



DECENTRALISED PAY SETTING IN THE NETHERLANDS

Recommendations for a continued reform of pay arrangements in the central government sector

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* . This paper draws on a comparative study *Governance of Decentralised Pay Setting in Selected OECD Countries*.

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GLOSSARY

Award	Pay settlement decided by a public authority.
Collective agreement	A binding agreement on employment conditions made with a trade union, or with another form of employee representation. The agreement can regulate individual wages.
Decentralisation	A transfer of one or more tasks from a central to a sub-central level, either through delegation or through devolution.
Delegation	A decentralisation where the centre retains the responsibility for the outcome of decisions taken at sub-central level.
Devolution	A decentralisation where the full responsibility for outcome has been transferred to the sub-central level.
Differentiation	Differences in pay levels or pay increases due to such factors as position, tasks, responsibility, age, seniority, merits, competencies, skills, performances or market pay.
Individual agreement	A binding agreement on employment conditions made with a single individual.
Individualisation of pay	Differentiated pay arrangements where compensation and terms and conditions vary significantly between people undertaking similar tasks on the basis of an assessment of the merits and performance of the individual.
Pay	Pay is here used as a general concept including both base rewards and allowances, and in-kind benefits including health insurance, etc.
Pay bargaining	Pay setting through a negotiating process, followed by a formal individual or collective agreement.
Pay setting	The process of setting pay. It includes the application of statutory rules or clauses in collective agreements to individual employees.
Reference model	Standard formula or algorithm for taking account of pay developments in other sectors when adjusting economic envelopes.
Remit system	A system where a pay setter has to submit its pay bid or bargaining parameters to a superior level for review and acceptance or approval. (Remit: to refer a matter for decision to an authority. Oxford English Dictionary.)
Sub-government level	Provinces, municipalities and water boards.
Sub-sector level	A part of a Cabinet or ministerial sector.
Subsidiarity	A principle that indicates that decisions should be taken at as low level as possible, provided that they still can be effective in achieving a desired outcome.
Unilateral pay setting	Pay setting without any formal individual or collective agreement. It may however have been preceded by an informal dialogue.

CHAPTER 1 SUMMARY

This report contains recommendations for a further development of the pay setting arrangements in the central government sector in the Netherlands. It covers the “cabinet sectors” and the sub-sectors within the education sector, but not provinces, municipalities or water boards. The industrial relations and bargaining arrangements are part of the background for the report, but are not covered by these recommendations. The report does not address pay strategies or pay policies as such.

This report draws on observations made in a review of decentralised pay setting arrangements in six OECD member countries.¹ This review has provided comparative information about a broad range of arrangements, practices and experiences.

The general trend towards more decentralised pay setting in almost all countries is driven by the need to adapt pay systems and structures to the individual competences and performances and to the business needs of each operational entity, and thus to create more varied and differentiated pay systems and pay structures within the public administration. These changes entail a separation of political and administrative functions, and an entrusting of pay bargaining and the actual pay setting to the central and sub-central civil service layers. Decentralisation in itself does not, however, guarantee any operational advantages. The outcome of decentralisation will depend on if and how the managers of the operational entities given responsibility for pay setting make use of the new opportunities.

The decentralisation of the pay setting arrangements in the Netherlands is less evolved than in the other five countries that were reviewed. This is particularly true for Australia, Denmark, Finland and New Zealand, where pay setting has been decentralised to a relatively large number of departments and agencies within the central government sectors. These countries have also effectively separated the policy level in their ministries from the implementation of these policies and the actual pay setting. They report considerable advantages from their governance arrangements and their extensive decentralisation of pay setting.

One of the conclusions of the comparative review is that there are two main alternatives for pay setting arrangements. These have in common the existence of a separate and professionally competent central agency able to govern and monitor the behaviour of the pay setting entities, and the provision of a standard and predictable envelope for the pay bill to the decentralised pay-setters. Each of the models works well in the context of the countries that operate it:

- *Remit-based approach:* A model with a central organisation that operates a remit system that enables a monitoring of the adherence to or observance of the government’s bargaining parameters, and that also may promote common human resource management values and practices. This model is used in Australia and New Zealand.

- *Consensus-based approach:* A model with a central employer's office and a two-level system for collective agreements. In these systems, it is the central collective agreements which provide the frameworks for decentralised pay setting. This model is used in Denmark and Finland.

In summary, both of the models that have been identified provide the decentralised pay-setters with an adequate framework for pay setting that includes a standard and predictable envelope for the wage bill. The essential differences between the two models are that:

- Australia and New Zealand have single level collective bargaining, while Denmark and Finland have two-level collective bargaining;
- Australia and New Zealand have separate and distinct entities with central responsibility for pay bargaining and for budget formulation, while Denmark and Finland have different units responsible for each function within the Ministry of Finance; separated by "firewalls"; and
- Australia and New Zealand have separate and distinct entities with central responsibility for pay bargaining and for overall labour regulations within the public sector; while Denmark and Finland have units within the Ministry of Finance which combine the central responsibility for these two functions.

Both models are intended to facilitate a greater adaptation of pay systems and pay setting to, *inter alia*, organisational performances and business needs. There are clear indications that this goal has been achieved, although the development so far seems to have been gradual and moderate.

The differentiation of pay structures is, in both models, achieved through the centre's allocation of the budget envelopes and through the decentralised pay setters' differentiation of pay systems (based on their business needs) and individual pay (based on skills, competencies and performances). The main role played by the central employer or personnel agency is to establish a central framework (bargaining parameters or central collective agreements) setting standard conditions and thus defining the scope for local differentiation.

It is particularly interesting to note the contrasting developments of pay setting arrangements in Denmark and the Netherlands. Denmark transferred all authority from the sector ministries to a single central authority in the 1970s. Since then, Denmark has extended its decentralisation and is at present introducing a new pay system designed to facilitate a local adaptation to business needs. The Netherlands moved in the other direction in 1993, transferring the authority from a single authority to sector ministries, but has since then not developed its system further.

The perceived advantages of decentralised pay setting arrangements are discussed in Chapter 2. Among these are that decentralisation permits more diverse pay and grading structures which are attuned to organisational goals and to the diverse services that the organisations deliver. Passing responsibility for pay and grading to local managers in public sector organisations encourages them to think more fundamentally about the objectives of the organisations they run and about how the pay and reward structure can help the organisation in meeting its strategic objectives. A key conclusion of the comparative report is that the reviewed countries seem to have derived considerable advantages from some distinctive governance arrangements. This report consequently recommends that the Netherlands pursue similar policies. The policy choices facing the government of the Netherlands are discussed in Chapter 4.

Both the models identified in the comparative review have distinct advantages, and reasonable people can come to different conclusion about which one to recommend for the Netherlands. The key advantages of the consensus-based approach are that the existence of a two-level system with formally binding collective agreements allows the central employer function to combine uniform conditions in some cases with a scope for differentiated conditions in other, and that the resulting central framework is an agreed document that national trade unions also support. The introduction of formal two-level bargaining in the Netherlands would however require substantial changes in both labour legislation and industrial relation arrangements, and it might not be a viable alternative at this stage.

The remit-based approach seems better suited to serve as a model for continued reform of the governance of pay setting in the central government sector in the Netherlands, since it can be seen as a logical evolution of the present sector model for decentralised pay setting. It would involve a continued and expanded decentralisation of pay setting to operational units within the central government sectors, which in its turn will necessitate the creation of more separately managed agencies and the creation of an adequate central co-ordinating function at central level.

The report contains a number of substantive recommendations for continued development of the pay setting arrangements in the central government sector in the Netherlands.

The first is that the government *strengthen the economic framework*. Decentralised pay setting should take place under a strict affordability restriction. The economic resources available for a pay-setter should have been determined in advance, and all pay-setters should have to manage their pay bargaining within that envelope. The existing process for preparing the economic envelope, starting with a standard adjustment of the budgets for all pay setting organisations based on a reference model, should be maintained. The government's deliberations should be concentrated on the budgets for entities where there is a clear case for an additional adjustment.

