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# Performance Related Pay in the Public Service In OECD and EU Member States

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## Introduction

Attempts to introduce performance related pay in the civil service took place in the 1980s and 1990s in some OECD countries. Public administrations began to react in coping with what was called "the fiscal crisis of the State", a way of naming the consequences of the economic crisis originated in mid 1970s. This led many to advocating for a more businesslike approach in public administration operations. Working processes needed to be reviewed and be made more efficient and civil servants needed to produce more and better results. This was at the root of the New Public Management (NPM) doctrine. Before the NPM other developments had taken place, such as the notion of responsiveness to the needs of citizens. Responsiveness was developed mainly in the late 1970s and the early 1980s to describe and emphasise the necessity for the public administration to connect better with the real needs of citizens in order to provide better and more suitable public responses to such needs.

Businesslike approaches to public management peaked in OECD countries in the 1990s, particularly among those members of the British Commonwealth, while former communist countries in Europe were veering out of the old regime and were attempting to create new democratic institutions, including public administrations and civil services. Performance related pay for the reformed civil services was regarded as a sort of panacea by many politicians in the region for stimulating the development of a more professional civil service and more accountable public administrations. Performance appraisal and performance related pay became the most advocated technique by many reformers and consultants in the region and was put in most, if not in all, new civil service Acts.

The question now is: Are performance measurement and performance related pay in the civil service working in practice? How have OECD countries used such technique?

## Performance-related pay in OECD countries

Before the 1980s the majority of civil services in OECD countries had salary systems which rewarded the job position regardless of the performance of the position holder. The system was based on job evaluations linked to the job description and grades by using different techniques such as analytical and non-analytical methods or some combination of both. The system was supplemented by an emphasis on seniority and length of service as the basis for career advancement. In the late 1980s and in the 1990s a number of countries sought to reduce the weight of length-of-service and job evaluation by introducing, or increasing, the importance in pay of the element of individual or group performance. There was a tendency to change payment systems in some OECD countries during the 1990s through experimenting with performance-related pay. At the forefront of adopting various types of performance-related pay schemes were the Netherlands, New Zealand and the United Kingdom. Austria, Australia, Denmark, Finland, France, Germany, Norway and Spain have also made some moves in that direction. For a long time, Canada and the United States have had performance-related pay for senior public service officials and middle managers. The results of these reforms can be better viewed by distinguishing between managerial and non-managerial positions in the civil service.

*Performance-related pay for managerial positions*

Countries with a significant element of performance-related pay for senior and middle public service managers include Australia, Canada, Denmark, Ireland, the Netherlands, New Zealand, the United Kingdom and the United States. Performance-related pay for managerial positions has been used mostly as a way to fill the gap between salaries of managers in the public service and those in the private sector in order to attract and retain private sector managers into the public administration to help build up a business like public administration. However, this has created problems of internal compatibility and triggered pressures for internal equalisation of salaries. There is no conclusive empirical evidence that such an approach has effectively helped to improve motivation and performance within the public service. No link has been found between performance-related pay for managers and improvements in organisational performance. Most accounts from OECD countries using performance-related pay for public service managers hint at the conclusion that the technique has been useful only in overcoming labour market pressures derived from the competing private sector rather than to reward actual outstanding achievements.

*Performance-related pay for non-managerial positions*
There is relatively little evaluation of the introduction of performance-related pay for non-managerial positions within the civil service. The majority of evaluations refer to Australia, United Kingdom and the United States. On the whole, the results have highlighted a number of weaknesses of existing schemes, and despite the attractiveness of the principle of rewarding good performance, in practice the schemes so far have had, at best, only limited success. For example, evaluations of the Performance Management and Recognition System (PMRS) established in 1984 in the United States and discontinued in 1993 as well as the evaluation of the United Kingdom Inland Revenue Service Scheme concluded that the majority of employees were almost never given less than satisfactory performance ratings. Given the fact that only those achieving outstanding performance were entitled to the bonus of pay per performance, it meant that in practice few employees obtained the bonus, while the majority, albeit performing satisfactorily, were not entitled to such bonus. The majority of staff found these schemes de-motivating, causing jealousies and leading staff to question and de-legitimise the established appraisal system. The managers who administered the appraisal also thought that performance-related pay had not improved motivation of their staff. These somewhat disappointing results were consistent with similar evaluations made in Australia.

