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Performance-related Pay Policies for Government Employees



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Foreword

More pay for better performance: can such a policy be beneficial in the public sector? This book provides a comprehensive overview of the trends in performance-related pay policies (PRP) for government employees in selected countries over the past two decades and draws some lessons from these experiences. Both the strengths and the weaknesses of PRP policies are assessed. The report explores the various PRP designs and emerging trends, investigating the reasons why PRP policies are being implemented and how the policies operate concretely. The outcomes of PRP policies at the individual and team levels are evaluated, and recommendations are made on what should be done or avoided with the implementation of PRP.

PRP is part of the key policy options and new approaches to human resources management in the public sector that the OECD Human Resources Management Working Party examines, on behalf of the OECD Public Governance Committee. The book is based primarily on twelve country reports that were presented at an OECD expert meeting in October 2003: Denmark, Finland, France, Germany, Hungary, Italy, Korea, Spain, Sweden, Switzerland and the United Kingdom – all OECD member countries – and Chile, which is an observer to the OECD Public Governance Committee. Canada and New Zealand contributed subsequently. The Public Governance and Territorial Development Directorate (GOV) gratefully acknowledges OECD delegates' contributions to this project and especially their preparation of the country reports.

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Executive Summary

Introduction

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

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

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

The adoption of performance-related pay in the **public sector** reflects the influence of the private sector culture of incentives and individual accountability on public administration. Civil services have increasingly sought to manage service production tasks on similar lines to those in the private sector. In the private sector, pay for performance is the norm in most companies: managers usually receive cash incentives and stock ownership opportunities that link rewards to the success of the company as well as

individual performance, and lower level employees receive individual or group bonuses for good performance.

The introduction of PRP in OECD public sectors is only one facet of a wider movement towards increased pay flexibility and individualisation. Another important change – especially at the managerial level – is the attempt to base individual salary on the specific difficulties of the post or the level of responsibilities. In most countries, the salary policy for civil servants now consists of three key components: **base pay**, remuneration linked to the nature or duties of a post, and performance-related pay elements. The two elements of variable pay should not be confused. The first relies on an *ex ante* evaluation of “anticipated” or “likely” performance based on job demands (for example, by assessing the qualities needed for the particular duties associated with the position) while the other relies on an *ex post* evaluation. Variability of pay in almost all OECD member countries at the managerial level tends to depend more on prior job evaluation than on the *ex post* evaluation necessary for a PRP scheme.

Two-thirds of OECD member countries have implemented PRP or are in the process of doing so. However, there are wide variations in the degree to which PRP is actually applied throughout an entire civil service. In many cases, PRP concerns only managerial staff or specific departments/agencies. Very few OECD civil service systems can be considered to have an extensive, formalised PRP system. PRP is sometimes more rhetoric than reality, as some systems actually base the assessment of performance on **inputs** – which cannot really be qualified as “performance-related”. In some cases as well, performance rewards are distributed without any formal assessment of individual performance. In fact, there is often a gap between the stated existence of a so-called “performance-related pay scheme” and its concrete functioning, which may be barely linked to performance.

The goal of this book is to provide a comprehensive overview of the different trends in performance pay policies across **government employees** of OECD member countries and to draw some lessons from their experience. The book focuses on PRP policies applied to ministries/departments/agencies of the **central/federal government level**. The report explores the various PRP designs and emerging trends, investigating the reasons why PRP policies are being implemented and how the policies operate concretely. The report also aims to analyse the apparent impacts of PRP policy. The book is organised as follows: Chapter 1 sets performance-related pay policies in the wider management context; Chapter 2 analyses key trends in performance pay policies in OECD member countries; Chapter 3 assesses the impact of PRP policies and draws lessons from the experience of implementing them.

The book is based primarily on twelve country reports that were presented at an OECD expert meeting in October 2003:² Denmark, Finland,

France, Germany, Hungary, Italy, Korea, Spain, Sweden, Switzerland and the United Kingdom – all OECD member countries – and Chile, which is an observer to the OECD Public Governance Committee. Canada and New Zealand contributed subsequently. The other main sources for the book are the answers given to the 2003 OECD/GOV Survey on Strategic Human Resources Management³ and the research on performance-related pay conducted by Professor David Marsden of the Centre for Economic Performance at the London School of Economics.⁴

Performance-related pay in the wider management context

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

The impact of the introduction of PRP has to be analysed according to the multiplicity of objectives for introducing it. The main argument put forward for implementing PRP, is that it acts as a motivator, by providing extrinsic rewards in the form of pay and intrinsic rewards through the recognition of effort and achievement. Overall, however, the types of objectives pursued with PRP vary across countries, with Nordic countries focusing more on the personnel development aspects, most **Westminster countries** focusing more on the motivational aspect and others such as France or Italy, stressing the leadership and accountability of top civil servants.