The second is that the government introduce a *formal remit process* of the type existing in Australia and New Zealand, that would enable a central organisation to monitor the adherence to and observance of a set of bargaining parameters and relevant government policies. The bargaining parameters should be issued by the central organisation responsible for co-ordination of personnel issues in the central government sector.

The third is that a *central government personnel agency* should be set up, and mandated to act for the government in co-ordinating personnel policy implementation and other personnel issues in the cabinet sectors. This implies a division of tasks between the cabinet ministries responsible for drafting government policy, and the agency as the central implementing organisation for human resource policies and management. This organisation should not, however, be directly involved in the actual pay bargaining.

The location of this agency within the central government organisation is a secondary issue, provided that it is assured of independent management. There is, however, no obvious compelling reason for transferring the responsibility for the government's human resource policies to another ministry, and it could consequently remain in the Ministry of Interior and Kingdom Relations.

The fourth is that the government initiate a programme for *investing in capacity building* in order to improve the capacity and competence of pay-setters at operational level, and thus the quality of the decentralised pay setting. Management development programmes for both top and middle managers should include modules dealing with the design of pay systems as well as the development of bargaining skills. A comprehensive and detailed pay statistic for the entire public administration should be produced regularly, based on a standardised system for job classifications. The other

possible forms of support to pay-setters could involve guidelines and similar tools for the use of pay-setters, and providing training in employee assessments and similar subjects. It could also involve the setting up of permanent and/or temporary co-operation mechanisms.

The fifth is that the Netherlands should look for and exploit opportunities for *further decentralisation* of pay bargaining and pay setting from sector to sub-sector or agency level. This could preferably be combined with the creation of additional separately managed agencies for policy implementation and service provision in the different policy sectors.

The sixth recommendation is that, in setting out the issues to consider in developing an implementation strategy, the Netherlands *make full use of existing capacity and experience* by ensuring that the valuable and experienced staff in the existing structures are encouraged either to transfer to the new central personnel function or to key positions with decentralised pay-setters.

Differentiation is not necessarily the same as individualisation. On the contrary, it is rational for the government and for the individual pay setting entities to make a conscious choice of an appropriate mix of standardised and individualised employment conditions, in order to optimise the outcome.

The extent of decentralisation can vary over a broad spectrum, from a limited set of performance-related pay elements, over progression within given pay scales or pay bands, to full responsibility for individualised and differentiated pay setting. The government should have a clear policy for determining which conditions should be common for the entire central government sector, which could vary within set limits and which could be allowed to vary freely across the central government sector.

The attractiveness of employment in an organisation does not depend solely on pay, but also on a broader package of employment conditions, working conditions, working environment and opportunities for personal development and professional career. The pay setting organisations should therefore also be given a freedom to design and develop other parts of the package in order to be as competitive as possible in recruitment and retention.

These recommendations can also be applied in an appropriate manner to entities that are under indirect government control. Co-ordination with pay setting in provinces, municipalities or water boards would be facilitated by the recommended replacement of the present Cabinet function with a government personnel agency mandated to act as the representative of the central government sector in cross-sector co-ordination and in formal social dialogues. Any stronger central government influence over pay setting in the non-central government sectors would however require constitutional reforms.

CHAPTER 2

LESSONS FROM THE REVIEW OF DECENTRALISED PAY SETTING

A comparative review of the governance of decentralised pay setting in six OECD member countries² has been undertaken as part of the preparations for this report. The six countries were chosen because they have experience and interest in decentralised pay setting. They have provided information about a broad range of arrangements, practices and experiences and thus also a good basis for comparisons and tentative conclusions.

The need for more differentiated pay setting in the public sector is probably the most important driver behind decentralisation. Both the labour market and the public activities have become less homogeneous, and public administrations need – just like any other employer – to develop pay setting arrangements that are sufficiently flexible to enable an adaptation of pay systems and pay structures to:

- the specific situation and requirements of each organisational unit;
- the specific competences, merits and performances of each employee; and/or
- the competition for competences and skills on the specific labour market.

Pay can be differentiated even in a centralised system. However, as pay systems become more flexible, centralised pay setting becomes less rational and less effective. A differentiation based on individual competences and performance or business needs has to be based on information provided by and held at the local level. It therefore makes sense to decentralise if and when this is desired. Decentralisation does, however, increase the transaction costs, since a single bargaining process is replaced by multiple bargaining processes. Decentralisation can therefore only be motivated if it is used to generate a sufficiently large added value through an adaptation of the pay systems and pay structures to the business needs of each operational entity.

Among the perceived advantages of decentralised pay setting arrangements are that:

- Decentralisation permits more diverse pay and grading structures which are attuned to organisational goals and to the diverse services that the organisations deliver.
- Responsibility for pay and grading encourages managers in public sector organisations to think more fundamentally about the objectives of the organisations they run, and how the pay and reward structure helps the organisation in meeting its strategic objectives.
- Decentralisation encourages departments and agencies to experiment both with the organisation of work and with different payment systems.
- Decentralisation enables organisations to design structures and reward systems that induce their employees to stay with the organisation for a longer period of time. And,

- Decentralisation allows organisations to adjust the pay of their employees to the specific market situation.

Decentralisation in itself does not guarantee any of these advantages. The outcome of decentralisation will instead depend on if and how the managers of the organisations that assume responsibility for pay and grading arrangements make use of the new opportunities. There is also a set of possible disadvantages of decentralised pay setting, namely:

- higher transaction costs if and when a decentralised system replaces the single pay bargaining of the centralised system with many separate negotiations;
- opaque wage signals since individuals seeking work will have to acquire and process a greater amount of information than under a centralised system; and
- opportunities for monopolistic or monopsonistic behaviour.

The transaction costs appear on both sides of the equation. Decentralisation entails higher transaction costs, but so does differentiation within a centralised system. The perceived added value of differentiation must be sufficient to outweigh the transaction costs associated with decentralisation (and conversely if decentralisation is only defensible if it is combined with differentiation).

The decentralisation of pay setting from a single central authority to a number of other organisations creates a principal-agent relation.³ The centre retains the ultimate responsibility for pay systems and pay structures, but the outcome will depend on the behaviour of the pay setters. The centre therefore has to design and implement strategies and methods by which it can ensure that the operational goals of the pay setters (the agents) are aligned with the strategic goals of the centre (the principal). This entails providing appropriate incentives so that the self-interested rational choices that the agents make coincide with the choices that the principal desires.

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The essential differences between the two models are:

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- Australia and New Zealand have separate and distinct entities with central responsibility for pay bargaining and for budget formulation, while Denmark and Finland have different units responsible for each function within the Ministry of Finance; separated by “firewalls”. And,
- Australia and New Zealand have separate and distinct entities with central responsibility for pay bargaining and for overall labour regulations within the public sector, while in Denmark and Finland units within the Ministry of Finance combine the central responsibility for these two functions.

The reason for the last-mentioned difference is probably that the responsibility for the labour regulations within the public sector has been seen as a political function that has to remain at Cabinet level.

Both models seem to work well for the countries that have them. The reason for that is probably that they are adapted to the specific political and administrative culture of the respective country. The models represent two different development paths: an Anglo-Saxon with, *inter alia*, a stronger focus on contract-based relations, and a Nordic with, *inter alia*, a stronger focus on cohesion and collective action.

The governance arrangements in the Netherlands and in the United Kingdom are not equally developed, and reportedly do not seem to work as well.

The comparative review contrasts the developments in Denmark and the Netherlands. Denmark transferred all authority on collective pay setting from the sector ministries to a single central authority in the 1970s. Since then, Denmark has gone on to extend decentralisation and is at present introducing a new pay system designed to facilitate a local adaptation to business needs. The Netherlands went the other way in 1993, transferring the authority from a single authority to the sector ministries.⁴ The subsequent developments have however been limited to the education sector, where sub-sectors have taken over the pay bargaining. It is a reasonable inference that development of a more differentiated, locally-responsive pay system in central government administration in the Netherlands may have been held back by the absence of a single central authority.