*Side effects of performance related pay*
One of the major problems with performance-related pay systems in the public service, and this is true also for almost all incentive payment schemes, is that they tend to produce an escalation of performance ratings and payments and consequently increases in personnel costs, even if there are formal payment ceilings set. Effectively, under pressure to retain staff or to enlist extra staff needed to overcome internal bottlenecks managers tend to award better ratings and better pay to staff sometimes in an indiscriminate way. This leads staff and their unions to see performance-related pay as a negotiable part of the salary, with effort being withheld unless performance-related pay is awarded.

Another major problem of performance-related pay is associated with the fact that no performance appraisal scheme can be fully objective, as by definition all of them have a strong subjective judgement component. In the public service this can lead to trespass the tiny line separating subjectivity from arbitrariness. If staff and the public perceive arbitrariness in public administration, this has devastating effects on the legitimacy of public institutions in the eyes of the staff and the public altogether.

Theoretically it is arguable that increases in salary costs produced by pay-per-performance schemes could be funded or even offset by increased productivity, as happens in some industries in the private sector. However, the measurement of productivity in the public service poses many problems. Not all activities the public service does are measurable. In some public administration areas, however, quantitative targets and benchmarks are already established and can be measured. In some countries some agency-level productivity bargaining arrangements are being put in place (e.g. Australia, UK) while recognising the important differences in the capacity of different agencies to generate the productivity-based savings necessary to fund performance-related pay. Another attempted solution has been to impose the requirement that performance-related pay should be cost-neutral, which demands careful and sophisticated management to ensure that service standards to citizens are not reduced.

One conclusion from the experience of OECD countries with performance-related pay is that the technique is functioning well in none of these countries' public services. In addition, it has created side effects that are difficult to deal with. In order to address the political urges to introduce performance-related pay, personnel administration and management in these countries have grown sophisticated and bureaucratic requirements have increased in order to keep the pay-per-performance schemes under control.

In May 2002, the conclusions were presented of a report[1] surveying systems of productivity-linked remuneration in EU Member States. The main conclusions were that:

- Performance-related pay systems are costly and time-consuming to implement.

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1 "Survey for the 38th Meeting of the Directors-General of the Public Service of the Member States of the European Union (La Rioja, Spain, 28-29 May 2002): *Comparative Survey of the Systems of Productivity-linked Remuneration that are Employed in the Civil Services of the Member States of the European Union (Performance Related Pay*)". European Institute of Public Administration, Maastricht, Spring 2002. Responsible for the survey: Seán Fitzpatrick.

- In many cases such systems are only applicable at senior levels.
- Discretion of managers is confined to issues such as measurement of performance and distribution of the small pool of money available for performance-related pay.
- Some systems have been introduced as pilot projects with a view to wider application at a later date, but in absence of rigorous analyses of the effects of the pilot projects it is not clear how wider application could be introduced.
- Almost none of the current schemes addresses the issue of underperformance (no punishment for failure to deliver).
- Measurement of performance, particularly in areas where there are no obvious quantifiable outputs, is a very difficult issue.
- No evidence has been found that performance-related pay schemes have contributed to an improvement in performance, in human resource management or in the quality of the service delivered.
- Additional remuneration was not a significant motivator for the employees concerned.
- The regular, annual or more frequent, formalised discussions between managers and employees on performance, targets and progress achieved have positive effects on motivation (recognition of the contribution of an individual to the organisational performance)

**Performance appraisal and performance-related pay**

The fact that the experience with performance-related pay in the public services has not been satisfactory should not lead to the conclusion that there is an inherent impossibility of keeping civil servants accountable for their performance. What perhaps has been a mistake is the somewhat blind importation to the public service of techniques developed in the early 20$^{th}$ Century in mass-production industrial settings.