There are large variations in the degree to which PRP is actually applied throughout an entire civil service. Only a handful of member countries can be considered to have an extended, formalised PRP policy (Denmark, Finland, Korea, New Zealand, Switzerland, the United Kingdom). Mostly, countries which have developed the strongest links between **performance appraisals** and pay as employee incentives, are those which have the highest **delegation of responsibility for human resources and budget management** – usually position-based systems. This illustrates the importance of such delegation to the development of PRP. Until recently, countries with a low degree of delegation – mainly career-based systems – tended to focus primarily on promotion to motivate staff. However, this has started to change and PRP policies have now been introduced into some career-based systems in such a

way as to increase flexibility and to promote individual accountability (Hungary, Korea and France, for instance).

Key trends in performance-related pay

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

- PRP policies have spread from management level to cover many different categories of staff in the past ten years.
- Among PRP policies, there has been some increase in the use of collective performance schemes, at the team/unit or organisational level.
- Long-running standardised PRP schemes have evolved into more decentralised systems, which facilitate delegation of managerial functions.
- There is an increased diversity of the criteria against which performance is assessed. Both career-based and position-based civil service systems tend to converge in the attention given to outputs, but also on competencies and social skills in general.
- Performance rating systems are less standardised, less formalised and less detailed than ten years ago. Performance appraisals rely more on the assessment of pre-identified objectives and on dialogue with line management than on strictly quantifiable indicators. On the other hand, systems of rating performance which impose **quotas** on the numbers who can succeed under them, are more widespread across OECD member countries.
- The size of performance payments is generally a fairly modest percentage of the base salary, especially among non-managerial employees. **Merit increments** tend to be smaller than one-off **bonuses**, they are often below a maximum of 5% of the base salary. PRP **bonuses**, which tend to supplement or replace merit increments, are in general higher – but overall, maximum awards usually represent less than 10% of the base salary for civil servants. At the management level, performance payments are generally higher, around 20% of the base salary.

Implementation and impact

Performance pay is an appealing idea, but the experiences reviewed in this study indicate that its implementation is complex and difficult. Previous OECD studies on the impact of performance pay at the managerial level concluded that many of the schemes had failed to satisfy key motivational

requirements for effective performance pay, because of design and implementation problems, but also because performance assessment is inherently difficult in the public sector (OECD, 1993; OECD, 1997). Performance measurement in the public sector requires a large element of managerial judgement. The notion of performance itself is complex, owing to the difficulty of finding suitable quantitative indicators and because performance objectives often change with government policy. Many studies have concluded that the impact of PRP on performance is limited, and can in fact be negative.

Evidence cited in this book indicates that the impact of PRP on motivation is ambivalent: while it appears to motivate a minority of staff, it seems that a large majority often do not see PRP as an incentive. While base pay as it relates to the wider “market” is important, supplementary pay increases for performance are a second-rank incentive for most government employees, especially those in non-managerial roles. Job content and career development prospects have been found to be the strongest incentives for public employees. PRP is unlikely to motivate a substantial majority of staff, irrespective of the design.

Despite such cautions, the interest in performance pay has continued unabated over the past two decades. This paradox arises from the fact that, despite the overall consensus on the types of problems raised by performance pay, PRP policies continue to be introduced on a large scale in many OECD member countries. There are few examples of public organisations having withdrawn their PRP policy.⁵ But the fact that organisations do not withdraw PRP is not necessarily a very good indication of its effectiveness, because the costs of doing so are a deterrent. However, one of the key reasons why PRP continues to be introduced on such a large scale across civil service systems, appears to be its role in facilitating other organisational changes.

It seems that, in the right managerial framework,⁶ the processes that accompany PRP have made such changes both possible and positive. When performance pay is introduced, there is a window of opportunity for wider management and organisational changes. These include effective appraisal and goal setting processes, clarification of tasks, acquisition of skills, creation of improved employee-manager dialogue, more team work and increased flexibility in work performance. Introducing PRP can be the catalyst that allows these changes to occur and, at the same time, facilitates a renegotiation of the “effort bargain” thus assisting in recasting the culture at the workplace. These dynamics have positive impacts on work performance. It appears that it is not through the financial incentives it provides that PRP can contribute to improving performance, but rather through its secondary effects, that is the changes to work and management organisation needed to implement it.