It is not possible to make any general recommendations; each country has to find its own path starting from where they are. It is, however, possible to draw some general conclusions from the review, and the comparative report presents a set of conclusions which can be summarised as follows.

- Appropriate financial management arrangements are essential for a well-functioning decentralisation of pay setting. The key aspect of these arrangements is that budget appropriations and pay bargaining should be effectively separated, so that the decentralised pay setting can take place within the confines of a stable and credible affordability⁵ restriction.
- Governments should have a clear position on whether a specific human resource management element should be uniform throughout the entire central government administration, could vary between different parts of the administration, but only within stated limits, or could vary freely between different parts of the administration, and adapt the scope of its decentralisation accordingly.
- Effective monitoring and assessment of the adequacy and appropriateness of decisions taken by the operational managers in pay setting entities is essential for a well functioning decentralisation, particularly over time. Countries with decentralised pay setting also need to invest in a corps of professional public managers with skills that are adapted to the specific context of the public administration.

- Introducing or extending decentralised pay setting involves a learning process. The chances for a successful introduction and extension of decentralised pay setting can be substantially improved by adequate preparations before the introduction or extension.
- Decentralised pay setting has positive effects on the performances of the public administrations, but this is contingent on the country having instituted adequate financial management and governance arrangements. One should not, however, expect any immediate outcomes of the introduction of decentralised pay setting.

CHAPTER 3

DECENTRALISED⁶ PAY SETTING IN THE NETHERLANDS

The human resource management in the central government administrations in OECD member countries have undergone substantial changes during the last half-century, and this period of change is by no means over. The Netherlands is no exception.

In 1993, the OECD judged that the relation between social security and the labour market in the Netherlands was “not clear”. The Dutch social partners were united in their criticism that the legislator circumscribed their attempts to find ways of adapting employment conditions to different groups of employees. The centrally agreed rules led to rigidities on the local level, and the collective agreements provided too little scope for a differentiation of pay. This debate mainly concerned the bargaining arrangements in the private sector, but they could have been applied to the public sector as well.

In the 1970s the deliberations between the unions and the Minister for the Interior (in his role as employer of all civil servants) were *de facto* consultations; the outcome was by no means binding. The pressure from the trade unions to amend the situation resulted in a number of changes in the 1980s. The most prominent feature was the establishment of a “requirement of agreement”. This means that the Minister for the Interior is unable to decide on, or implement amendments on, the terms and conditions of labour, unless a majority of the bargaining partners agrees to them.

The next phase of development saw the division of the public labour domain in several sectors. From 1993 onwards, bargaining took place in a number of sectors composed of so-called cabinet sectors (ministerial sectors) and local and regional administrations.⁷ The Minister of the Interior⁸ is the *primus inter pares*, and the public employers co-operate within the League of Sector Employers (VSO), a platform for peer consultation and coordination. The cabinet sectors were authorised to make reallocations within their aggregated budget, thus facilitating diverging pay developments between the sectors. Later, sub-sectors emerged within the cabinet sector for education.⁹

The sector model has rested on a number of assumptions. The social partners are expected to find a suitable format for agreements on more differentiated employment conditions. Sector employers are expected to behave as “genuine” employers, allocating a pay budget to achieve their organisational goals more efficient. The unions are expected to want to differentiate their pay demands and bargain for specific employees needs.

The economic framework for decentralised pay bargaining appears to have some flaws. The pay envelope, set by the Minister of Finance in detail by means of the minister of MBZK’s *Speerpuntenbrief*, and formally established after consultation in Cabinet, seems less definitive than intended. Practice shows, that requests for additional funding by Cabinet employers, in the event of a bargaining result exceeding the pay budget, are always approved. The picture emerging out of this practice is the existence of parallel negotiations, *i.e.* between the Cabinet employer and the Minister of Finance on political level, and the Cabinet employer and the unions in the wage setting environment. This practice clearly affects the bargaining game, as the implicit message to the trade unions is that the already allocated budget is not a firm restriction. The cabinet sector employers tend to renegotiate their pay envelopes with the Minister of Finance, rather than facing the unions in tough bargaining over pay

issues. It is reasonable to believe that the unions are aware of this weakness, and that the stabilising system of countervailing forces therefore is at stake.

The situation appears to be limited to the cabinet sector employers. The employers at sub-sector and sub-government¹⁰ level seem to take their budget as a firm ceiling. One reason is that on these levels, requesting an additional pay budget is just “not done”. These employers recognise that acting differently would weaken their future bargaining position. Finally, they are also well aware that a request for additional funding would almost certainly be turned down by the Minister of Finance.

There is no clear separation of political deliberations and pay bargaining at the central government level. The coordination of the cabinet sector employers’ bids for the next bargaining round is done in the Cabinet, where they also discuss political issues such as the overall labour market policy and the budget appropriations.

The sub-government employers in provinces, municipalities and water boards have set up negotiating cartels. The cabinet sector employers meet with the sub-government employers in the League of Sector Employers (VSO), which serves as a platform for consultation and coordination. In the interviews, the employers felt that this platform was useful, but that they did not consider it to be a setting for powerful coordination. Among the reasons for this are the fairly loose character of the VSO and the diverging interests of its members. Employers at sub-sector and at sub-government level underline their independence from the cabinet sectors, taking Cabinet suggestions for labour market policy and pay policy with some reservation. The VSO has also repeatedly been denied membership in the tripartite Social Economic Council (SER), among other things because of the dual roles (employer and legislator) played by the cabinet sector representatives.

There is thus no sufficiently independent central employer or personnel authority corresponding to the employee’s offices in Denmark and Finland, or to the commissioners in Australia and New Zealand. There does not seem to be any systematic monitoring of the outcomes of the sector negotiations. Evaluation reports on sector pay bargaining seem scarce, and a permanent and concerted effort for systematic post-bargaining evaluation has not been identified. The lack of this type of structured information makes it difficult to learn from experiences and to continue to develop the system.

CHAPTER 4 THE PATH AHEAD

Before addressing possible alternatives and innovations in the Netherlands' system for pay setting in the central administration, it is necessary to discuss what the Netherlands might want to achieve from such reforms. This report, based on the interviews and literature studies, identifies five possible key government goals.

- To begin with, decentralisation is inherently linked to *differentiation*. The main motive for allowing differentiation is, in its turn, that performance will improve if the operational managers are able to adapt pay and other remuneration elements to the individual competences and performances of their employees and to the business needs of their organisations.
- Second, one can assume that the government also wants to preserve a certain *coherence* in pay levels and employment conditions for the government employees. Its goal would thus be arrangements that enable the government to achieve an appropriate synthesis between coherence and differentiation.
- Third, one can also assume that the government has a general *human resource policy* that it wants the organisations in the central government sector to respect and implement. The arrangements should therefore enable the government to govern the decentralised human resource management in a way which is appropriate for the government's policy.
- Fourth, the government has a fundamental need to *control public expenditure* and to ensure that government resources are used wisely and in an appropriate way. The arrangements should therefore support macroeconomic stability as well as a stable and credible economic framework for decentralised pay setting.
- Finally, one can assume that the government wants to treat its employees as *respected partners* in the fulfilment of the tasks and duties of the state. The arrangements should therefore enable a constructive social dialogue between state employers and trade unions for state employees.

Differentiation is not necessarily the same as total individualisation. On the contrary, it is rational for the government as an employer and for the individual pay setting entities to make a conscious choice of an appropriate mix of standardised and individualised employment conditions, in order to optimise the outcome.

The extent of the decentralisation is by no means a given variable, and it can vary over a broad spectrum, from a limited set of performance related pay elements over progression within given pay scales or pay bands to full responsibility for individualised and differentiated pay setting. There is no standard solution for the design of arrangements for decentralised management of pay setting and other human resource management issues. It can and should instead be subjected to a subsidiarity criterion – decisions should be decentralised when appropriate, and remain centralised when appropriate.

