality school teachers in England and Wales. Clearly, more research needs to be undertaken to understand the implications of these findings.

### 3.2.3. *PRP: an opportunity for an organisational culture shift*

137. When the wider effects of performance-related pay policies are observed, over and above their impact on staff motivation, it becomes apparent that PRP can act as a lever for the introduction of wider organisational and management changes to such an extent that it can make a major contribution to the "**renegotiation of the effort bargain**", one of the major cultural shifts occurring in work today.

138. Performance pay creates an incentive for management to introduce an effective "goal setting" approach, at the individual or team levels. Of course, it is possible to use the goal setting element of performance management without a specific link to pay. However, it seems that the link with money can



be a key incentive to fully endorse a goal setting approach (Marsden, 2004). In addition, evidence from the CEP, as well as from OECD country reports, indicates that introducing PRP works to validate goal setting in a positive way, at both managerial and non-managerial levels, independently of any motivational effect due to the anticipation of increase in pay.

139. How PRP has worked in this way seems to be the following. Formerly, performance was defined by a static job description, especially for non-managerial positions. In this environment, performance appraisal was fairly routine, appraising according to standard criteria such as how conscientiously people worked. Under this system, the reality of many jobs was not examined (*e.g.* work overload). Introducing formal appraisal processes based instead on job objectives/goal setting changed the work roles of both managers and employees. The key innovation has been to address variability in work loads. Instead of treating it as an additional demand to the job holder's standard workload, it makes coping with its variability a central part of an employee's work. The primary function of PRP, through goal setting and appraisal has been to enable management to redefine the established performance norms in their organisation, and then to operate them effectively, with the explicit or tacit agreement of as many employees as possible. When PRP schemes have a strong focus on goal setting and organisational objectives, they can help to achieve improved performance by providing management with a framework for renegotiating performance norms: that is, renegotiating the "effort bargain".

140. 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.

141. One of the positive impacts of PRP is also that it may lead to a clarification of job descriptions and tasks. Hungary has mentioned that 'in the short term, we consider it a great achievement that discernible improvements have appeared regarding the system of individual job descriptions. Since the performance assessment system has been introduced, job descriptions which had been outdated and confused have been revised in almost all public administration organisations. Job descriptions have been updated, made clear and transparent nationwide, allowing the definition of responsibilities and competencies at the individual level'.

142. Performance pay gives managers an added incentive to manage effectively, so as to achieve their own and their employees' goals. To do this, dialogue with staff is crucial. 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. It allows staff to be more involved in management issues. For example, a comment from the Swiss country report was that "PRP allows discussion between staff and management. In fact, staff are as much involved in personnel questions as is management". At the individual or unit level, performance-based management works well when accompanied by more interaction between manager and staff member so that any reduction of formal controls is substituted by informal control.

**Box 3.4. The impact of performance pay: The case of Statistics Finland**

One of the main effects of the new pay system has been that the work of supervisors has taken on added significance. When correctly applied, the pay system has proved an effective management tool which can be used to guide operations in accordance with the targets set.

The transition to the new pay system has made the performance reviews introduced before the pay system more systematic. Revised job objectives and individual performance criteria as the principles for pay adjustments within Statistics Finland have been applied gradually and flexibly. The performance reviews have given tangible form to requirements focusing on individual work performance, and have created a basis for individual development plans. The reviews have also highlighted shortcomings in the work of supervisors, giving direction to the improvement of their skills within Statistics Finland.

The new system has brought a new approach to wage negotiations between Statistics Finland and the trade unions. Instead of negotiating with the unions on adjustments to individual pay levels, negotiations now focus on establishing the principles for pay adjustments. The new pay system has also made recruitment more competitive than before. The average pay at Statistics Finland rose by about 22.9% between December 1997 and December 2002. Meanwhile, the average increase in central government monthly salaries according to the level-of-earnings index was 19.9%. However, staff turnover and the increase in the number of people within the new system has kept down the rise in average pay at Statistics Finland.

*3.2.4. PRP: A lever for change in the organisation of work*

143. In addition to its role in reorienting organisational culture, PRP can act as a window of opportunity for the introduction of significant managerial changes. This is especially true for service delivery public services – tax, social security, hospitals – where work organisation can be more directly linked to outputs or citizen demands than core administration. However these organisational changes linked to PRP can also occur in the core civil service – when PRP is accompanied by a strong political will.

144. PRP may facilitate wide-ranging organisational changes by linking pay bonuses to new objectives at the individual and the departmental levels. New methods of work have often been introduced as a corollary of performance-related pay, a common example being to encourage a move away from a focus on working to a job description and towards an approach more focused on performance and customer or citizen needs. Performance pay may not be strictly necessary to ensure this result, but changing the pay system may enable management to mobilise efforts to shift to new methods of working. The following organisational changes have been introduced, as a corollary of PRP:

- PRP can be used as a lever for the **introduction of more flexible working methods**.<sup>43</sup> For instance in one of the hospitals studied in the CEP analysis, management wanted to move away from covering extended working after normal hours and at weekends by means of overtime and weekend premium payments. It wanted a system which could require staff to work more flexible hours without the budgetary implications of the premia mentioned above, so it could provide cover in a more patient-centered way. In exchange, it rewarded agreement to such changes with a higher basic salary and performance pay.
- In the Inland Revenue, one of the goals of the PRP scheme introduced in 1993-94 was to move away from defining job performance by a set of standards designed for a class of job, and move towards individualised objectives that were agreed between line managers and employees. The latter could be more easily adapted both to the abilities of individual employees, and to the varied needs of the different parts of the tax service. In both examples, there is a degree of working

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43. A good example of this process, from another domain, has been the reduction of working time in France where many large firms have been able to use this as the carrot to trigger negotiations over new, more flexible, working practices.

more efficiently, but also a significant element of working more intensively when patients' or tax-payers' needs required this. In doing so, public employees have become more exposed to the uncertain timing of citizens' demands, and have less control over their pace and manner of work. Even where such changes are agreed with unions, management has still to make the deal stick on the shop and office floor.

- The introduction of PRP can be used as a way to **encourage team working** – through collective bonuses or credit given for cooperation in the performance appraisal. For instance, encouraging different health professions to work together in 'care teams' has been one of the ideas that health service management have sought to promote by means of team working, supported by performance pay.
- PRP can be the occasion to **reform or strengthen the information and communication technology policy (ICT)**. Many countries have mentioned that the introduction of PRP was the occasion to reinforce the ICT focus in government agencies. It is a kind of bargain: in exchange of better working tools (improved ICT), a performance element in the remuneration is introduced. In Spain for instance, the introduction of PRP in the social security administration was accompanied by a considerable investment in ICT.
- Performance-related pay can provide the opportunity **to focus on training policies**, in order to reward efforts staff make at personal development. This is particularly noticeable in Scandinavian countries. In a staff survey conducted in Denmark in 2001, 48% of union representatives and 33% of manager stated that PRP gives more responsibility to the individual employee for the development of their own competencies. In Hungary, too 'an extensive training programme was launched within the realm of the public administration' as a corollary of PRP.

**Box 3.4. The impact of PRP: the example of Finland**

The overall management process has certainly been improved with the New Pay System (NPS). The unanimous message from management has been that when linked with pay incentives and sanctions, the rate of improvement of management procedures increases, as do the opportunities for more efficient management and leadership. The employers in the agencies feel the NPS, PRP and results-based rewards (RBR) are a useful incentive in managing staff, for example as a tool for organisational development. The introduction of NPS has also resulted in improved staff development and training, assisting in the implementation of the personnel strategy. The employers think that the RBR system has had a fairly beneficial effect on the collaboration within teams.

Source: country report on PRP from Finland (OECD, 2003xfinland).

*3.2.5. Are team performance-related pay systems effective?*

145. It is a bit early to assess the impact of team performance pay systems, as in most countries they have been implemented only recently (end 1990s – early 2000s in Finland, Germany, the United Kingdom for instance). However, empirical studies as well as a preliminary reading of the situation in the OECD member countries which have gone furthest along this path, provide some evidence of the beneficial effects of team rewards (Drago and Garvey, 1998).