Recommendations

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

The performance appraisal process is at the heart of the whole system. It is recommended that performance appraisal be based on goal setting rather than on standard criteria for a job. Performance rating should not be too detailed and should avoid rigidity. The objectives set for an individual’s performance appraisal should act as a basis for ongoing dialogue throughout the year between the manager and the employee. Detailed feedback on the appraisal undertaken at the end of the year should be provided. Transparency in the whole process is the key factor in ensuring its success, which ultimately relies more on an effective measurement of performance than on the distribution of payment.

Implementation problems need to be anticipated. This implies primarily co-ordination with staff and unions on the implementation of PRP; the preparation of top and line management; clear anticipation of the budget needed for, and the costs linked to, PRP and of the ways of funding PRP; and of the time and work that the introduction and monitoring of the system requires.

Performance pay goes hand in hand with human resources management delegation. Some delegation of human resources and pay management is crucial for the effective implementation of performance pay. This is because of the close link between goal setting and performance pay. The more successful schemes appear to rely upon a close integration of these two functions, in contrast to more traditional models which tended to award PRP against standardised performance criteria. It is easier to articulate individual employees’ objectives and those of their organisation in a meaningful way if the local management has a degree of autonomy to adapt the scheme to its own needs.

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

The significance and impact of PRP on motivation should not be overestimated. PRP is of secondary importance as a managerial tool for improving motivation. Criteria such as satisfying job content, promotion possibilities or flexibility in work organisation come far ahead of performance

pay in motivating for staff. The evidence points, therefore, to the need for a broad approach to better performance management as against a narrow preoccupation with performance-related compensation.

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

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

Notes

1. The words in bold are explained in the glossary.
2. Reports were prepared by delegates within the framework of guidelines set by the Secretariat. The guidelines were structured around four key points: i) background, scope and coverage of PRP policy; ii) design of PRP policy: performance appraisal, rating and payment systems; iii) implementation and assessment of impact of PRP policy; iv) difficulties facing PRP policy, lessons learnt and prospects.
3. The Survey on Strategic Human Resources Management [PUMA/HRM(2002)3/FINAL] was answered by 29 OECD member countries (Turkey was not included). It was completed by ministries/departments in charge of human resources management in the public sector, and one official answer was provided by each country. This book relies in particular on sections 7 and 8 of the survey which deal with performance management and pay determination systems.
4. See the bibliography. The results of this research are based on a series of attitudinal surveys of employees and line managers in several areas of the United Kingdom public service: the Inland Revenue, the Employment Service, NHS Trust Hospitals, and head teachers in primary and secondary schools.
5. The New Zealand police is one example.
6. The right managerial framework means the basics of sound management; that is transparency within the organisation, clear promotion mechanisms and trust in top management.

Glossary

Base pay

The salary or wages that every civil servant receives regularly (usually fortnightly or monthly) from the government by virtue of being on the payroll. Base pay is usually linked to an employee's position and is uniform across similar positions. The base wage is often cited to compare wages in the public and private sectors. It is, however, only one component of civil servants' total rewards.¹

Bonus

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

Career-based systems

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

Central government

All units of government that exercise authority over the entire economic territory of a country. In general the central government is responsible for those functions that affect the country as a whole: for example, national defence; conduct of relations with other countries and international organisations; establishment of the legislative, executive and judicial functions that cover the entire country; and delivery of public services such as healthcare and education.

Delegation in HRM

Delegation in HRM refers to the fact that human resources responsibilities (including issues related to recruitment, training, promotion, mobility, pay, performance management) are increasingly delegated to individual ministries/departments and onwards to line managers, instead of being kept and controlled by the centre, and by top managers of organisations.

Efficiency

The relationship between the goods and services produced by a programme or an activity (outputs) and the resources used to produce them (inputs).

Effectiveness

The extent to which programmes achieve their expected objectives, or outcomes. Effectiveness is the most important element of value for money in the public sector. Goods or services may be provided economically and efficiently but if they do not achieve their intended objectives the resources used could be wasted.

Forced ranking system

Forced ranking systems specify the proportion of staff to be placed at each rating level. Such systems are based on the assumption that the actual distribution of performance outcomes matches the theoretical distribution which is being applied.