There is no reason to limit decentralisation to pay setting. The operational organisations could be given a freedom to design and develop other parts of the remuneration package in order to be as competitive as possible in recruitment and retention. A broad decentralisation of the decisions about the work organisation and the employment conditions would also facilitate an operational organisation to take the specific labour market situation and the preferences of the employees into account.

Decentralisation sets up a principal-agent relation between the centre and the pay setter. This type of relation is more easily managed in activities where result of the organisation's activities is more easily observed or assessed. An extension of decentralisation should start by identifying this type of candidate for decentralisation. It must however be combined with an appropriate reinforcement of the centre's governance capacity.

The present pay arrangements in the Netherlands differ from those in the other five countries in that the sector model is not a form of decentralisation, but a fragmentation of the central political authority through a horizontal devolution to a small number of sector ministries. Pay setting thus remains centralised and under political control within each cabinet sector, with the exception of the education sector.

As noted above, the review of pay setting arrangements in six OECD member countries has identified two alternative models for governing decentralised pay setting, which both correspond to the five goals listed above:

- *Remit-based approach:* A model with a central organisation that operates a remit system that enables a monitoring of the adherence to or observance of the government's bargaining parameters, and that also may promote common human resource management values and practices. This model is used in Australia and New Zealand
- *Consensus-based approach:* A model with a central employer's office and a two-level system for collective agreements. In these systems, it is the central collective agreements which provide the frameworks for decentralised pay setting. This model is used in Denmark and Finland.

Both entail a separate and professionally competent central agency able to govern and monitor the behaviour of the pay setting entities, and the provision of a standard and predictable envelope for the pay bill to the decentralised pay-setters.

Both the models identified in the comparative review have distinct advantages, and reasonable people can come to different conclusion about which one to recommend for the Netherlands. The key advantages of the consensus-based model are that the existence of a two-level system with formally binding collective agreements allows the central employer function to combine uniform conditions in some cases with a scope for differentiated conditions in other, and that the resulting central framework is an agreed document that national trade unions also support. The introduction of formal two-level bargaining in the Netherlands would however require substantial changes in both labour legislation and industrial relation arrangements, and it might not be a viable alternative at this stage.

The remit-based model seems better suited to serve as a model for continued reforms of the governance of pay setting in the central government sector in the Netherlands, since it can be seen as a logical evolution of the present sector model for decentralised pay setting. It would, however, involve a clearer separation of political functions and managerial/professional functions, the creation of an adequate central co-ordinating function at central level, a continued and expanded decentralisation of pay setting to operational units within the central government sectors, which in its turn will necessitate the creation of more separately managed agencies.

One essential prerequisite for a continued development of the pay setting arrangements in the central government administration in the Netherlands is thus that the government revise the roles of the political level and the civil service level. The political level should continue to set policy, adopt frameworks and goals, and ensure accountability for performance, but should no longer be directly involved in pay bargaining. That, and the actual pay setting, would instead be handled by professional civil servants charged with implementing the policies and the frameworks.

CHAPTER 5 RECOMMENDATIONS

5.1. *Strengthen the economic framework*

Recommendations

The Netherlands should strengthen its already existing economic framework in order to achieve a clear and credible separation of the budget process and the pay setting process. All decentralised decisions on pay and other employment conditions should be subjected to a strict affordability restriction.

The preliminary adjustments of budgets for pay setting entities should continue to be standardised and based *inter alia* on pay developments in the private sector. The government's deliberations should be fully separated from the pay bargaining and concentrated to entities where there is a clear business case for an additional adjustment.

A key element in any model for decentralised pay setting is the existence of an adequate and credible economic framework for decentralised pay setting. This framework must be compatible with the government's macroeconomic stance, but yet sufficiently supple to accommodate labour markets trends and avoid labour market disparities. It should be finalised before the start of the pay negotiations for the central government administration, and it should never be revised or amended during the pay negotiations.

The review of arrangements in six OECD member countries indicates that this framework should be based on a strict *affordability restriction* for all pay setting organisations. By this is meant that the economic resources available for a pay-setter should have been determined in advance, and that all pay setters should have to manage their pay bargaining within that envelope.¹¹ If an organisation agrees to a more expensive round of pay increases, it should have to finance this by reducing its staff, or by cost reductions in other areas. In this way the government can minimise the risk of intermixing pay bargaining and political processes. Adjustments of funding of the pay setting organisations should only be done as part of the normal budget process.

The review also indicates that the process for preparing the economic envelope should start with a *standard adjustment* of the budgets for all pay setting organisations. This would enable the government to concentrate its deliberations and assessments on the budgets where the political cases or the business cases for increases or decreases are the strongest.

The standard adjustment should be based on a *reference model* composed of indexes for pay increases and for other price increases, and with a standardised deduction for increased productivity. It should also include adjustments for any changes in the tasks of an organisation. The reference model should be made public, since that would make it possible for both the pay setting organisations and their counterpart to foresee the long-term trend.

The review did not find an example of a more explicit reference model in any of the other five countries. The calculation of the standard adjustment is either based on a confidential model or determined on a case by case basis.¹² The only known example is therefore the Swedish reference

model, where the pay index is calculated by an independent agency on the basis of pay developments *ex post* in the manufacturing sector.

An explicit reference model would probably be more credible if the indexes are calculated by an independent statistical authority on the basis of government decisions in principle on the construction of the reference model. The pay index should measure historical pay increases, in order to avoid subjective assessments.¹³ It could either be a simple index showing the average pay increases in the private sector of the Dutch labour market, or a more advanced model showing the average pay increases for the type of labour that the government employs. The price index should also measure historical price increases.

The market wage will not move in the same way or in the same pace for all types of labour, and the potential productivity improvements will vary from one type of activity to another. Any standard adjustment will therefore over-compensate some organisations, and at the same time under-compensate others. The government would need a mechanism for assessing and evaluating the market position and resource need of a pay setting organisation. This is particularly important in the case of over-compensations, since these will rarely be signalled by the affected organisations. The government must also be prepared to make adjustments if and when the aggregated over- or under-compensation has become too large.

The reference model should include a deduction for estimated productivity increases. There is always scope for arguing that the estimation formula could be refined to take sector specific conditions into account. While this offers, in principle, a potential for a better adaptation to varying conditions, it might also entail the risk that the bargaining parties come to regard the economic envelopes as being negotiable, and thus for a continued intermingling of budget processes and pay bargaining. The alternative that seems to be more generally practiced is to require the pay setting entity to argue its business case if it considers that the standardised adjustment of its economic envelope is insufficient. This then triggers a comprehensive review of quality factors, demand factors (externally generated workload), actual and potential productivity increases and the evolution of the relevant market wages for the specific groups employed by that entity.

Requests for *additional resources* should however not be considered until the preparation of the next budget. Requests that refer to pay developments should always contain factual information on the relative pay for the organisation's employees compared to others with similar competences, merits and tasks.

A separate sub-allocation or expenditure limit for pay would imply a more restricted decentralisation, and would prevent the pay setting organisations from letting their employees share in above-standard productivity increases. The review indicates that countries with appropriate accountability mechanisms are able to do without separate pay expenditure limits.

This type of economic framework will provide a level and foreseeable pay setting field for the pay setting organisations, and enable a complete devolution of the actual pay setting. It would prevent an organisation from consistently over-bidding, and would provide the government with the necessary means to ensure a reasonable balance between coherence and allocative efficiency¹⁴ in labour use.

5.2. *Introduce a remit process*

Recommendations

The Netherlands uses the *Speerpuntenbrief* to govern the decentralised decisions about pay and other employment conditions with the central government sector. These should be supplemented by a separate set of bargaining parameters, a remit process that enables the centre to monitor the adherence to the bargaining parameters, and by a credible mechanism for holding pay setters accountable for their use of the decentralised mandate.

The key elements in the recommended governance arrangements are a set of bargaining parameters and a remit system. The bargaining parameters should be separated from the budget-oriented sections in the *Speerpuntenbrief*, be issued by the central government employer function, and reflect the government's political priorities and policies. The bargaining parameters would enable the central government personnel organisation to provide goals, guidelines and other parameters for the decentralised pay setting. A remit system would enable a central monitoring of the observance and/or adherence to the bargaining parameters.