146. This is notably the case in Finland, where results based rewards (RBR) are allocated at the team level and are combined with an individual component of PRP. Finland mentioned in the report that 'the employers think that the RBR system has had a fairly beneficial effect on collaboration within teams'. Finland considers that 'a group-based reward system is the most effective method of reward allocation'. It is believed that this system had a positive impact on performance: 'an indirect but still useful statistical indicator is that the increase in earnings in the organisations that have implemented the new pay system are a bit better than in the non-implementing organisations' (OECD, 2003xfinland). The experience of Spain with collective performance pay in the Institute of the National Social Security system is also reported to be highly positive.

**Box 3.5. Impact of the collective PRP system in the Institute of National Social Security in Spain**

In 2000, the productivity bonus represented 22.1% of total salaries in the Institute of National Social Security (INSS). Performance payments are distributed to all staff in the same provincial office, depending on the general results of the office. This system, linked with a strong focus on ICT, is considered to have greatly improved management processes: the average time for any procedures related to social security benefits have moved from 6 months at the end of the 1980s to less than 7 days in 2000. The average time for processing a retirement pension in 1989 was 100 days, it is now 10 days (OECD, 2003xspain).

The best result in this field is the greater link between the objectives to be achieved by employees and those to be achieved by the provincial office. Control by each management tier within a provincial office has also significantly improved.

PRP has increased collaboration within teams and also within the INSS management units since performance is measured by the results of each provincial office as a whole.

147. The United Kingdom has moved to a more collective approach to performance pay. The new performance management systems underline this approach by explicitly encouraging the reward of exemplary team behaviour not just individual behaviour (OECD, 2002b). The Makinson Report recommended that performance awards should be given on a team basis. In the Inland Revenue for instance, performance-related pay will be delivered wholly through the payment of team bonuses as from 2004.

148. Interestingly, an interim report has been conducted on the effects of the first year of the team-based bonus scheme at the United Kingdom Department of Work and Pensions. The statistical approach examines the effect of the scheme by comparing the performance of offices with team PRP with those without team PRP, and netting out factors that may affect performance over and above the impact of the scheme (differences in staffing, labour market conditions, seasonal factors). Data limitations mean that the interim report is only able to investigate the impact of the scheme on one of the five targets for DWP offices (job entries). Interim results have found that:

- i. The scheme had a significantly positive effect on job entries: on average, the effect is of the order of an increase of 11.1%.
- ii. This effect is smaller in larger offices, and is smaller in districts with many offices.
- iii. Analysis of behaviour against targets in one region shows some evidence that teams try to hit their targets exactly.

149. This interim report conducted in the United Kingdom Department of Work and Pensions on the effects of team-based bonuses provides interesting and positive results, which have encouraged the British government to continue developing collective PRP systems.

### **3.3. Conclusions**

150. The introduction of performance pay raises design and implementation problems (for example, lack of budgetary provision and training of managers). Most important are the problems linked to the monitoring and measurement of performance, especially the conduct of staff performance appraisals.

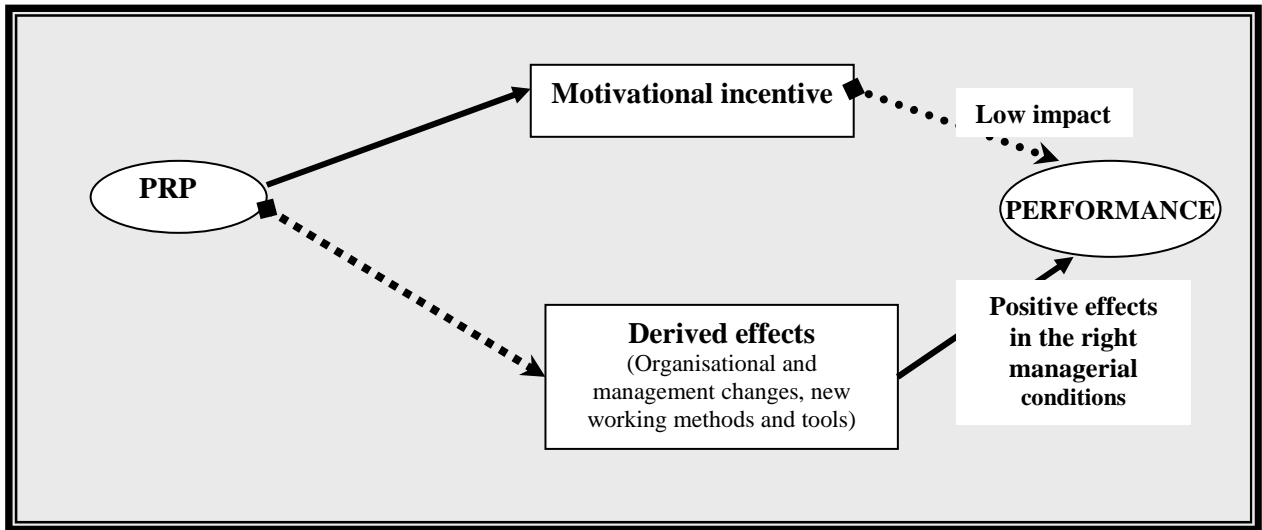
151. Inadequate infrastructure for performance management (for example, lack of transparency, trust or managerial delegation within an organisation) is a serious obstacle to PRP.

152. The impact of the financial incentives of PRP appears to be limited and other incentives are more influential in motivating employees, such as satisfactory job content and career development. Nevertheless, it is possible to draw conclusions on ways of improving PRP schemes.

153. However, the processes accompanying PRP have produced positive results, as an impetus to organisational culture change and management innovation, and thereby to improved performance.

154. Collective performance pay systems may, on the preliminary research undertaken, produce a more positive impact on employees than strictly individual ones.

**Figure 3.1. The overall impact of performance-related pay on performance**



### Recommendations

- *The design of PRP is a trade-off* between various options which have to take into account the background culture of each organisation/country. There is no “best” solution. When designing new schemes, management should consider what will prove acceptable to large numbers of the staff in its organisations. Management should also seriously consider team/unit PRP systems for employees, which can be introduced in a less disruptive way and appear to be able to produce more positive results than strictly individualised PRP.
- *The performance appraisal process is at the heart of the whole system.* It should avoid rigidity, not be too detailed, and be based on clear criteria. Performance appraisal should act as a basis for ongoing dialogue throughout the year between the manager and the employee. Transparency in the whole process is the key factor of success. The success of PRP ultimately relies more on the effective measurement of performance than on the distribution of payment.
- *Implementation problems need to be anticipated.* This implies primarily coordination with staff and unions on the implementation of PRP, the preparation of top and line management, clear anticipation of the budget and costs linked to PRP and of the time and work that the introduction and monitoring of the system requires.
- *Performance pay goes hand in hand with human resources management delegation.* Some delegation of human resources and pay management is crucial for the effective implementation of performance pay. This is because of the close link between goal setting and performance pay. The more successful schemes appear to rely upon a close integration between these two functions, in contrast to more traditional models which tended to award PRP against standardised performance criteria. 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.
- *Evaluations need to be conducted regularly* and a PRP system needs to be revised from time to time.
- *The significance and impact of PRP should not be overestimated.* PRP is of secondary importance as a managerial tool for improving motivation. Criteria such as satisfying job content, promotion possibilities or flexibility in work organisation come far ahead of performance pay in motivating for staff. 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.* In such an environment there is a balance between formal and informal processes, with on-going dialogue, information sharing, negotiation, mutual respect, and transparency being prioritised. It is also suggested that 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 the introduction of wider management and organisational change,* rather than solely as a motivational tool for staff. The objectives of PRP should be set accordingly.

## CONCLUSION

155. Over the past two decades there has been widespread growth in the adoption of PRP policies across civil services in OECD member countries. It is probable that in the medium-term almost all OECD member countries will have introduced PRP to some extent.

156. The spread of PRP may at first sight appear counterintuitive as the evidence indicates that the financial incentives for staff of PRP are not strong. But its introduction is overwhelmingly seen by government as a way of signalling the need for change in the way they work to civil servants and as a way of indicating to citizens that performance is regularly assessed in public administration.

157. Significantly, it is becoming increasingly understood that when PRP is introduced, a window of opportunity for wider management and organisational changes occurs. In implementing PRP, effective appraisal and goal setting processes are put in place, and organisational changes such as increased employee-manager dialogue, more team work and greater flexibility in the approach to work are set in train. PRP can be the driving force that allows these changes to occur and, at the same time, to enable the renegotiation of the culture at the workplace, leading to an increased focus on getting the job done and thereby to improved performance.