What has been a problem in public administrations under fiscal pressures has been the weak performance culture existing in many public services and the lack of managerial sensibility for achieving more and better results from public resources. The solution for this shortcoming does not consist of introducing performance-related pay in the public service, but just making small steps towards developing a more results and performance oriented administrative culture.

In late 1990s and early 2000s a trend is observable in many OECD countries towards a more comprehensive approach to the problem. This has been labelled as Performance Management, which implies much more than the mere introduction of performance-related pay. It is too early to say whether or not this approach is working well. Performance management systems are aimed at linking the management of people with institutional goals and strategies. In practice, countries that have attempted to establish performance management systems (e.g. New Zealand, Australia, Canada, United Kingdom and the United States) have found it difficult to achieve a working linkage between individual, unit and institution target-setting. In these countries there is little evidence that departments and agencies are using performance-related pay to implement their institutional strategies or to shape a performance culture in their organisations. The view is gaining momentum that attempting to develop highly formalised performance management techniques is inimical to a transparent and democratic public service culture.

One of the main difficulties occurs when it comes to measuring performance. Performance indicators are old practices in public organisations, but have extensively developed in the last two decades. Many National Audit Offices have extended their remit beyond regularity and legality issues to embrace more sophisticated concepts of efficiency, effectiveness and service quality in what has come to be called ‘performance audit’. The more ambitious uses of performance indicators have taken place in Anglo-Saxon countries where managers’ discretion plays a larger part. This is less so in administrative law systems, where administrative behaviour is more inspired by laws and regulations than by performance indicators and where managers’ discretion is more constrained by procedural rules. The attempts to introduce a performance culture in both types of countries have been controversial and have produced meagre results.

Performance management needs to be based on strategic management according to which goals and results are established in a consistent way during the political, policy-making and managerial processes. But the introduction of strategic management in public organisations is difficult because of the fact that strategy and strategic management do not have the same meaning for politicians and for managers. For example, performance-based budgets are a rational approach to link results and resources. However, the economic rational logic behind performance-based budgets is different from the political logic and these two logics do not necessarily converge. A strict economic logic does not represent the ultimate rationale behind public decisions. Political compromises can leave objectives, goals and results somewhat ambiguous and inconclusive. Political goals and organisational objectives are not easy to reconcile. Strategic management schemes have been introduced in Australia, Canada, Finland (Strategy Portfolio scheme, 1995-1999), New Zealand (Strategic Results Areas and Key Results Areas schemes), United Kingdom (New Strategic Approach for Public Spending of 1998), and the United States (Government Performance and Results Act of 1993- GPRA). Performance-based pay sounds appealing as a rational means to promote good performance by civil servants, but we have shown how problematic it is in practice.

In the end, as Pollit and Bouckaert (2000, page 120)[2] point out "the fundamental difficulties in assessing most, if not all of these strategic initiatives are those of determining how far (if at all) the quality of top-level decision-making is improved, and whether the new decision procedures ultimately lead to more efficiently produced outputs and/or substantively better outcomes".

If one looks at the experience of non-OECD countries around the world, it is worth quoting Salvatore Schiavo-Campo[3]: "…A word of caution about 'performance pay' is in order here. It is intuitively appealing to link bonuses to yearly performance in terms of specific output measures. However, the facts show that bonus schemes have been only marginally effective in improving performance, even in the private sector and especially in the public sector, where outputs are difficult to quantify. Performance pay schemes may also introduce an element of political control over a career civil service…Even if such schemes are fairly administered, it is next to impossible to prevent the perception of favouritism".

A research paper by the World Bank (2003) on elements influencing better performance in public administration concluded that 1) Building a meritocratic civil service is of universal value for performance; 2) a well functioning system of administrative procedures lays the foundation for meritocracy; 3) Performance management systems demonstrated remarkably little influence on anything and in some cases produced negative effects. The Bank concludes that "strengthening of both meritocratic civil service management systems and administrative systems (administrative procedures) should precede extensive efforts to build performance management systems"[4].

A 2005 study by the OECD[5] concludes that performance related pay has little or no effect on increasing the motivation of civil servants. However, it can be a powerful instrument in the hands of managers and politicians to assert their power in pushing forward reforms or in achieving other policy goals.