Remit systems

A remit system is a process whereby a central authority monitors or approves decentralised pay bids or policies before they are implemented.

A remit system can be designed in many different ways. At one end of the spectrum are centralised systems involving central approval of all components in a local pay bid. At the other end of the spectrum are purely advisory systems where the pay setter can choose which aspects to remit.

A typical remit system in a country with decentralised pay setting would be selective and less than commanding, but more demanding than just advising. The centre would only monitor elements which are perceived to be of a special importance for the implementation of the government's policies, or for the coherence of the totality of the remuneration system. The pay setter could have an option of disregarding the centre's advice, but would then be expected to provide an objective and professional motive for doing so.

Central collective agreements in countries with two-level collective bargaining fulfil many of the functions of remit systems. These countries may however also have remit elements built into their central collective agreements.

The combination of a set of bargaining parameters and a remit system provides the centre with a flexible tool for monitoring decentralised pay setting and for promoting a desired level of coherence in pay systems, pay setting and other employment conditions. The content and scope of the bargaining parameters and the balance between mandatory and advisory elements can easily be adapted at the centre's discretion. This flexibility can be used to introduce decentralised pay setting through a gradual process.

In order to use the full potential of these arrangements in an appropriate way, the centre should determine whether a specific human resource management element:

- should be uniform throughout the entire central government administration, and thus be determined at central level;
- could vary between different parts of the administration, but only within stated limits, and thus be delegated within bargaining parameters; or
- could vary freely between different parts of the administration, and thus be devolved.

In this context, the complexity of pension systems should be noted. These have to be defined on a whole-of-government level if they are benefit defined, in order to prevent them from hampering internal mobility within the central government sector. The design and even scope of such systems can, however, be decentralised if they are contribution defined, since that would enable easy transfers of earned rights between different employments. One prerequisite for decentralising decisions on pensions system should be that the organisation taking the decision also has to carry the full cost of the decision on its own budget.

A pay remit system can be used very selectively. The bargaining parameters can be updated regularly in order to enable the centre to react to evaluations and other forms of feedback. They do not have to include all aspects of decentralised remuneration policies – it is probably even preferable not to include any devolved issues in order to avoid giving the impression that the devolution is not respected. One can also argue that it should not include the cost or the structure of the planned pay policy, since that should merely be limited by the budget envelopes and the affordability principle.

The centre might want to collect additional information in order to have a good overview and as a basis for evaluations and assessments. This should, however, preferably be done separately from the remit system, for example in connection with an annual reporting arrangement.

The operation of the remit system has to be adapted when it is used in parallel with pay bargaining situations. A properly functioning bargaining process requires that the employer's negotiator has the necessary mandate to sign an agreement that conforms to his bargaining parameters. It could therefore cover the pay setter's bargaining strategy and his own bargaining parameters, but it should not include an actual pay bid. The inclusion of pay bids would imply that the negotiator does not have the necessary mandate, could slow down the bargaining process, and might increase the risk that the centre is drawn into the bargaining process.

5.3. *Set up a government personnel agency*

Recommendation

Pay bargaining should be handled by civil servants at both central and sub-central level. The political level should at the same time retain its responsibility for policy, for frameworks and for evaluating performances.

The present fragmented central pay setting arrangements should be replaced by a single central government personnel function. This should be given an identity of its own, and a status as an agency within a ministry, and be mandated to act for the government in co-ordinating personnel policy implementation and other personnel issues. It should, however, not be involved in the actual pay bargaining.

The key prerequisites for an adequate and effective employer function in the public administration are a professionalization of wage setting, and a clear and credible separation of the policy level and the implementation level. The policy level should set policy, determine goals and issue bargaining parameters, but ought not to be directly involved in implementation of the policy and the monitoring of adherence to or observance of the parameters.

The key outcomes of such an arrangement would be that:

- wage setting is seen as a management issue and not a subject for political deliberations; and
- the democratic prerogatives of the government are exercised by setting policy, appointing managers and holding them accountable for actions, performances and outcomes.

The review of pay setting arrangements in other OECD member countries shows that the three other reviewed countries with single level collective bargaining have this type of arrangements, although with variations in their exact design.

Table 1. The organisation of central government personnel management in three countries

Country	Organisation monitoring collective agreements	Organisation monitoring human resource management
Australia	Department of Employment and Industrial Relations	Australian Public Service Commission
New Zealand	State Services Commission	State Services Commission
United Kingdom	The Treasury	Cabinet Office and Public Service Commissioner

Australia has chosen to separate the functions related to collective bargaining from the functions related to human resource management. The advantage of this organisational solution is that it facilitates the combination of a consistent market orientation in pay issues with a traditional civil service orientation and coherence in other aspects of human resource management.

New Zealand has chosen to have a single organisation for these two functions. This organisation also has other statutory functions, and it seems to have some difficulties in combining its mandatory functions with its advisory functions. This does not seem to be an unavoidable weakness, however, since Denmark and Finland seem to be able to combine the two functions in the same organisation.

There seem to be substantial difficulties in the arrangements in the *United Kingdom*, with some political involvement in implementing and executing policy and a lack of an adequate stringency in the application of policy and bargaining parameters. It seems to be preferable not to involve the organisation handling the budget function in the handling of the human resources management and pay bargaining functions.

Different functions at the centre
<i>Budget function:</i> The part of the centre that supports the government in formulation and implementation of the budget; that is of the economic envelopes for the different public activities.
<i>Staff regulations function:</i> The part of the centre that supports the government in drafting and implementing staff regulations and other statutes relating to central government employment.
<i>Human resource management function:</i> The part of the centre that advises the government in human resource issues, and that supports and evaluates sub-central human resource management.
<i>Pay bargaining function:</i> The part of the centre that either negotiates a central collective agreement for central government employees, or monitors and evaluates the implementation and outcome of sub-central pay bargaining for central government employees.

The present fragmented central structure in the Netherlands should thus be replaced by a single government personnel function spanning all central government sectors, mandated to act for the government. Among the possible tasks of this agency could be to:

- advise and assist the government and the departments in the preparation of statutes and policies;

- issue the bargaining parameters for decentralised pay setting;
- negotiate central collective agreements on whole-of-government employment conditions, if such are deemed to be necessary;
- operate a remit system in order to ensure that decentralised pay setters adhere to or observe the bargaining parameters, and that delegated authority is used in an appropriate way and in line with government policy;
- monitor that other elements of human resource management adhere to adopted government policy;
- advise and support pay setters in the central government sector, but without getting involved in actual negotiations; and
- promote integrity and common civil service values.

The possible forms of support to pay setters could involve producing statistics, guidelines and similar tools for the use of pay setters, and providing training in the design of pay systems, pay bargaining, employee assessments and similar subjects. It could also involve the setting up of permanent and/or temporary co-operation mechanisms.

Another option that could be considered is to entrust the operation of the senior executive service (*Algemene Bestuursdienst, ABD*) to this government personnel agency. The New Zealand State Services Commissions has this task, and it seems to have enabled the Commission to refrain from using its formal mandate in pay setting and instead rely on soft co-ordination and accountability for results.

The location of this organisation within the Cabinet organisation is a secondary issue, provided that it is assured of independent management. There is, however, no obvious compelling reason for transferring the responsibility for the government's human resource policies to another ministry, and it could consequently remain in the Ministry of Interior and Kingdom Relations.

5.4. Invest in capacity building

Recommendation

<p>Skilled pay setters at the decentralised level are a prerequisite for a successful decentralisation of pay setting. The Netherlands should therefore ensure that chief executives and other involved staff are sufficiently equipped for managing remuneration policies, in terms of knowledge, access to advice and to supporting tools.</p>
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The outcome of decentralised pay setting depends heavily on the professional and administrative capacity of the pay setting organisations to handle the decentralised authority in adequate and appropriate ways. A revision of an existing pay system or pay structure may be particularly demanding, since it involves both overcoming inertia and inexperience, and designing a new efficient and appropriate system.