Government employees/Public servants/Civil servants

Government employees refer to public employees working in ministries, departments and government agencies to carry out the business of government and paid from public funds. The term “government employees” is used as a synonym for **public servants**. In many OECD countries, the term **civil servant** is used in a much more limited sense than “public servants” and is limited to core central public employment, i.e. employees in the central executive and legislative administration, in departments directly dependent on the Head of State or the Parliament, together with all other ministries and administrative departments of central government, including autonomous agencies paid by central government. For example, teachers and doctors in publicly owned schools and health facilities may or may not be civil servants legally, but they are always public servants if employed by government-funded organisations.

However, for the purpose of this book, the terms “government employees”, “public servants” and “civil servants” are used interchangeably, as the report focuses on a wide overview of the trends in performance-related pay policies in OECD central governments and does not aim to distinguish specifically among categories of public servants; which can differ significantly across countries.

Input

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

Merit increment

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

Output

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

Outputs targets

A description of the level of activity or effort that will be produced or provided over a period of time or by a specified date, including a description of the characteristics and attributes (*e.g.*, timeliness) established as standards in the course of conducting the activity or effort.

Outcome

The impact on or the consequences for, the community from the outputs or activities of the government. Outcomes reflect the intended and unintended result from government actions and provide the rationale for government interventions. For example, an outcome from a Ministry of Finance could be that government finances are sustainable and an outcome from the Ministry of Transport could be a decline in road accidents.

Performance

Performance can be defined as the ability of a government organisation or authority to acquire resources economically and use those resources

efficiently (input-output) and effectively (output-outcome) in achieving the output and outcome targets or goals.

Payment by results

Bonus earnings depend on measured qualities or values of output for individuals or groups, usually based on work studied time units; this covers a range of bonus schemes and still form the main method of performance pay for manual workers.

Performance agreements

Organisational performance agreements

Negotiated agreements between the minister and chief executive or between the chief executive and senior managers within the department or agency, which break down overall strategic goals into programme elements, setting specific, often detailed, operational, procedural and output oriented targets.

Individual performance agreements

These may take the form of a non-legal written agreement as part of an annual performance appraisal and goal setting, or be part of an employment contract process, regarding the work to be carried out over the coming year. Regardless of the format, performance agreements are generally evaluated and negotiated on an annual basis.

Performance appraisal

Performance appraisal is a methodology and set of procedures for rating the work performance of individuals according to objective standards and criteria applied uniformly across one or several organisations.

Performance management

Performance management systems are aimed at linking the management of people with institutional goals and strategies.

Performance-related pay

Performance-related pay refers to the variable part of pay which is awarded each year (or on any other periodic basis) depending on performance. PRP may be awarded on an individual or on a team or group basis. The definition of PRP excludes: i) any automatic pay increase by, for example, grade promotion or service-based increments (not linked to performance); ii) various types of allowances which are attached to certain posts or certain

working conditions (for example, overtime allowances, allowances for working in particular geographical areas).

Position-based systems

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

Profit-related pay

Bonus or share options based on the organisation's profit performance; this is widespread in the private sector, where share options are often important for senior managers. This is less common in the public sector.

Public sector

The scope of the public sector is not defined on the basis of functional sub-sectors, but on the basis of employees paid from public funds, either directly by government or on the basis of budget allocations from central government to services, departments or agencies.

Quotas

Quotas are a formal way to distinguish among staff performance, for instance by saying that only the top 15% are allowed to receive a financial bonus.

Senior Civil Service/Senior Executive Service

In many countries a group of senior public servants is identified as a "senior executive service" (SES). In the United Kingdom and Hungary it is known as the Senior Civil Service. Senior civil servants (SCS) refer to the group of civil servants belonging to the top management category. This is a mobile cadre of senior executives that have broad management expertise and an overview of public sector values and responsibilities.

Usually, senior civil servants are grouped and managed under a different HRM policy than other civil servants – notably in relation to their performance management policy. The purpose of the SES/SCS is mainly to promote policy coordination between departments and a sense of cultural cohesion between high level civil servants.

360-degree feedback system

System of performance appraisal where the assessment is made not only by superiors, but also by peers, and/or subordinates.

Westminster countries

Westminster countries are democratic systems of government modelled after that of the United Kingdom system of government. In essence, Westminster is the name given to the system of parliamentary democracy used in a number of Commonwealth nations such as Australia, Canada, New Zealand, and the United Kingdom.