158. It is also apparent from the research that there has been an increase in the use of collective PRP systems for employees during recent years. They appear to constitute a viable alternative to individual PRP schemes, as they seem to harness the motivation generated by team work. Their full potential needs to be explored further, as preliminary research indicates that they have beneficial effects upon performance.

159. In summary, it is crucial not to have a narrow focus on the pay incentive aspects of PRP as the way of addressing the range of factors needed to improve performance management. The potential of PRP schemes to improve employee performance appears rather to be due to the way in which they act as the catalyst for far-reaching organisational and managerial changes, which then lead on to improved performance.

ANNEX A PERFORMANCE PAY POLICIES ACROSS 12 OECD COUNTRIES: BRIEF OVERVIEW<sup>44</sup>

COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
DENMARK	<p>PRP established for the first time in 1997. PRP policy revised in 1997. In 2002, most of the unions entered the new pay system.</p> <p>PRP applies to all staff in Denmark. For some personnel groups, it is voluntary to transfer from the old to the new pay system; for others it is mandatory.</p> <p>PRP is not defined in any laws. All rules related to PRP have been adopted in the collective agreement with the central employees' organisations.</p>	<p>In the new pay system, the pay runs are generally shortened and pay setting is to a wide extent decentralised. However, overall pay determination is still decided in a centralised manner.</p> <p>The Danish performance-related pay system is decentralised.</p> <p>This decentralisation is counterbalanced by the comprehensive control of each institution/agency using the new pay system. In order to monitor the wage level trends, the State Employer's Authority has developed a special on-line statistical tool – accessible from the internet – called ISOLA.</p>	<p>There is no common PRP model across government organisations. However, most PRP schemes are based on the same three elements:</p> <ul style="list-style-type: none"> <li>Basic pay to be agreed upon centrally between the Ministry of Finance and the organisation negotiating on behalf of the employees.</li> <li>A superstructure which is agreed centrally/locally on the basis of any special functions which are attached to the job and on the employee's personal qualifications and performance.</li> <li>A PRP element which is agreed at the organisational level and reflects the fact that the employee has met a number of</li> </ul>	<p>All allowances are decided on the basis of individual appraisals, based on a dialogue between the employee and the line manager.</p> <p>This salary <i>discussion</i> is integrated into the yearly performance interview. The agreements are agreed and signed by the manager and the union representative/liaison. In some institutions a balanced scorecard is used for this appraisal, but normally the rating is much more informal and the salary discussions are only based on the local salary policy.</p>	<p>In the new Danish pay system there are no centrally-determined levels of pay reward. This question is to be decided at the local level by institutions/agencies. All control elements imposed on the new pay system are less restrictive, because the pay-pool system is in principle replaced by individual grants to institutions.</p> <p>Institutions controlling their own wage bills may make their own wage decisions within the wage-bill grant</p> <p>The new pay system entails additional budget responsibility. Consequently, it presents an additional challenge to management.</p>	<ul style="list-style-type: none"> <li>Sign of success since 1997: the number of employees under the new pay system has increased. Since the last collective agreement, the Ministry of Finance has made about 20 new collective agreements with the respective unions/central organisations.</li> <li>In 2001 the Ministry of Finance, the State Employer's Authority and the Danish Federation of State Employees' Organisations conducted an evaluation of the new system in 111 government institutions. Some key results are: <ul style="list-style-type: none"> <li>A positive effect of PRP is "more focus on and acceptance of individual appraisal and payment."</li> </ul> </li> </ul>	<p>Among the most significant negative effects mentioned by managers and employees' representatives:</p> <ul style="list-style-type: none"> <li>PRP represents too much administration;</li> <li>it creates uncertainty among employees.</li> </ul> <p>The main problems – seen from the Ministry of Finance's point of view are:</p> <ul style="list-style-type: none"> <li>lack of delegation within the institutions</li> <li>lack of competencies/qualification of line managers to handle the new pay system;</li> <li>not enough courage by line managers to treat the employees differently.</li> </ul>	<p>To achieve the full effect of PRP, it is important that decentralisation continues within each institution/agency by empowerment of the immediate line manager.</p>

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The descriptions in this analysis are derived from the country reports referred to in the Foreword. Chile, not being an OECD member country, has not been included here whilst the material for New Zealand is derived from material provided by the State Service Commission of New Zealand.



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COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
		<p>This database has been important for enabling the State Employer's Authority to run, monitor and control the highly decentralised pay system.</p>	<p>pre-defined qualitative or quantitative targets.</p> <p>The ultimate goal of the new pay system is that up to 20% of the total salary payment in the Danish state should consist of allowances and (directly) performance-related pay.</p>			<ul style="list-style-type: none"> <li>▪ PRP leads to better opportunities for recruitment.</li> </ul>	<p>On the institutional level, the following difficulties are often seen:</p> <ul style="list-style-type: none"> <li>▪ the salary policy is not clear enough all fully operational;</li> <li>▪ no clear link between the goals of the institution, personnel policy and salary policy;</li> <li>▪ not enough information from management to the individual employee (creates uncertainty)</li> </ul> <p>The introduction of PRP was a highly controversial issue with the members of the different unions (not enough money in the new pay system; too much focus on pay).</p> <p>The 2001 survey conducted on PRP indicated that only 39% of managers and 23% of union representatives think PRP leads to more focus on results.</p>	

COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
FINLAND	<p>The State Salary and Wage Policy Programme (known commonly as NPS, New Pay System) was launched in 1992 after several years' preparation.</p> <p>NPS is becoming mandatory for all organisations. This has meant a gradual increase of pressure for organisations and the collective bargaining parties to prepare, negotiate and realise NPS. This development is about to reach full implementation, as there are provisions about NPS in the central state collective agreement for 2003-4, as well as for the demise of the old pay systems.</p> <p>The scope of NPS is wide and encompasses all personnel up to middle managers. Managers above that level are excluded from NPS. Top managers cannot benefit from results-based rewards either.</p> <p>NPS is intended to be applied in all sectors/activities and at all levels of the administration.</p>	<p>Ministries/units prepare, agree and implement NPS within the general framework and guidelines set at the central level.</p> <p>Once implemented, ministries/units have the responsibility for their performance appraisal system, as well as for covering its cost.</p> <p>The new pay system has not been defined in law or regulation. The implementation of the NPS policy is to take place by collective bargaining.</p>	<p>The three main elements of salaries and wages are:</p> <ul style="list-style-type: none"> <li>pay according to the demands of the job;</li> <li>pay according to individual performance (parts of a collective agreement);</li> <li>results-based rewards (RBR), allocated at the team/unit level (RBR may exist independently of the other two elements, as RBR are not based on collective agreements).</li> </ul> <p>Performance appraisal is based on job objectives.</p> <p>The main elements for determining the criteria by which to assess performance are: organisational targets (politically determined); the collective bargaining process.</p>	<ul style="list-style-type: none"> <li>The principles and elements of performance assessment are specified for each unit separately, within the general framework of NPS.</li> <li>Every organisation has a set of criteria for assessing individual performance. Ordinarily 3-5 main criteria are agreed upon in the collective agreement and a network of sub-criteria as well as their weights are specified. A typical set of criteria would be a variation of "competence, effectiveness, and co-operation".</li> </ul>	<ul style="list-style-type: none"> <li>Pay according to individual performance is a combination of bonus and merit increment based directly on performance ratings. This link is standardised in each collective agreement. The amount of this pay element is correlated with the individual performance as well as the position in the salary range.</li> <li>The maximum pay (for exceptional performance) is between 25-50% of the basic salary. The average of individual performance pay in relation to individual total pay is currently about 15%.</li> <li>RBR are bonuses. The average amount of RBR was 1.7% in relation to individual total pay in 2002. The range between the agencies was 1-8.3%.</li> </ul>	<p>Implementation of NPS had a mixed reception. Top management has generally accepted NPS and energetically striven for its implementation, even if sometimes the amount of necessary input was underestimated.</p> <p>The employee organisations have principally accepted NPS.</p> <p>Recent evaluation reports reveal that a minority of organisations which implemented NPS have analysed its effects on functioning or staff.</p> <p>An indirect but still very indicative statistical fact is that salaries and wages in organisations that have implemented NPS prove to have been a bit better than in other organisations.</p> <p>The overall management process has been improved with NPS. The unanimous message from management has been that, when linked with pay incentives and sanctions, the impetus for maintaining good management processes grows, as well as the likelihood of efficient leadership. Employers in agencies feel that NPS, PRP and RBR are a very good incentive, for example as a tool for organisational development.</p>	<ul style="list-style-type: none"> <li>Homogeneity in ratings;</li> <li>Slow progress</li> </ul> <p>Since the early 1990s, progress towards the realisation of NPS has proved slower and more difficult than expected at first.</p> <ul style="list-style-type: none"> <li>Financing RBR is a problem for agencies with no chargeable activity. RBR, which are self-financed by agencies, are often considered relatively modest.</li> <li>RBR systems were often very complex at the beginning.</li> </ul>	<ul style="list-style-type: none"> <li>The implementation strategy of the new pay system has proved to be a long-term project. The full benefits of it are expected to become evident only during the next generation'.</li> <li>The State Employer's and the central State employee organisations have formulated principles to be applied to RBR-systems in agencies:</li> <li>RBR needs to be allocated at the team/unit level.</li> <li>RBR is a tool for managing, but the reward system should be constructed in consultation with the staff.</li> <li>The improved result must be objectively demonstrated using specially constructed indicators.</li> <li>Financing must be ensured.</li> <li>The development and operation of the results-</li> </ul>

COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
FRANCE	<p>The focus in France has traditionally been on incentives such as promotion or advancement.</p> <p>No real extended system of PRP until now. Individual remuneration for civil servants is based on:</p> <ul style="list-style-type: none"> <li>▪ Their position (corps, grade and step);</li> <li>▪ Specific characteristics of the job for senior civil service jobs (civil service jobs (<i>Nouvelle Bonification Indiciaire</i>, about 10% of basic salary)</li> <li>▪ Bonuses can be granted for overtime work, according to the difficulty of the work, special qualifications, etc.</li> </ul> <p>Bonuses generally allocated collectively and their amount varies greatly</p>	<p>The system of bonuses is highly decentralised and differs greatly between ministries and corps.</p> <p>Annual budgets for bonuses are allocated by the Finance Ministry to departments/corps.</p> <p>The budget is based on an average rate for each occupational group multiplied by the number of staff in that category within a department. The budget is indexed according to the general wage increase.</p> <p>Individual departments decide how to allocate bonuses among their staff and can supply budgets from their own resources.</p> <p>Audits by financial controllers, the General Inspectorate and Parliament.</p>	<p><i>Current system:</i></p> <p>This is not performance-related pay in the strict sense of the term but a flexible scheme reflecting a person's responsibilities and manner of working, the technical skills required in the post and the person's performance.</p> <p>The government has a "budgetary package" to cover the average amount, multiplied by the number of civil servants eligible for the allowance. How those resources are then distributed among civil servants is left entirely to the discretion of each government department.</p> <p>Joint technical committees are consulted on "allocation criteria for performance bonuses".</p>	<p>Since 2002, the evaluation and rating of civil servants must be part of an integrated policy process. The performance review results in a report validated by the official concerned and his/her line managers. Criteria for assessing performance:</p> <ul style="list-style-type: none"> <li>▪ Professionalism and technical skills</li> <li>▪ Organisation and performance</li> <li>▪ Personal qualities and interpersonal skills</li> </ul> <p>The employee's rating is taken into account for fast-track promotion to another step within a grade.</p>	<p>Performance bonuses are not included in basic salary and did not enter into pension calculations until the 2003 pension reform.</p> <p>Indemnities represent about 17% of the remuneration of civil servants, but vary amongst ministries, sectors and level of qualifications of staff. Senior civil servants receive higher bonuses than other categories of staff (about 40% of their remuneration depends on these bonuses).</p>	<p>The introduction of NPS has also resulted in improved staff development and training.</p> <p>Employers think that the RBR system has had a fairly beneficial effect on collaboration within teams.</p>	<p>Overall, no real PRP system in France for the moment. The bonus system is complex and obscure for most civil servants.</p> <p>Problems raised by the existing system:</p> <ul style="list-style-type: none"> <li>▪ There is a natural tendency of secondary remuneration schemes to converge and give every person in the same grade approximately the average.</li> <li>▪ Disparities between ministries and corps</li> <li>▪ Lack of transparency of the bonus and allowance systems and for the setting up of a clear evaluation process based on job objectives – notably for senior management.</li> </ul>	<p>based pay model must be followed and evaluated.</p> <ul style="list-style-type: none"> <li>▪ It is useful to develop simple PRP models, including at least three but preferably not more than 5 or 6 indicators.</li> </ul> <p>Two reports were published in April 2004 on performance management and PRP in France (Report from the committee of enquiry into the cost and efficiency of public services and a report from JL Siliquina from the <i>Conseil d'Etat</i>). These reports call for a gradual introduction of PRP in the public sector, for a clarification of the bonus and allowance systems and for the setting up of a clear evaluation process based on job objectives – notably for senior management.</p>

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COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
	<p>according to ministry and grade.</p> <p>Only 10% of civil servants earn bonuses that are more than 30% of basic pay.</p> <p>High bonuses are concentrated in senior management groups.</p> <p>Groups not covered by bonus schemes include teachers.</p> <p>Senior civil servants have NBI: a variable part of pay linked to the post.</p> <p>Bonuses were not pensionable until 2003.</p> <p>In October 2003 the French Minister of Civil Service and State Reform announced a proposal to introduce performance pay for top civil servants. The variable part of pay linked to performance will represent 15-20% of total pay for top civil servants. It is planned that performance pay be applied as of 2005 to the group of 1 000 top public executives in France.</p> <p>In a later stage, it is planned to extend it to the whole civil service, but probably not under the form of individual PRP, rather collective PRP.</p>						<ul style="list-style-type: none"> <li>The variable parts of pay – bonuses or NBI for senior civil servants – are not directly related to performance in most cases.</li> </ul>	

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COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
GERMANY	<p>PRP introduced in 1997.</p> <p>The Act Governing the Structure of Remuneration in 2002 created new opportunities to award performance steps, bonuses and allowances in a flexible manner.</p> <p>The Civil Servants Remuneration Act governs the legal basis for performance steps, bonuses and allowances as follows:</p> <ul style="list-style-type: none"> <li>▪ Performance steps (no more than 15% of employees)</li> <li>▪ Performance bonus/ performance allowance (no more than 15% of employees)</li> <li>▪ Allowance for temporary assignment to special duties</li> </ul> <p>PRP is meant to apply to all categories of staff. It is allocated at the individual or team/unit level.</p> <p>The granting of performance-related elements of pay as a means of rewarding excellent performance is applied throughout the federal administration. In 2003, for instance, over 41 000</p>	<p>The general guidelines for PRP arrangements (performance steps, bonuses, etc.) are defined at the federal level. Each department is responsible for designing and implementing its own performance appraisal system.</p>	<p>Combination of :</p> <ul style="list-style-type: none"> <li>▪ Performance steps.</li> <li>▪ Performance bonuses.</li> <li>▪ Allowances.</li> </ul> <p>In order to prevent performance bonuses and allowances from becoming set elements of remuneration and to keep them from becoming routine, there are restrictions in the Civil Servants Remuneration Act (<i>Bundesbesoldungsgesetz, BBesG</i>) with regard to the beneficiaries, the amount and the modes of payment.</p>	<p>Aptitude and professional achievements of a civil servant must be evaluated at least every five years.</p> <p>Detailed process of performance appraisal decided at the department level.</p>	<p><i>Performance steps:</i></p> <p>The number of performance steps awarded by the employer within one calendar year shall not exceed 15% of the civil servants and military personnel employed by a particular employer under remuneration scheme A.</p> <p><i>Performance bonus/ performance allowance:</i></p> <p>Performance bonuses shall not exceed the initial basic salary of the pay grade of the civil servant; performance allowances shall not exceed 7% of the initial basic salary.</p> <p>Performance bonuses and performance allowances shall be awarded only within the framework of special budgetary provisions.</p>		<p>During the last legislative term, the basis for performance-related remuneration was amended by the Federal Act on Special Payments. This amendment was prompted by a scientific study on the effects of the performance-related remuneration system introduced by the Act to Amend the Public Service Law of 1997.</p> <p>This study raised the following points of criticism:</p> <ul style="list-style-type: none"> <li>▪ Demotivation of a majority of staff members because of the quota of 20% of staff members per year who may be awarded performance-related pay.</li> <li>▪ Lack of binding performance criteria and of objective performance evaluation.</li> <li>▪ Lack of information on performance-related elements of remuneration. Lack of transparency in the awards procedure.</li> <li>▪ Lack of financial resources for performance-related elements were only</li> </ul>	<p>In the amendment to the provisions on performance-related pay of 2002 some of the problems identified were remedied (increase of the quota to 15%, discontinuing the rule that staff members remain at a particular salary step for at least half of the usual time before being eligible to advance to the next step, transfer clause, improved system to reward teams).</p> <ul style="list-style-type: none"> <li>▪ So far there is no information on current problems and difficulties with the implementation of the new rules.</li> <li>▪ Furthermore the 2002 reform of professors' remuneration introduced a performance-oriented remuneration system (fixed</li> </ul>