The complexity of pay systems tends to increase over time. Today's pay systems are composed of many interchangeable elements, which allow for a wide range of practices in adapting to individual qualifications and performances and to business needs. This growing complexity is one of the drivers of decentralisation of pay setting.

The more sophisticated pay systems used today are based on both inputs and outputs. Inputs are the competences, skills and abilities which an employee brings to the job. Outputs are the results in quality or quantity which the employee achieves. A focus on inputs entails elements like competence- or skills-based pay, while a focus on results entails performance-related pay elements. A common theme is that employers give greater emphasis to the attributes employees possess and to the results that they achieve, while less attention is paid to, for instance, the length of service or to the formal position.

Pay systems are also in the modern environment increasingly a subject of dialogue or negotiations with two partners. On the one hand, management is looking to such goals as recruiting and retaining the best employees, motivating their workforce and achieving the organisation's goals and objectives. On the other, trade unions are looking to such goals as fair and equal treatment of all employees, reduced pay differentials, pay levels comparable with other appropriate organisations, and maintained real value of pay in cost and living.

Bargaining over pay is a delicate matter. On balance, the employer should aim for a pay system where:

- pay decisions are objective, rather than subjective;
- the principles behind the pay setting are explicit, clear and straightforward; and
- there is no favouritism, and all staff are treated in the same way, regardless of gender, ethnicity and age.

Public managers and administrators normally lack experience of differentiated pay setting. This report recommends a continued and extended decentralisation of pay setting in the central government administration. One key requisite for a successful decentralisation is however that chief executives, other managers and staff in pay setting entities are assisted in acquiring the necessary knowledge, and are adequately assisted and supported.

There are three major implications.

- In order to build support for the extension of decentralised pay setting, the government should consider initiating a programme for promoting decentralised pay setting as a key mode for achieving efficiency and increased equity. The campaign should be targeted to public sector employees, as well as to a wider audience, stressing the public sector's state of "modern" employership.
- The management development programmes for top managers (as provided for by the *Algemene Bestuurdienst, ABD*) should include modules dealing with the design of pay systems as well as the development of bargaining skills. A corresponding effort should be made in middle management development programmes.
- A comprehensive and detailed pay statistical framework for the entire public administration should be established, based on a standardised whole-of-government system for job classifications. It would provide a firm base for both the centre's monitoring of the outcome of delegated pay setting, and for the delegated pay setters' comparisons with pay setting in other parts of the public administration.

5.5. *Expand the decentralisation*

Recommendation

The decentralisation of pay setting and other remuneration policies in the Netherlands is still relatively limited. A continued decentralisation of pay setting to sub-central operational organisations could generate substantial advantages for the central government administration.

The Netherlands should take steps to expand the decentralisation as part of a general programme towards further improvements in the professional management at the operational level.

Pay setting in the central government administration in the Netherlands is decentralised in the sense that bargaining rights have been transferred from a single central authority to a number of sectors. It is, however, still relatively centralised, in the sense that bargaining in all except one of the “cabinet sectors” is still done exclusively at the central level. The exception is the education sector, where bargaining (so far) is decentralised to five sub-sectors.

This situation can be compared with the situation in the other five reviewed countries, where pay setting and other remuneration issues have been decentralised to operational entities.

When the Dutch social partners evaluated the sector model in 1996 and 1999, they agreed on a set of terms under which bargaining and pay setting could be transferred to a sub-sector. Among these were that the sub-sector would have to be clearly distinguishable, and that it was possible to identify functioning bargaining units on the side of both employer and trade unions. The motive for the agreement was a consensus that a shift to sub-sector bargaining would facilitate adaptations of pay structures and employment conditions to the specific situation in the sub-sector.

Public services in the Netherlands are predominantly provided by a range of independently managed service providers, operating on different levels in the public administration. Among these are agencies (*Agentschappen*), independent bodies (*Zelfstandige Bestuursorganen, ZBO*) and organisations with a semi-public/semi-private status (*Gepremieerde en Gesubsidieerde, G&G*). The available experiences indicate that it is possible to improve the responsiveness, effectiveness and efficiency of these service providers by giving their chief executives a greater freedom to manage the services. A decentralisation of pay setting to the various service providers would be a key part of such a policy for expanded managerial freedom, combined with accountability for results.

In Section 5.3 it was recommended that the present fragmented central pay governance arrangements be replaced by a single government personnel agency mandated to act for the government. This agency should not itself be involved in the actual pay bargaining, and pay bargaining would thus not be centralised compared with the present structure.

This should be seen as merely a first step towards an extended decentralisation of pay setting. The government should at the same time initiate an analysis of the potential for additional decentralisations to parts of the administration that already function as separate operational units; with their own budgets, clear output or outcome targets, and chief executives and/or boards responsible for results.

Centralised pay setting can be based on a pay framework that includes pay differentiation after objectively determinable factors such as held post, education, seniority and locality. Any adaptation to individual competences and performances or to business needs would, however, require assessments, and therefore also a more intimate knowledge of the individual and the business, and a more direct involvement in the development and efficiency of the organisation concerned.

Coherence can be described as a *ceteribus paribus* condition; pay and other employment conditions should be equal if all other relevant factors are equal. A corollary to this is that non-uniform differentiation is compatible with coherence, if it is the result of an appropriate adaptation to individual competences and performances, and to business needs.

The extent of the decentralisation does not have to be uniform, either across sub-sectors and bodies, or over time. It can vary over a broad spectrum, from a limited set of performance-related pay elements, over progression within given pay scales or pay bands, to full responsibility for individualised and differentiated pay setting. The ability to establish appropriate restraints and accountability mechanisms will determine the scope for delegation, and the willingness to cede responsibility to the chief executives will determine the scope for devolution.

CHAPTER 6 THE SUB GOVERNMENT LEVEL

This main subject of this report is the governance of pay setting and other aspects of human resource management in the central government sector in the Netherlands, that is the “cabinet sectors” including the education sub-sectors.

The public administration in the Netherlands also contains “decentralised sectors” that are not subject to direct government instructions, namely the provinces, municipalities and water boards. In addition there is a number of third sector bodies; that is private law entities that fulfil public functions. These are fully or largely funded by the central government, either through economic transfers or through contract-like budget allocations.¹⁵ There are also private law entities owned by the state.

There are two main policy reasons why central governments seek to influence or control the human resource management practices in sub government sectors. The first is that pay developments at sub-government level can drive pay demands at the central level, particularly when the labour market is tightly integrated. The second is that this would enable the central government to pursue other equity goals such as gender and minority group recruitment, that are not easily achieved through such means as legislation or incentives in the intergovernmental fiscal transfers.

The constitutional arrangements governing the relations between the central government and the various independent or semi-independent entities are not covered by this report, or by the comparative review that it is based on. One can, however, without going into any details or assessing their practical or political feasibility, point to a range of options available for a central government that wants to coordinate remuneration issues in what one might call the *wider state sector*.

- Entities that are under direct government control (that is the government can issue binding directives) can be governed and co-ordinated through the type of system recommended in this report. This would involve a professional oversight authority, appropriate bargaining parameters, and a monitoring system based on a remit process.
- Private law entities that are owned by the government can be governed through owner directives. These could, when appropriate, be subjected to the same type of governance as a public law entity under direct government control.
- Private law entities that operate under a government contract can be governed through contract clauses. These could also, when appropriate, be subjected to the same type of governance as a public law entity under direct government control.
- Any entity that receives a state subsidy or grant can be governed by making these subsidies or grants, wholly or in part, conditional on adherence to an appropriate set of bargaining parameters. These could therefore also be subjected to the same type of governance as a public law entity under direct government control.

- The government could, when appropriate, propose laws and other generally applicable statutes that would establish coherent remuneration and/or employment conditions in all public and private law entities.