Note

1. Definition extracted from <http://www1.worldbank.org/publicsector/civilservice/glossary.htm>.

PART I

Performance-related Pay Policies for Government Employees: An Overview of OECD Countries

Part I provides a comprehensive overview of the trends in performance-related pay (PRP) policies across civil services of OECD member countries. Two-thirds of OECD member countries have introduced PRP to some degree or are in the process of doing so. However, few member countries have an extensive, formalised PRP system in their civil service. Although PRP systems have become increasingly common in OECD member countries, their design and application varies considerably. Nevertheless, some common trends are emerging, such as the increased use of bonuses instead of merit increments, the extension of PRP to all categories of staff and the increased use of team/group-based PRP. Part I also aims to analyse the apparent impacts of PRP policy. It concludes that the incentive effect of the financial aspects of PRP has often been overestimated. However, the processes accompanying PRP have produced positive results, as an impetus for improved goal setting, organisational culture change and management innovation, thereby leading to improved performance. Performance-related pay, when implemented in a sound management framework, and as part of a wider performance management strategy, can be an effective lever for change at the workplace both by shifting attitudes to work and by re-examining work organisation.

PART I
Chapter 1

**Performance Pay
in the Wider Management Context**

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

1. Introduction

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

“Performance is a deceptively simple idea. Simple because it is easy to express key concepts and objectives; deceptive because it is hard to apply these ideas in government” (OECD, 2003d). Performance can be defined as the ability of a government organisation or authority to acquire resources economically and use those resources efficiently (input¹-output²) and effectively (output-outcome³) in achieving the output and outcome targets or goals.

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

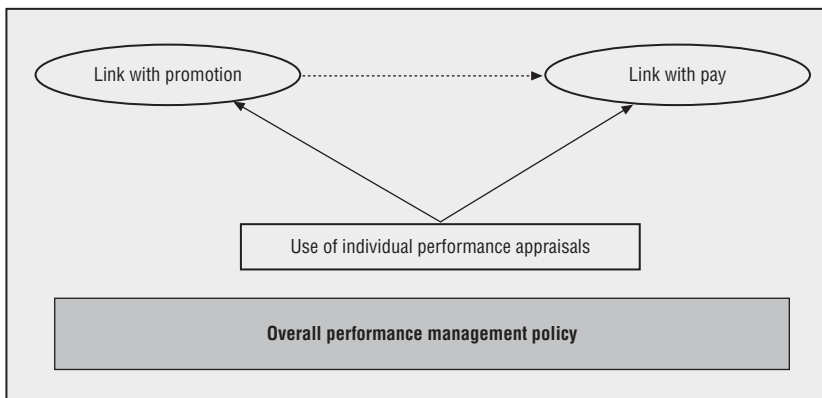
Before analysing the extension of PRP for government employees in OECD member countries in the past two decades, it is worth clarifying the different concepts used in this book:

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

The three concepts are interdependent, as a performance-related pay strategy should rely on a clear performance appraisal process, within the framework of a wider performance management strategy. However, performance appraisals have existed for a considerable time in many public service organisations without any link to remuneration. Often, the performance appraisals are instead linked to promotion, formally or informally; or are simply considered a pure management and planning tool. However, over recent years performance appraisals have increasingly been linked to pay. In some cases as well, PRP exists without any formal performance appraisal process, but this is likely to be counterproductive for reasons discussed later in the report (see Chapter 3).

2. The development of PRP over the past two decades

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

Figure 1.1. **PRP and performance management: interdependent elements**

United States introduced a system of performance pay for managers (the Senior Executive Service) with the 1978 Civil Service Reform Act.

However, most so-called merit increases available under many of the other schemes in operation before the mid-1980s, could not be considered to be true performance-related pay. This was because merit was defined so as to avoid having to apply penalties; indeed, these increases were frequently allocated on a collective basis regardless of performance. They were

Box 1.1. **Performance-related pay in the private sector**

Performance-related pay is widely used in the private sector. Individual performance payments have been used for a long time, but were traditionally used as a merit payment over and above the annual pay award, and more as a means of rewarding “good behaviour” rather than performance. It was also largely concentrated in white-collar managerial occupations.

Since the 1980s, there has been an extension of PRP schemes based on job objectives to all categories of staff in the private sector, and PRP schemes have been increasingly linked to organisational objectives, against which individuals are appraised on an annual basis. There are a range of different schemes which utilise a variety of individual, team-based and skill-based criteria for making such rewards – in reality the schemes often involve some combination of the three. In many schemes, the employees involved now have all of their annual pay increase awarded through this method.