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COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
	<p>performance-related elements of pay were given to 550 000 staff members.</p> <p>Over € 50 million were spent on performance-related pay. However, this instrument of pay is not applied uniformly by the <i>Land</i> administrations; some make much use of it while others do not.</p>						<p>allocated during the current year and only for that year.</p> <ul style="list-style-type: none"> <li>Restrictions concerning performance-related pay for top performers because of eligibility criteria (for example for the performance step).</li> </ul>	<p>basic salary/variable performance-related pay). The experience of the <i>Länder</i> concerning the implementation of this measure must be taken into account before any problems and difficulties can be analysed. A thorough evaluation of the model for professors will be undertaken by 31 December 2007.</p>
HUNGARY	<p>Hungary introduced its performance assessment system in 2001 when the Service Act was amended, creating the performance-based pay system. In practice this legal instrument was first introduced in 2002.</p> <p>The system embraces the majority of civil service personnel from interns to department heads.</p> <p>Rules pertaining to performance assessment shall not be applied to administrative state secretaries, deputy</p>	<p>The basic features of the regulation are uniform. The Civil Service Act provides the regulatory framework.</p> <p>Performance assessment is obligatory for central and regional public administration organisations and local governments (municipalities).</p> <p>Beyond complying with the statutory requirements, it is for each public administration to decide how to implement PRP, full</p>	<p>The performance assessment system is based on three components:</p> <ul style="list-style-type: none"> <li>The definition of the key objectives of the public administration organisation.</li> <li>The definition of personal performance assessment criteria.</li> <li>The assessment of the civil servant's performance on the basis of the performance criteria by the person exercising the employer's rights by the end of the current year at the latest.</li> </ul> <p>The head of the organisation exercising</p>	<p>The definition of the <i>key objectives of the public administration organisation</i>. The key objectives are annually set by the ministers or the heads of public administration organisations. In local governments, key objectives are set by the body of representatives.</p> <p>The definition of <i>personal criteria</i>. It is the job description which ensures a link between the organisational/operational objectives and individual ones.</p>	<ul style="list-style-type: none"> <li>Merit increments.</li> <li>- +/- 20 % of salary.</li> </ul>	<p>An extensive training programme was launched and numerous national conferences held.</p> <p>The introduction of the performance assessment system was preceded by a published performance assessment guideline for civil service personnel and by professional conferences.</p> <p>It is too early to speak about substantial changes, but it is apparent even now that the system has induced positive changes in the civil service.</p>	<p>The greatest problem seems to be the lack of a separate financial allocation for public organisations to back up the possible +/-20% fluctuation in remuneration, so the possible changes in salary must be financed by public organisations themselves from their own budgets.</p> <p>Short- and mid-term organisational objectives are hard to incorporate at individual level, making it difficult to harmonise organisational and individual objectives.</p>	<ul style="list-style-type: none"> <li>increase the professional level of work;</li> <li>promote change of the organisational culture.</li> </ul>

COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
	<p>state secretaries, political consultants and political consultants.</p> <p>The performance assessment system provides for personal assessment exclusively without ensuring a separate budgetary allocation for it.</p>	<p>responsibility for its actions.</p>	<p>his/her transferable rights may alter the rank-based remuneration of the civil servant by a +/- 20% degree for the following year on the basis of the results. However, it is not obligatory to alter the basic remuneration of the civil servant.</p>	<p>The assessment of the civil servant's performance. The person exercising the employer's rights provides a written performance of the civil servant.</p> <p>A legal dispute can be launched in order to eliminate false or incorrect statements of fact contained in the assessment.</p>	<p>A number of public administrations have developed their own internal procedures. This improves the objectivity and transparency of assessments, taking local conditions into consideration.</p>			
ITALY	<p>Several initiatives were adopted to ensure a more transparent and accountable administration in the 1990s. Performance-related pay policy was implemented in this context in 1993.</p> <p>The current PRP system is based on evaluation of the individual performance of managers. PRP is applied to the managerial level only.</p> <p>The law states that managers are divided into two: first and second level directors. The level characterises the type of office that the director can be appointed to and the remuneration he/she is entitled to.</p>	<p>Governed by law and by collective agreements.</p> <p>All government bodies, local and central, are required to set up a performance appraisal system.</p> <p>Measures concerning the PRP system have been diffused through collective agreements since 1999.</p> <p>The evaluation is carried out by the same organisation which fixes its objectives at the start of the year for those in senior grades. Officials are subject to an annual merit assessment, carried out by their line managers, which is then submitted to the evaluation organisation.</p>	<p>Managers' remuneration is defined through collective contracts. The structure of additional pay for managerial staff in ministries is made up of the following:</p> <ul style="list-style-type: none"> <li>▪ remuneration linked to the post;</li> <li>▪ performance pay.</li> </ul> <p>For managerial staff at the director general level, fixed remuneration is defined through individual contracts.</p>	<p>The evaluation concerns the performance and organisational skills of each manager individually. The evaluation process is carried out by:</p> <ul style="list-style-type: none"> <li>▪ the staff of the directors general's office for state administrations;</li> <li>▪ the head of department or other superior general directors for director level staff;</li> <li>▪ the minister, on the basis of the indicators furnished by the unit carrying out the self-assessment for managers. Non-attained objectives result in the cancellation of the appointment and a new appointment</li> </ul>	<p>Bonuses: do not represent an ongoing increment to the manager's remuneration.</p> <p>The annual performance-related pay cannot be inferior to 20% of the annual value of the salary for the particular post, within the limits of available resources.</p> <p>For management staff at director level, the salary for the particular post and the performance pay are entirely personalised. These are established in the individual contract.</p>	<p>The system has the potential to improve performance by providing managers with a mechanism for the structured review of performance.</p>	<p>Excessive competitiveness can damage constructive collaboration.</p> <p>Often it is not easy to evaluate the achievement of objectives that cannot end in quantitative outputs, leading to a lack of objectivity during the process.</p> <p>Additionally, discrimination in the evaluation process is possible, with negative effects on the motivation of managers and their autonomy in management.</p> <p>Other difficulties noticed in the implementation of PRP: the insufficient dissemination of planning and control systems; resources actually assigned are insufficient; trade unions do not accept</p>	<p>The first critical element in guaranteeing the transparency of the process is a clear and detailed description of objectives that have to be achieved by managers and indicators that will be used during appraisal process. Additionally, the results of the appraisal should be communicated.</p> <p>The system also needs all managers to go through a practical training programme on evaluation.</p> <p>The concept of team results connected to a bonus represents</p>

COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
KOREA	<p>The Government introduced an annual merit increment and performance bonus programme in 1999.</p> <p>The Korean civil servant's pay is composed of base salary, allowances and welfare expenses:</p> <ul style="list-style-type: none"> <li>▪ <b>Base salary</b> is the regular pay by grade and step</li> </ul>	<p>The system is designed and applied at the central level.</p>	<p><b>Annual Increment (AMIP):</b></p> <ul style="list-style-type: none"> <li>▪ Yearly stipend system</li> <li>▪ Application: director general and above in each ministry</li> <li>▪ Performance-related pay</li> <li>▪ Increased variable proportion of pay is added to the fixed portion the following year.</li> </ul>	<p>Two measures are used:</p> <ul style="list-style-type: none"> <li>▪ MBO (management objectives) for higher-level employees and performance appraisal rating for mid- and lower-level employees:</li> <li>▪ The performance appraisal includes three major areas with different weights:</li> </ul>	<p>There are two forms of PRP schemes used in Korea: merit increments and bonuses.</p> <p>Merit increments are added to the annual salary of a higher level government employee and linked to his/her performance ratings.</p> <p>Bonuses are paid to government employees annually and designed for mid- and lower-level</p>	<p>PRP is newly introduced in Korea and it will take time to succeed so it is necessary to make continuous improvements based on both domestic and international partnership.</p>	<p>Employees may receive merit increases even if performances do not warrant them, because supervisors want to avoid creating animosity among employees.</p> <p>Employees' job performances tend to be assessed subjectively, based on supervisors' judgments.</p>	<p>Link performance appraisals to business goals. The standards of judgement for employee performance should be linked to the competitive strategies and aims an agency has decided upon.</p>
				<p>of the manager to another post in the same or another administration. In the case of non-observance of the directives given by a competent body or in the case of several negative evaluations, the manager can be ineligible for a new appointment to other posts equivalent to the annulled one for not less than two years. In the case of particularly serious situations, the administration can decide to rescind the individual agreement with the manager.</p>			<p>evaluation and remuneration systems as adequate in evaluating differences of productivity and professionalism; the part of pay linked to evaluation is not fixed nor, therefore, sufficient to be an incentive to managers (even though the last collective agreement changed this situation somewhat).</p>	<p>an entirely new way of operating. According to the debates and experiences noted, the PRP system is applied with greater effect at the local rather than the central level, because of the proximity with the citizens.</p> <p>Additionally, experience shows that some aspects of the system can be improved:</p> <ul style="list-style-type: none"> <li>i) evaluation and incentive techniques;</li> <li>ii) training of managers.</li> </ul> <p>The main challenge for the future is to realise the homogenous application of the system.</p>



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COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
	<p>according to the degree of responsibility, difficulty of the position, and length of service. It accounts for approximately 50% of monthly pay, depending on the rank in the organisation.</p> <ul style="list-style-type: none"> <li>The allowance is an additional remuneration paid separately according to the position and living conditions of individuals. Allowances are broadly classified into three categories: common allowances, special allowances, and extra work allowances. There are five types of common allowances (seasonal, diligence, seniority, family support, and managerial allowances). Also, there are three categories of special allowance (hardship post, high risk, and special task allowances) and three types of extra work allowance (overtime, midnight work, and holiday work allowances).</li> <li>The expenses paid for civil servant's welfare include</li> </ul>		<ul style="list-style-type: none"> <li>Excellent performer (top 20%) = 7% of performance standard amount in each grade; outstanding performer (21-50%) = 5%; normal performer (51-90%); 3%; unsatisfactory performer: 0%</li> </ul> <p><b>Performance Bonus Programme (PBP):</b></p> <ul style="list-style-type: none"> <li>Application: division director and below</li> <li>Form of payment: lump sum bonus</li> <li>Bonus amount: excellent performer (top 20%): 100% of his/her standard salary; outstanding performer (21-50%): 70%; normal performer (51-90%): 40%; unsatisfactory performer (below 91%): 0%.</li> </ul>	<p>performance ability and attitude (10%).</p> <ul style="list-style-type: none"> <li>Management objectives (MBO) is a planning and appraisal tool that has different variations across organisations. MBO is based on evaluation by the degree of goal accomplishment. Each goal is classified as follows:             <ol style="list-style-type: none"> <li>the strategic goal assigned to the level of the director general;</li> <li>the main goal assigned to the level of the division-director; and</li> <li>the basic goal assigned to the level of the assistant director.</li> </ol> </li> </ul> <p>In addition, 360-degree feedback is used for supplementing existing appraisals.</p>	<p>employees. Performance bonuses can be provided in various ways: 1) on an individual basis, 2) on a departmental basis (i.e. collectively), and 3) combinations of both. Performance bonus on an individual base is the most common form at present.</p>		<p>Unfortunately, performance measures for every single job is not only difficult but also expensive.</p> <p>Because PRP programmes focus mostly on individuals, they do little to integrate workforce members. With limited budgets for merit increases, employees must compete for larger shares. Competition among employees is counter-productive if teamwork is essential for successful projects.</p> <p>Merit increases should consist of meaningful increments.</p>	

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	meals, grade, household support, commuting, traditional holiday bonus, and non-vacation payments.  All categories of staff are covered by PRP schemes, with two different systems applying to top-level staff and mid-managers and below.	There is no standardised system of performance pay. Within broad departmental provisions, departments are free to design their own systems and must fund them from their own budgets.  There is no centralised oversight of the operation of departmental performance pay systems.  Control is through the overall financial accountability of the Chief Executive Officer who must ensure there is adequate budgetary provision for approved performance payments.	Each manager is responsible for managing his own budget. Departments have to achieve certain 'bargaining round parameters' <sup>45</sup> set by the government.  Departments should work closely with the State Services Commission in planning for collective bargaining. Departments should set remuneration levels taking into account: 1) market demand for the relevant skills/capabilities, experience, and responsibilities; 2) recruitment and retention factors; 3) ability to pay within approved baselines; 4) comparisons with other groups within the department; 5) any government policies aimed at achieving equitable outcomes for	Different in each department.  Recognition of performance and/or acquisition of skills:  <i>In general terms:</i>  (i) performance which meets the normal expectations of the job should be recognised by salary rather than by lump sum;  (ii) salary increases (rather than recurrent lump sum payments) should be given to employees who year after year exceed the normal expectations of the job;  (iii) departments with existing contractual arrangements to make lump sum payments should	<ul style="list-style-type: none"> <li>▪ Merit increments (decided by individual departments within the pay range set out in voluntary agreements)</li> <li>▪ Bonuses</li> </ul>	The State Service Commission notes that experience of base remuneration based on performance or levels of competency (or a mix) has been very positive.	The one exception is Police – which is moving back to a more length of service basis for pay.	The schemes have led to clarification of job goals and greater accountability of staff.  More successfully implemented in small departments where they can be more closely monitored.  The schemes have not led to the expected reduction in wage drift.  In the last five years there has been increasing emphasis on the competency basis and some agencies have moved away from the pure performance

<sup>45</sup> .

The purpose of the bargaining parameters is to establish government policies and expectations for collective bargaining and employment relations generally in the public service, so that departments can act in accordance with these.

COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
	<p>Chief Executives and the Senior Executive Service (about 150 positions) are covered by individual employment contracts.</p> <p>The health and education sectors overall are not covered by a national collective agreement (but groups within them are).</p>		<p>employees generally or for particular groups of employees; 6) other factors relevant to the particular department.</p> <p>The remuneration policy for Chief Executives and top managers is set by the State Services Commission and determined in agreement with the government.</p>	<p>have a strategy in place for negotiating/phasing out such arrangements as opportunities arise.</p> <p><i>There are some exceptions to this general approach.</i></p>				<p>basis.</p>
SPAIN	<p>The productivity bonus remunerates specific performance or working behaviour.</p> <p>The productivity bonus can be used in all public administrations – central, autonomous and local – although it is generally used in the central administration.</p> <p>The productivity for remunerating achievement objectives is applied in specific sectors, for example: social security, state traffic office, police, university professors.</p> <p>The productivity bonus is applied to a high percentage of civil servants in groups A and B. The percentage of groups C and D is much lower and, in general, the productivity bonus is not based on performance</p>	<p>At the beginning of each fiscal year, the Ministry of Finance issues a resolution fixing the productivity level for each department or autonomous administration.</p> <p>During the year, the productivity level can be adapted to the number of staff. The Ministry of Finance determines the amount of the global credits intended for the productivity bonus, adapting it to the number of staff and the degree to which the objectives fixed for each programme have been achieved.</p> <p>Inside this total salary allocation the different departments and organisations are free to design and develop their own systems of performance and</p>	<p>The different departments and design their own productivity performance remuneration systems independently. There are models based either on assessing individual performance or for team/units.</p> <p>Team/unit PRP is the majority system when productivity is used for remunerating special performance.</p> <p>The main characteristics required by law for calculating productivity bonus are the following:</p> <ul style="list-style-type: none"> <li>▪ It remunerates any special performance, extra activity and interest or initiative used in doing the job.</li> <li>▪ The global amount cannot exceed a certain percentage of total personnel costs in each programme and organisation.</li> </ul>	<p>There is no standardised appraisal system. Each department /agency has the responsibility for developing its own system. Once the global amount or salary allocation for the productivity bonus has been fixed, each department enjoys wide independence in establishing individual criteria for each civil servant.</p>	<p>Productivity bonus</p>	<p>No evaluation of the results at the central level.</p>	<p>The application of the special performance bonus is limited as it only affects specific sectors. In most cases the productivity bonus has been linked to the extra activity (longer working hours) and it is almost always a fixed amount related to this criteria. At the same time, there are different sizes of productivity bonuses according to working hours in the different ministerial department for equivalent positions.</p>	