**What can be done?**

Perhaps it is necessary to recall the basic aim of any performance management and performance appraisal systems in public service. These systems and techniques make sense only if the aim is to increase and ameliorate the accountability of public officials and the performance of public institutions. This suggests that clear links should be visible between the technique and a more general change management process, which would ideally include the reshaping of the public human resource policy in a country, by keeping basic public service and public administration values intact or reinforced: predictability, regularity, legal certainty, fairness, etc.

Taking stock of the somewhat disappointing experience of OECD member countries with performance-related pay after some 20-years experience and the still unseen results of performance management may lead to questioning whether it is worthwhile to make an effort to improve performance in the public service. This question is of particular relevance for countries in Eastern Europe trying to build new civil service systems. The politicians' temptation to blame civil servants for everything bad is higher in Eastern Europe than it was

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2 Pollit, Christopher and Bouckaert, Geert: "Public Management Reform. A Comparative Analysis". Oxford University Press. Oxford, 2000. This is a comparative study on ten OECD countries.

3 Schiavo-Campo, Salvatore: "Reforming the Civil Service" in *Finance & Development*, Vol. 33, No.3, September 1996, pages 10-13. *Finance & Development* is a quarterly publication of the International Monetary Fund and the World Bank.

4 World Bank: "Understanding Public Sector Performance in Transition Countries- An Empirical Contribution". June 30, 2003. Page 38-39.

5 OCDE 2005: *Performance-Related Pay Policies for Government Employees*. OECD Publishing, Paris, 2005.

during the NPM years in Western Europe and other non-European OECD countries. In eastern European countries most politicians and civil servants are undergoing their own personal transformation from communist to non-communist thinking. Misgivings between elected politicians and civil servants are even more acute than in Western Europe. Copying bad experiences from western countries would be a mistake bearing serious negative consequences for eastern countries.

In an age where it is important to build up public administrations and civil services that are reliable and predictable and at the same time able to gain the trust of rather sceptical public opinions, perhaps it is wiser opting for civil service pay systems based on pay-for-grade rules instead of pay-per-performance schemes. One reason is quite obvious. Pay-for-grade provides a greater deal of predictability for employees and reduces the likelihood of arbitrariness in determining individual salaries and this is essential if public authorities have to gain first the confidence of their own civil servants as a pre-condition to gain the trust of the population at large. Another reason is that even if a pay-per-performance scheme would hypothetically work well, the ratio between costs and benefits of the system would probably not paying off mainly because of the bureaucratic sophistication needed to manage a pay-per-performance scheme in public organisations and to keeping it going. Furthermore, from a budgetary standpoint, pay-per-performance may turn out to be incompatible with tight budget allocations for reforming the civil service in a transition period and public expenditure may run out of control.

This does not mean that performance appraisal is not possible or valuable in the public service, but rather the contrary is true. The problem comes when a big amount of the pay is linked to performance appraisal. The main purpose of performance appraisal should not be to increase or decrease the pay, but it should be used for career planning and development as its main aim. Performance appraisal has been used in some countries, for instance, to orient training activities and to assess training needs in a given administrative unit, or to assess the possibilities for future promotion of a given individual or to encourage transfers and secondments (horizontal mobility) in order to fulfil the human resource management tenet of having the right person at the right position at the right time. A positive aspect of a performance appraisal scheme is that it may lead to opening a constructive and regular dialogue between superiors and subordinates on the objectives of the organisation and the role of each individual in the attainment of such objectives. This might give employees an increased sense of participation and stimulate their creative contributions to achieve such goals. Managers might also find it a useful tool for gaining employees' commitment with the organisational objectives.

In any case the performance appraisal scheme should be designed and practised in a way that places its legitimacy beyond any doubt. This has many meanings. Among others, it signifies that the performance appraisal scheme implies a fair and balanced system of allocation of individual responsibilities within the organisation, a transparent mechanism for setting organisational objectives and to make them known by the incumbents, an individual evaluation procedure pre-established in legal instruments or in clear internal guidelines, a possibility of internal and external review and oversight over the procedure and results of the appraisal, and finally individuals need to be reassured that the results of their evaluation will be used correctly.