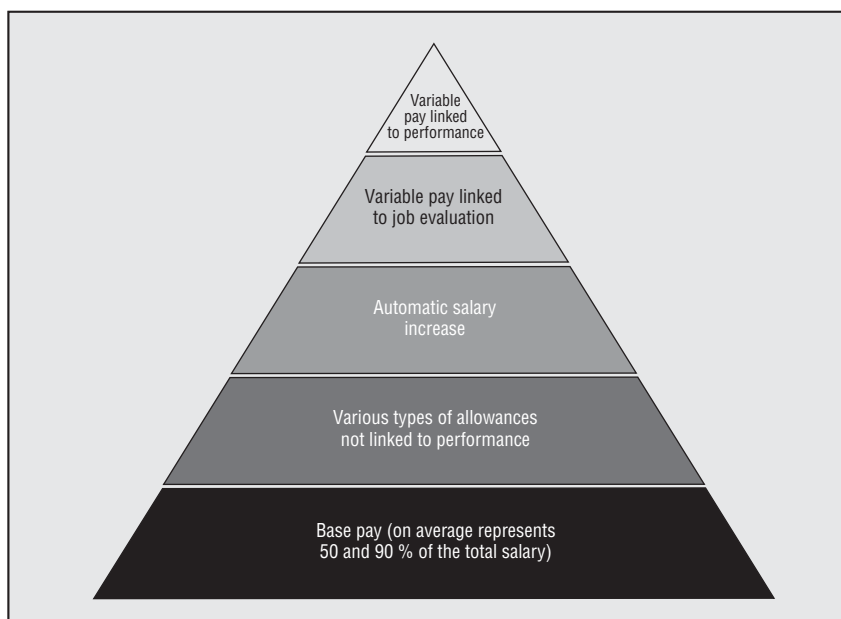
Quotas and forced ranking systems are also increasingly used in the private sector. For instance, at General Electric only 20% of staff can be rated at the highest level and 10% have to be rated at the lowest level, using a three-level rating scale.

effectively length of service or age-related increments. Performance-related pay has to be carefully distinguished from other types of allowances not linked to performance, from automatic salary increases, and from the part of variable pay linked to job evaluation (see Figure 1.2).

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

- The first wave of PRP policies were put in place in OECD member countries at the end of the 1980s. The central governments of Denmark, the Netherlands, New Zealand, Spain, Sweden, the United Kingdom and the United States⁴ all adopted PRP in one form or another. Experimental policies were tested during the 1980s in certain organisations in Finland and in the German postal service.
- A second round of establishing PRP systems started in the early 1990s, with the adoption of PRP policies in Australia, Finland, Ireland and Italy.
- Most recently, in the late 1990s and early 2000s, countries such as Germany, Korea, and Switzerland, as well as some in Eastern Europe (the Czech Republic, Hungary, Poland, the Slovak Republic) began to put PRP mechanisms in place. In 2004, France started experimenting with the introduction of PRP for top level

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



civil servants (director's level) in six pilot ministries (Ministries of Finance, Defence, Interior, Equipment, Agriculture, Civil Service). PRP will be in the form of bonuses, up to a maximum of 20% of the base salary.

- In the United States, 2004 legislation has given the Departments of Homeland Security and Defense the flexibility to develop their own pay systems, and both have announced plans to shift General Schedule (GS) employees to salary systems based on pay for performance. Combined, the two new pay systems will cover nearly 750 000 employees.⁵

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

Performance-related pay systems are not static. Aspects of their design may prove unsuited to the environment in which they are implemented and, like all pay systems, they are likely to go through a life-cycle. Pay systems may start with clear principles, but over time they have to be adapted on an *ad hoc* basis to changing organisational demands and labour market pressures, leading to a gradual loss of their initial logic. As a result, from time to time, they need to be fundamentally reformed or replaced. There is no reason to believe that current PRP schemes are any different from their predecessors in this respect.