Relations between the central government and directly elected bodies at sub government level may be particularly sensitive and not amenable to direct government instructions or interventions. In such cases, the government might have to rely, at least in the first instance, on consultations aimed at achieving a convergence of remuneration policies and bargaining positions. The effectiveness of such consultations would probably be improved, if they could take place between a limited number of actors. The creation of a government personnel agency responsible for the bargaining parameters of the central government sector would therefore be essential in this context. It would also mean that provinces, municipalities and water boards should be represented by their negotiating cartels, which enable them to act in unison, both when discussing co-ordination issues with the government personnel agency, and also when meeting their labour counterparts.

The government should however always - to use the words of US President Theodore Roosevelt - *speak softly but carry a big stick*. It should therefore never give up its fundamental option of resorting to legislative action. It should also maintain the option of financial conditionality as a last resort. Any stronger central government influence over pay setting in the non-central government sectors would, however, require constitutional reforms.

CHAPTER 7 IMPLEMENTATION ISSUES

The scope of this report does not include the implementation phase or implementation issues. Some observations are however appropriate for the understanding of the report's conclusions.

There are strong indications that success in decentralising pay setting and other elements of remuneration policy is dependent on adequate preparations and on a sufficient capacity building in advance. An incremental approach might therefore be preferred to sudden step change.

There are at the same time aspects that call for a distinctive change in the pay setting regime. The involved managers and other staff in both sector ministries and operational organisations have to start to adapt to a new role and changing responsibilities. An incremental approach might lead to old roles and relations lingering longer than desired, and to a prolonged transition.¹⁶

The experiences from the Danish and Finnish reforms of their pay systems for government employees can, however, serve as examples of useful syntheses of these two approaches. There, the initial statutory changes necessary to enable a differentiated local pay setting were followed by a transitory period during which local pay setters could prepare for and design local pay systems adapted to their respective business needs.

One step that should be taken as early as possible is however a revision of the budget process aimed at ensuring a complete and sustainable separation of the budget process from the pay setting process, and the introduction of a strict affordability restriction..

Decentralising of pay setting and other elements of remuneration policy does not mean that there will no longer be any need for central functions. An appropriate decentralisation requires the existence of strong central functions able to monitor the developments in each of the ministerial sectors, to assess the operative performances and outcomes in the respective sector, and to handle the political issues that may arise. This would include the adequacy of the budget resources made available to the different operational entities. There is also, as noted in previous chapters, a need for a competent government personnel agency with a sufficient capacity.

The tasks of the central units in sector ministries would, however, undergo substantial changes. Existing competences and experiences in pay setting would no longer be needed at this level, and new competences and experiences in governing a system of delegated managerial responsibility would have to be acquired. There is also a need for a cultural reorientation, from hands-on pay setting to monitoring, advising and assessing. Ministerial staff that want to continue working with the actual pay setting could, however, be transferred to key positions in operational organisations in order to augment their capacity to handle their new responsibilities.

ANNEX A

FACT SHEET ON SETTING PAY IN THE PUBLIC SECTOR OF THE NETHERLANDS*

Importance of competitive pay in the public sector

Enhancing the competitiveness of public sector employers in Dutch labour markets is vital, because over the next few years many government employees will retire, while at the same time employers in the market sector are offering increasingly attractive pay packages to recruit qualified workers in a labour market with stagnant supply. Enticing elderly workers to postpone the day of their retirement by one or two years offers no structural solution to coming labour shortages that many observers predict.

In the bidding war for higher-educated and experienced employees with market sector employers, managers in the public sector are confronted by stronger budget restraints than in the case of private enterprises. One explanation for this is that the scope for productivity gains in the private sector will normally exceed those in the public sphere. If the budget for pay in the public sector is linked to the rise of wages in the market sector – the standard approach in the Netherlands – the cost price of each unit of services provided by the government will rise faster than cost prices of market producers. In the end, if no additional budget is made available, the relative volume of government provided services will shrink.

Efficiency drive

In February 2007, the incoming Cabinet (Balkenende IV) has announced that in the years 2008–2011 it will spend € 8.2 billion on new policies. At the same time, budget cuts to the tune of € 5.2 billion are planned (CPB, 2007, pages 4 and 7). Given that the Cabinet sees only limited merit in raising taxes, this combination of planned spending and budget cuts is the only way to build a budget surplus of around 1% of gross domestic product (GDP) by 2011. Intended budget cuts include € 2.35 billion (0.4% of GDP) as the result of an overall efficiency drive.

Recently, the media has mainly focused on one particular element of the Cabinet plans, *i.e.* the € 0.75 billion that departments are expected to realise in savings, an amount that implies a reduction of 14 400 full time equivalents, or 8.5% of current staff. However, it will not be easy to implement the proposed policies, and one-off costs to public coffers to allow for structural savings of € 0.75 billion at the level of departments alone may amount to € 0.5 billion (SGO, 1997, page 16).

The sector model: Its goals and outcomes

Currently, employers and union representatives in 13 government “sectors” negotiate money wages and other elements of pay packages. Table A1 reveals that the number of employees covered varies considerably between sectors, between no more than 2 000 researchers in specialised institutions and 277 000 teachers in primary and secondary schools.

*. Prepared by Professor Flip de Kam, Groningen University.

Table A1. Employment (full-time equivalents, 2007) and contractual wages, by sector

Sector	Number of employees (in thousands)	Number of employees (% of total)	Cumulative increase in wages (excluding short-term and other temporary staff, 1993-2005 in %)
Central government			
Departments	116	12.4	27.5
Armed Forces	70	7.5	32.0
Police	58	6.2	30.0
Courts	3	0.3	30.1
Education			
Primary/secondary	277	29.7	30.4
Professional	54	5.8	31.5
Higher professional	35	3.8	30.3
Universities	51	5.5	31.8
University hospitals	57	6.1	39.0
Research institutions	2	0.2	31.8
Local government	185	19.8	33.9
Provincial government	12	1.3	33.5
Polder boards	11	1.2	33.8

Source: Tweede Kamer (2006–2007), pages 82 and 105.

At this time, in five sectors – the four cabinet sectors and the primary education sector – ministers concerned act in a double capacity, both as budget authority and employer.

For the remaining education sectors the Ministry of Education decides on the budget that is made available to school boards and university governors. Annually, these institutions receive a lump sum from the ministry to be spent as their managers see fit. In principle, every employer is free to hire the number of staff deemed necessary and to set the pay of their personnel, as long as they remain within the limits of the total budget made available to them. Wage negotiations are held between the employer organisation of each sector and union representatives.

At the level of decentralised government separate employer organisations represent the (about 450) municipalities, the (12) provinces and the (27) polder boards, respectively.

In the run-up to the ritual of wage negotiations, the Ministry of the Interior tries to co-ordinate employer positions. However, it should be noted that officials of the ministry have no formal powers to correct outcomes of the negotiations in non-cabinet sectors (at present with the exception of primary education). When it was introduced, the sector model was seen as an important step towards greater flexibility in pay setting in the public sector that would permit more diverse pay and reward structures to develop, in line with the specific situation of each sector. For example, work in night shifts or at irregular hours and the adjustment of grading structures might ask for sector-specific solutions. However, it may be noted that the sectors were never defined following a well-considered blueprint. It seems that the type of activities performed and constitutional layers of government were predominant in defining sectors as they are now.

Units and agents operating within the department sectors are also performing highly differentiated tasks – collecting taxes, guarding prisoners and law-making – and this implies very different working conditions and demands varied qualifications of personnel. In this light it is perhaps surprising that the department sector (116 000 employees) was never broken up into smaller sectors. This observation serves to illustrate the *ad hoc* evolution of the current sector structure.

As a rule, the budget of the spending departments and the education sectors is annually adjusted by a uniform percentage, which is applied taking into account the sensitivity of each line item in the budget to price and wage increases in the economy. Nevertheless, managers of spending departments do have (some) discretionary power to differentiate pay per staff member, for example by introducing pay-for-performance and promoting valued employees, because under the existing budget rules they may shift resources intended for non-labour costs to increase spending on the payroll. Managers can also pocket productivity gains to raise pay of their employees.