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	<p>assessment but on longer working hours. There are two important exceptions: Social Security and the Police, which have their own systems, based on performance measured by achievement of objectives and are linked to collective performance assessment at the team/unit level. All categories of staff are included in these schemes.</p>	<p>productivity related pay. Each department determines the criteria for awarding the amounts of the productivity bonus.</p>	<ul style="list-style-type: none"> <li>The amount of PRP awarded has to be known by the other civil servants in each department or organisation concerned, as well as by trade unions' representatives.</li> </ul>					
SWEDE	<p>Until the late 1980s, pay agreements were very centralised and negotiated increases were applied to the entire civil service. From 1980-89 a new budget system was introduced, replacing detailed annual appropriations by performance control and framework budgets. In 1989, the salary grade system was abolished and replaced by individual salaries. In 1994, full autonomy in employer policy matters was granted to heads of agencies. The centrally negotiated and individualised pay system implemented around 1990 and is today well established</p>	<p>The remuneration system is highly decentralised. Agencies are almost completely autonomous in employer policy. Legislation concerning labour is largely discretionary – i.e. collective agreements may be substituted for legislation, provided that the labour market agrees. Most terms of employment are laid down in collective agreements. Since 1997, the government monitors agencies' employment policies by using a system with annual reporting of competence planning, salary level and development, gender age distribution,</p>	<p>Every individual salary is negotiated at local level and is open to public scrutiny. Pay should be individually determined and differentiated. The system demands that management develop local pay policies that are generally transparent and understood by most staff. A typical local pay policy:</p> <ul style="list-style-type: none"> <li>focuses on the agency's activities and objectives;</li> <li>supports the agency's ability to recruit and retain staff with adequate skills;</li> <li>clarifies how pay determination can motivate the staff;</li> <li>defines criteria for pay determination;</li> </ul>	<p>There is no uniform government staff evaluation system in Sweden. Nearly all agencies use some kind of performance appraisal/ evaluation dialogue once a year to review performance and potential future tasks, results and training needs. Most agencies have evaluation and pay talks between a manager and each of their subordinates. Some agencies, such as the tax authority, have started to try to introduce 360-degree dialogue where the employee gives feedback to the manager and vice versa. Supervisors are</p>	<p>There are three types of agreement negotiated at the agency level within a few framework agreements covering the entire central administration. The basic agreement and the general agreement are negotiated at the central level between the Swedish Agency for Government Employers and the central unions. The basic agreement deals with the negotiation procedure and is valid over a period of time, and must be confirmed by the government. The general framework agreement deals with overall salary levels and other general conditions. Local agreements determine the individual pay and other local conditions of employment and are negotiated at the agency level between</p>	<p>Individual pay determination is much appreciated among employees and employers alike. Directors-general are well aware of their role as employers. They carry their responsibility for employer policies very well. Recruitment and retention of good managers is believed to have improved under the individual salary setting scheme.</p>	<p>There is a risk that individualised pay awards are used to pay newly recruited staff competitively rather than to award good performance. That is, PRP is used to recruit and train core staff rather than motivate and reward the majority of staff</p>	<p>The division of functions between the government and agencies facilitates a clear separation between:</p> <ul style="list-style-type: none"> <li>pay increase – and budget appropriations;</li> <li>staffing policies – and labour market policy;</li> <li>available resources – and new unplanned activities;</li> <li>recruitment – and politics.</li> </ul>

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	<p>throughout the civil service. There is no uniform system of PRP. Nearly all agencies use some kind of performance appraisal/evaluation dialogues once a year.</p> <p>Most employees of the Swedish Government are under individual pay systems set by collective bargaining, except senior government officials – including university professors, Directors-General, Under Secretaries of State – who were taken out of the collective bargaining system. Their salaries are now set on an individual basis either by a review board or directly by the government.</p> <p>Workers at all levels may be covered by bonus systems as part of their local collective agreements. There are however some exceptions among the police, armed services, and judges. In practice, agencies are reluctant to award them and bonuses are therefore more used in businesslike activities than in traditional central administration.</p>	<p>structure and staff turnover.</p>	<ul style="list-style-type: none"> <li>includes the means to prevent discrimination.</li> </ul>	<p>required to inform their subordinates of individual wage increase, explaining it in terms of job performance.</p>	<p>management and union representatives. There are no centrally determined pay scales or remuneration schemes.</p> <p>The agencies are fully responsible for the results and consequences of their collective agreements.</p> <p>Where applicable, bonus payments are more directly linked to efficiency measures and cost savings, but see column 1 as to the award of bonuses generally.</p>			

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SWITZERLAND	<p>The previous pay system allowed for a virtually automatic pay increase every two years for all staff, until their wages reached the ceiling of their respective pay bands.</p> <p>A PRP prototype was launched as far back as 1996.</p> <p>The Law relating to Confederation staff (LPers) was adopted by Parliament on 24 March 2000 and came into force on 1 January 2002. It ended the automatic wage increases to which civil servants had until then been entitled.</p> <p>There is a single implementing provision for PRP embracing all posts. The system is applicable to all Confederation staff on an individual basis.</p>	<p>The pay system is the same for the whole Confederation. Performance-related pay is defined centrally, its principles being enshrined in legislation and its implementing directives. The implementation of PRP, on the other hand, is decentralised in that individual managers have responsibility for applying it to their own staff.</p>	<p>Staff pay bands are determined by three different bodies, depending on the employee's position in the hierarchy.</p> <p>Appraisers have a certain amount of flexibility in that they are the ones to determine the percentage pay increase for employees whose performance is considered to be "highly satisfactory" or "excellent".</p> <p>Performance-related pay is incorporated into the regular pay system, with each administrative section having its own budget. This budget can be cut. A budget for performance deemed to be "outstanding" is also available, and this too can be cut.</p> <p>Pay increases based on performance can vary between 2-6%.</p>	<p>The targets set for employees are agreed between the latter and their immediate superiors.</p> <p>First, there are targets that are performance-related and that enable work to be geared to objectives and results.</p> <p>The next set of targets relates to employee conduct, covering certain personality aspects and working methods (vocational skills, personal skills, inter-personal abilities, the art of leadership, etc.).</p> <p>Interviews take place throughout the year to monitor performance.</p> <p>The formal process of performance appraisal takes place shortly before the end of the year and is conducted in writing.</p> <p>If an employee disagrees with the results of an assessment, the next manager in line can be asked to conduct a second appraisal.</p>	<p>Financial rewards under performance-related pay consist of wage increases based on merit, and bonuses.</p> <p><b>1/ Merit increments:</b> there are annual wage increases (from 0-6%), which are applicable until the wage band ceiling is reached, then a complementary bonus once the ceiling is reached (up to 12% if appraisal rating is A++: "far surpasses requirements").</p> <p><b>2/ Bonuses:</b> This type of remuneration is left entirely to the discretion of managers. Performance bonuses can be awarded at any point in the year regardless of the rating. The size of the increase is normally decided by individual departments. The amount decided on is not negotiable.</p>	<p>An appraisal of PRP implementation was carried out very soon after the law came into force.</p> <p>The majority of people canvassed after the new pay system was introduced thought that the use of different performance appraisal techniques was a positive thing. They saw it as a sign of change and a departure from the image of the dyed-in-the-wool civil servant towards one of entrepreneurship based on modern public management techniques.</p> <p>Six months after the first compulsory annual appraisal, the majority of employees felt that a performance-linked pay system was a good thing. It gives employees and management the opportunity for open discussion, promotes results-oriented work, and encourages communication. It also means that both employees and managers have to deal with personnel tasks.</p>	<p>Some of the problems indicated are: the fact that PRP is linked to the Gauss curve, the difficulty of making the appraisal methods uniform, the income-penalty of some managers, the negligible impact on salaries, the fact that public service culture is not amenable to performance-related pay.</p> <p>Given that the system has to be cost-neutral, employees have doubts as to whether the new system will be applied in its entirety. They are also concerned about whether performances will be correctly ranked. On this point, managers have remarked that if targets are to be properly assessed they must be set with care.</p>	<p>No extensive reforms have yet been envisaged. However, adjustments can be made, particularly to percentage pay increases relating to each ranking level.</p> <p>Like all administrations, the Confederation is faced with budgetary constraints. If on top of this, other measures are taken affecting pay adversely, staff could become demotivated very quickly and this could rapidly result in a downward spiral, where poor results due to demotivation, lead to less pay.</p>