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

Introduction of PRP						
Canada (1964)	United States (1978)	Spain (1984)	Denmark (1987) Netherlands (1989) New Zealand (1988) Sweden (1989) United Kingdom (1985 and 1987; Inland Revenue Scheme, 1988)	Finland (1992) Italy (1993) Ireland (1995)	Australia (1997) Germany (1997) Korea (1999)	France (2004) Hungary (2002) Switzerland (2000)
Revision of schemes/implementation of more operational ones						
	United States (1984)			Sweden (1994) United Kingdom (1996) United States (1994)	Denmark (1997-2002)	Ireland (2002) Some US departments (2004)

3. An overview of the current state of play in performance management

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

- Most OECD member countries report having a formal extended performance appraisal system for civil servants. The exceptions are Greece, Iceland, Luxembourg, and Spain. Most performance appraisal systems are based on an individual assessment of performance. Such assessments in their turn rely largely on job objectives as defined in an employee/management performance agreement, rather than on standard, generalised criteria for a given job (that is a job description established by management irrespective of the aims for the position at a given point in time).
- Most OECD member countries have tried to implement a wider performance management strategy, linking, at least formally, individual objectives and performance to institutional ones.
- Many OECD member countries have developed a different performance management system for senior managers than for the other categories of staff (including, for instance, Canada, Denmark, Ireland, Italy, Korea, Norway, the United Kingdom and the United States). There has been a trend across the OECD to focus special HRM policies on managers, which was traditionally not the case before the 1990s (OECD, 2003a).
- Few countries have developed systematic policies to address underperformance. Traditionally career civil service systems⁶ have certain procedures, but these are generally for misconduct rather than attempts to impact positively on underperformers.⁷
- OECD member countries focus on incentives to promote good performance rather than on sanctions for bad performance. Overall, career-based systems focus on incentives linked to promotion and advancement (and in limited cases they introduce one-off performance payments) while position-based systems focus on monetary incentives such as merit increments and bonuses. Two-thirds of OECD member countries have, to some degree, tried to formally link performance appraisal of their civil servants to pay.⁸ However, there are wide variations in the degree to which PRP is actually applied throughout an entire civil service. In many cases, PRP concerns only managerial staff or specific departments/agencies. In fact, only a handful of OECD member countries have truly implemented PRP on a large scale. Those countries that have an extensive, formalised PRP system include Denmark, Finland, Korea, New Zealand, Switzerland and the United Kingdom.

4. Why have governments introduced PRP?

The reasons given for introducing PRP and extending its coverage within public services in OECD member countries are varied, as illustrated by the country reports and the academic literature. Individual countries often have multiple objectives for their PRP schemes. The main reason given for introducing

Box 1.2. What does the literature say about PRP?

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

PRP is that it motivates, by providing extrinsic rewards in the form of pay and intrinsic rewards through the recognition of effort and achievement.

4.1. Improving motivation

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

Box 1.3. Rationales for service incremental pay scales

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

Promotion has severe limitations as a generalised incentive. Even where there is scope for promotion, it may be slow because of the generally stable employment in public services. This has been intensified by a "delaying" of levels of management in many organisations which has reduced previously existing promotion opportunities. The ageing of the workforce and the fact that, since 1990, the age groups "50-59 years" and "60 years and more" have seen their share of the civil service workforce increase (OECD, 2002c)⁹ have limited the opportunities for promotion in the past decade. As a result, large numbers have stayed at the same rate of pay or within narrow pay bands, and management has had little to offer by way of further financial inducements. For example, in the United Kingdom civil service administrative group, in the 1980s, a newly promoted Senior Executive Officer could expect to wait, on

average, over 20 years to be promoted to Principal, the first grade with significant managerial responsibilities. When examining police pay in the United Kingdom in the 1990s, the Sheehy Inquiry (Sheehy, 1993) found that a very large percentage of all ranks (42%) “did not expect to be promoted”. The introduction of PRP is thus seen as an alternative method of motivating staff.

4.2. Attracting and retaining talented and dynamic employees

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

The other key role of PRP in recruitment concerns the type of person it attracts. Government organisations may often appeal to employees who, although competent, are somewhat risk averse. Pay scales with service-related increments may reinforce that perception of public service jobs, whereas performance pay may well attract more dynamic and risk-taking people.¹⁰ Particularly for jobs which require risky decisions, as in senior management, it is possible that PRP has a role in recruitment. To attract people from the private sector with the right kind of expertise, it is seen as necessary not just to match pay levels, but to adopt similar kinds of incentive systems.