In the education sectors managers have, formally, discretionary powers over how they want to spend their budget, since school boards and university governors receive an annual lump sum out of the central government budget.

In the decentralised sectors of the municipalities, the provinces and the polder boards – autonomous bodies commanding tax resources of their own – managers are free to set the pay of their employees, and employer organisations bargain wages with the unions without veto power for the central government.

After the introduction of the sector model in 1993, wage trends between sectors have not diverged significantly. The cumulative change in wages (excluding short-term and other temporary staff) over the 1993–2005 period varied between 28% and 34%, with the exception of university hospitals (39%). Decentralised sectors show highly similar outcomes, as is demonstrated by a comparison of local government (33.9%) and provincial government (33.5%). The observed spread – although minor – is in fact still surprisingly large, given the rigid implementation of the reference model to all cabinet and education sectors.

University hospitals form an outlier in Table A1. In this particular case, managers met strong labour market competition from general hospitals, where the self-employed medical professions often earn (considerably) more than specialists on the payroll of university hospitals.

Although the observed spread in contracted wage rises between sectors is rather small, it may well be that, within each sector, other elements in employee compensation packages show greater variety. There is no readily available information to clarify this. The lack of transparency regarding its overall results is one of the disadvantages of the sector model.

It follows that: (a) that the current model with 13 sectors is no precondition to achieve (some) flexibility in setting public sector pay; and (b) that the spread in negotiated pay levels after 14 years is not very different from the situation where the central government bargains a uniform wage rise for the public sector as a whole – the situation that existed before 1993. The second conclusion should not come as a surprise, since the existing sector model offers limited flexibility between cabinet and education sectors, as long as the sectors concerned are all entitled to a uniform annual adjustment of their budgets to meet the contractual wage increase dictated by the reference model.

Within both the cabinet sectors and the education sectors, the scope for discretion of agency managers could be expanded further. Thus, managers of individual agencies would be free to allocate resources as they see fit to improve pay or other conditions of employment (educational leave, child care), for example by reducing the number of staff or using funds initially allocated to cover non-labour costs. By being able to offer an attractive package of employment conditions to prospective employees, managers would be in a much improved position to face competition in labour markets.

Reference model

The so-called “reference model” determines the scope for raising public sector pay. Every year, in May and September, the Netherlands Bureau for Economic Policy Analysis (henceforth: CPB) estimates for the market sector the average rise of contractual wages and the change in employer contributions to social insurance programmes and private pension plans. In recent years, the effect of wage drift in the market sector was deemed to be zero. In principle, the CPB-estimate determines how much public sector pay – including the effect of wage drift – can be increased. As a result, contractual wages and salaries in the market sector and the public sector move in tandem. Table A2 provides an illustration.

Table A2. Contribution by central government to cover higher labour costs in cabinet sectors and education sectors, 2007 (%)

Wage rise market sector (estimate)	1.75
Employer contributions to social insurance / pension plan	- 0.22
Wage drift (Dutch: <i>incidenteel</i>)	0.0
Contribution (preliminary, May 2006 estimate)	1.53

Source: BKZ (2006), page 2.

In preparing the annual budget of each department, budget figures for the previous year are adjusted by the contribution percentage as derived in Table A2, taking account of the sensitivity to labour costs of each spending item in the budget. In a similar way, budget officials set the increase of the aggregate budget for the education sectors. At the decentralised government levels, the CPB figure is indicative only, and plays no formal role.

In some years, the contribution percentage by central government may be adjusted upwards, as was the case, for example, in 2005 when industrial action moved the government to raise pay for police officers and teachers by an additional 0.8%.

In similar vein, the contribution by central government may be adjusted downwards, as an instrument to implement budget cuts. Notably, in recent years, managers – especially at the departmental level – were exposed to efficiency targets. These targets were not based on any thorough analysis of current productivity. This efficiency drive is to be continued in the years to come.

Taking account of labour productivity

The Board of Secretary-Generals suggests (SG-Overleg 2007, page 7) that the current annual productivity growth in the public sector of 0.3% (in itself an *assumption* of the CPB) can be raised in the 2008-2011 period by a full percentage point per year. There can be no doubt that this lofty goal is quite ambitious, given the present limited knowledge of productive efficiency in the public sector.

Potential productivity gains will differ between sectors and within each sector from one producer to the next. A general reduction of budget allocations for labour costs by 1.3% per year may hurt the quality of some public production, for example in those sectors that, on average, do already function efficiently. On the other hand, some sectors may offer scope for greater budget reductions than by 1.3% per year, given current sloppy performance or overstaffing. Budget cuts that take into account potential productivity gains in various sector require information that at the moment simply is not available, not only at the central government level but often also at the management level of the agencies concerned.

Although the departments and the Ministry of the Interior do not systematically monitor efficiency/productivity of public sector producers, the Social and Cultural Planning Bureau (henceforth: SCP) has collected data on inputs, cost and output of a range of service providers that are financed by tax payers. Different from the assumption by the CPB (0.3%), the Social and Cultural Planning Office (SCP) finds that average productivity growth in main sectors of the public sector during the 1995-2004 period amounted to about nil per cent per year.

Table A3. Labour productivity trends, 1995–2004 (% per year)

Education	- 0.9
Health care	0.4
Police force, prisons, the courts	1.2
Total public sector	0.0
Total market sector	2.3

Source: SCP (2007), page 34.

In its budget allocation process, the central government could take account, more than is now the case, of the varying potential of public sector agencies to improve productivity. This is a hard nut to crack, because even if the volume of services provided can be adequately measured and related to inputs of the agency concerned, monitoring the quality of the services provided is especially problematic. This issue matters, because management of agencies may be tempted to trade (more) volume against (lower) quality.

In practice, in many cases even the quantity of services provided by public sector producers is hard to measure. Inadequate data are the Achilles heel of a budget allocation process that tries to take into account the potential for (average) productivity gains sector by sector. Still, a precondition for the remit based approach advocated in the OECD report seems to be that the central government (“principal”) is able to monitor whether agencies in decentralised sectors (“agents”) produce the volume of services contracted in advance.

Without sustained efforts to enrich information about the volume and quality of services produced by public sector – and to improve the interpretation of pertinent data – any attempt to set pay in the Dutch public sector in the future on a more rational basis seems doomed to fail.

NOTES

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1. Governance of Decentralised Pay Setting in Selected OECD Countries: Draft OECD Working Paper, OECD (2007), examines the situation in Australia, Denmark, Finland, The Netherlands, New Zealand and the United Kingdom.
 2. Governance of Decentralised Pay Setting in Selected OECD Countries: Draft OECD Working Paper, OECD (2007), examines the situation in Australia, Denmark, Finland, The Netherlands, New Zealand and the United Kingdom.
 3. See the comparative report for more information on this.
 4. Decentralised government levels are negotiating separately in both countries.
 5. “Affordability” means that the pay setter should be able to finance the resulting costs with the present budget.
 6. See Glossary for the distinctively defined concepts of decentralisation, delegation and devolution.
 7. Provinces, municipalities and water boards.
 8. At present the Ministry for Interior and Kingdom Relations (MBZK).
 9. Universities, higher professional education, university medical centres, research institutes, occupational and adult education. Primary education and secondary education will emerge as sub-sectors in 2007 and 2008.
 10. The phrase “sub-government level” refers to provinces, municipalities and water boards. These are also often called “the decentralised sectors”.
 11. The situation would be somewhat different in countries with two-level systems for collective agreements. There, the government would have to accommodate the central collective agreement, but should apply the affordability principle to all second-level bargaining.
 12. A standard adjustment in countries with two-level systems for collective agreements would normally be based on that agreement.
 13. A possible alternative might however be to combine an ex ante assessment with an ex post correction.
 14. This means that scarce skills should be allocated to the jobs where they can create the highest added value.
 15. That is they receive a government grant or allocation in explicit or implicit return for providing specific services.
 16. This is a possible explanation to why the reforms in the Netherlands have not continued after the sector model was introduced, in spite of a basic agreement with the trade unions for public employees.

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