COUNTRY	PRP	Flexibility and control	Overall design of PRP	Performance appraisal	Performance payment	Overall impact	Specific problems	Lessons learnt
UNITED KINGDOM	<p>The previous administrations to decentralise civil service management by creating free-standing agencies, and to reward all staff according to their performance, distinguishes civil service pay practices from much of the wider public sector, such as local government and the National Health Service. The two distinctive features of civil service pay are:</p> <ul style="list-style-type: none"> <li>the delegation of pay grading and performance management arrangements to departments and agencies for staff below the Senior Civil Service;</li> <li>the near-universal application of individual performance pay.</li> </ul> <p>Prior to delegation, HM Treasury centrally determined the pay, grading, and terms and conditions of employment for all civil servants in negotiations with unions. Individual departments had no control over the terms and conditions of their staff. The delegation of pay and grading regimes to depart-</p>	<p>The system was originally centralised with a trend to decentralisation in the past 10 years. In 1994, the government announced its intention to extend its policy of delegation to all departments for staff below the senior civil service and to replace the existing national pay frameworks. The senior civil service pay and grading remained centralised and managed by the Cabinet Office.</p> <p>In developing their own systems, departments are required to have regard to the four key principles set out in the Civil Service Management Code (CSMC):</p> <ul style="list-style-type: none"> <li>better value for money from the pay bill;</li> <li>improved flexibility in the pay system;</li> <li>better budgetary control of pay costs;</li> <li>an effective link between pay and performance.</li> </ul> <p>The Cabinet Office is the custodian of the CSMC and all civil service organisations are bound by the Code.</p>	<p>Current practice varies greatly within the civil service, with departments and agencies encouraged to align their reward strategies with their own business objectives. Current pay systems typically involve:</p> <ul style="list-style-type: none"> <li>Most departments and agencies set pay ranges by grades.</li> <li>Most departments are designing reward systems in support of business needs.</li> <li>Most departments and agencies provide progression to a target rate or a 'rate for the job'.</li> <li>Non-consolidated bonuses.</li> </ul> <p>Other departments and agencies generally offer very good non-pay rewards, such as good annual leave, flexible working hours, work/life balance policies, varied work, etc. The benefits of these are not "sold" particularly well and can sometimes become stale if not refreshed or publicised.</p>	<p>Most departments and agencies set pay grades. These are set in order to relate to market pressures and/or recruitment factors. Pay ranges are generally revalued on an annual basis to meet needs and keep in line with market pressures.</p> <p>Most departments design reward systems in support of business needs.</p> <p>Most departments and agencies provide progression to a target rate or a 'rate for the job'. Target rates are set in accordance with what is considered to be the market rate for the job and are generally positioned between 80% of the pay range and the maximum. Once at the target rate, it is generally the best that only the best performers can receive consolidated payments past this point. Departments may also vary starting pay to reflect particular skills or pay in previous posts. High performers will not necessarily be the best paid in their grade. Departments</p>	<p>Non-consolidated bonuses are now being used as one of the main vehicles for delivering performance-related pay to staff performing above a satisfactory level. Bonus levels vary in different organisations and can be substantial in some and much less substantial in others.</p>	<p>There are a number of important elements that make reward schemes work well, including:</p> <ul style="list-style-type: none"> <li>transparency;</li> <li>employee involvement;</li> <li>sense of fairness;</li> <li>realistic and clear goals;</li> <li>proportionality of the reward to the effort required;</li> <li>high degree of employee control over the measured outputs;</li> <li>impartial and high quality</li> <li>people management.</li> </ul>	<p>Management capability: A report to the Civil Service Management Board in 2003 recommended "more active organisational and personal performance management including greater transparency and regular honest feedback based on better evidence, more clarity on how we will reward people who perform, and a simplified appraisal process" as part of a wider programme of improving leadership capacity.</p> <ul style="list-style-type: none"> <li>Flexible funding: due to constraints, departments and agencies are not able to provide adequate financial incentives for staff to want to perform at the top level. Departments and agencies also have difficulty measuring the impact that a performance-related pay system has in the achievement of organisational objectives.</li> </ul>	<p>The government considers pay delegation an important tool to facilitate improvements in delivery and productivity. Permanent secretaries/chief executives can determine how best to recruit, retain and motivate staff and they have the ability to control their pay bill.</p> <p>The design of the reward system should reflect the nature of how work is actually carried out and also the culture and direction of the organisation. Performance-related pay schemes are used to align employees' performance with organisational objectives, to create a clear line of sight between individual objectives and achievement of organisational goals.</p> <p>It is important to pay attention to the culture of the organisation. If an organisation</p>

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	<p>ments and agencies began in the early 1990s. At the same time, performance-related pay was introduced to achieve a closer link between performance and reward for individuals and groups of staff. Departments received full delegation to develop terms and conditions for their staff in 1996.</p> <p>PRP policy applies to all staff. Senior civil servants' pay is managed directly by the Cabinet Office. PRP policy can be applied both at the individual and collective (team/unit) level.</p>			<p>are working hard to develop progression arrangements that are robust against equal pay challenges.</p>				<p>has a team-based culture, individual rewards may not be suitable. It is important to keep schemes fresh. There is scope to expand the use of non-pay rewards in the civil and public services.</p> <p>The Cabinet Office, with the help of key stakeholders, is currently developing practical proposals to improve the workings of the delegated arrangements within which departments can operate.</p>



**ANNEX B REPLIES TO EMPLOYEE ATTITUDE SURVEYS IN SELECTED PUBLIC SERVICE ORGANISATIONS IN THE UNITED KINGDOM**

Research led by Dr David Marsden, at the Centre for Economic Performance, London School of Economics (United Kingdom)

Replies to employee attitude surveys in selected public service organizations<sup>46</sup>

Question: % in each cell replying "agree" or "agree strongly"	Civil Service			NHS trust hospitals		Schools	
	Inland Revenue 1991	Inland Revenue 1996	Employment Service	Individual PRP trust	Group PRP trust	Primary (NAHT)	Secondary (SHA)
<b>Pay and work orientations</b> PP a good principle	57	58	72	62	52	29	42
<b>Motivation: perceived incentive</b> PP gives me an incentive to work beyond job requirements	21	18	12	32	22	8	10
PP gives me an incentive to show more initiative in my job	27	20	20	36	19	9	11
PP means good work is rewarded at last	41	19	24	47	34	38	40
<b>Motivation: perceived divisiveness</b> PP causes jealousies	62	86	78	61	51	58	70
PP makes staff less willing to assist colleagues	28	63	52	22	19	51	54
PP has made me less willing to cooperate with management	10	30	26	19	14	7	4
<b>Relations with management: non-manager replies:</b> Management use PP to reward their favorites	35	57	41	41	27	Na	na
There is a quota on good assessments <sup>47</sup>	74	78	74	57	36	48	45
<b>Line manager replies:</b> PP has reduced staff willingness to cooperate with management	20	45	39	30	27	Na	na
PP has increased the quantity of work done	22	42	28	52	34	Na	na
N (total replies)	2 420	1 180	290	680	900	1 050	860
Response rate (%)	61	30	33	28	21	51	21

Note: based on five-point Likert scales: "strongly disagree", "disagree", "no view", "agree" and "agree strongly". NAHT: National Association of Head Teachers (mainly primary schools); SHA: Secondary Heads Association (mainly secondary schools). For an explanation of the nature of the surveys, see the methods appendix (Marsden and French, 1998).

Source: Marsden and French, 1998.

46. Results shown in the Table are broadly consistent with the results of other attitudinal surveys that applied the same methodology as that used by Marsden and Richardson (1992), notably, Thompson (1993), Kessler and Purcell (1993), Heery (1998), IRS (1999), and in the private sector, Carroll (1993).
47. Head teachers were asked whether financial constraints on the schools would mean that they would not receive performance pay.

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