4.3. Facilitating management changes

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

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

4.4. Will PRP control the pay bill?

The introduction of PRP can have differing aims regarding the pay bill:

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

4.5. Making accountability visible

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

5. PRP and the delegation of human resource and budgetary responsibilities

Analysis of the HRM Survey (OECD, 2004) shows that there are two noticeable trends in human resources management in the past decade, although the scope and pace of these trends vary greatly from one country to another: an increased delegation of human resources and budgetary management responsibilities to individual ministries/departments and onwards to line managers; and increased individualisation of human resources management that is, management of employees as individuals not just by grade classification. While traditionally, career-based systems tend to

create little individualisation and delegation of human resources practices, position-based systems have had more individualised and flexible human resources practices. Many countries now fall in between the two systems as regards delegation and individualisation (OECD, 2004).

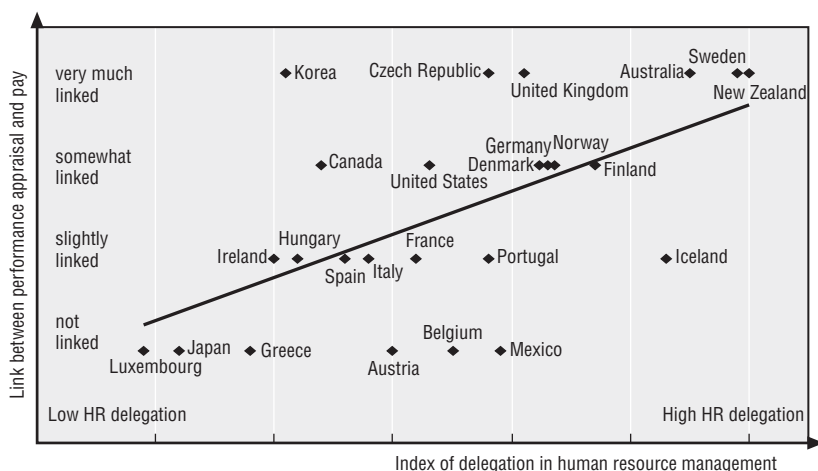
Overall, countries which have introduced performance-related pay policies are those which have the most devolved budgetary frameworks. These provide essential underpinning for the delegation of central controls over key HRM aspects such as staff numbers, classification, grading and pay, itself critical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

Figure 1.3 and Table 1.2 show the relationship between the level of delegation and the existence of a formal link between performance appraisal and pay. They are based on an index of delegation developed on the basis of the HRM Survey (OECD, 2004). Overall, they show that the greater the HRM and pay delegation, the stronger the link between performance appraisal and pay.

It must, however, be stressed that, even when human resources and pay management are substantially delegated, finance ministries generally keep tight control over pay budgets. Flexibility for local management is confined to issues such as measurement of performance and distribution of the limited amount of money available for performance-related pay.

Figure 1.3 uses an index on delegation in HRM based on answers provided by OECD member countries to the survey on strategic human resources management (see Table 1.2) (OECD, 2004).¹¹

Figure 1.3. **Relationship between delegation and link between performance appraisal and pay in OECD member countries**



Note: Figure 1.3 excludes the Netherlands, Poland, the Slovak Republic, Switzerland and Turkey in the absence of sufficient data.

Table 1.2. **Index of delegation in human resources management**

Delegation index	Low delegation	Fairly low delegation	Fairly high delegation	High delegation
OECD Countries	Greece	Austria	Belgium	Australia
	Japan	Canada	Czech Republic	Finland
	Luxembourg	France	Denmark	Iceland
	Slovak Republic	Hungary	Germany	New Zealand
		Ireland	Mexico	Sweden
		Italy	Norway	
		Korea	Portugal	
		Poland	Switzerland	
		Spain	United Kingdom	
		United States		

Overall, one can distinguish four groups of countries:

- The first group of countries (which include notably Australia, Finland, New Zealand, Sweden and the United Kingdom) has developed strong links between performance appraisal and pay. They are position-based systems and have a very high degree of HR delegation in common.
- The second group of countries (which include notably Canada, Germany, Norway and the United States) has developed links between performance appraisal and pay, but it is not systematically applied through the civil service and is in some cases limited to the managerial level. They have a lower level of delegation.
- The third group of countries (such as Austria, France, Ireland, Italy,¹² Poland and Spain) has introduced very limited links between performance appraisal and pay. This link is often limited to certain ministries/agencies and to the managerial level.
- The fourth group of countries (Greece, Japan, Luxembourg and the Slovak Republic) has not developed any formal links between performance systems and pay. They have a low degree of human resources delegation in common.

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

Over recent years, it appears that countries which have moved towards more delegation have introduced PRP systems. This is not surprising given that performance-related pay requires enhanced discretion to manage. However, reinforcement of accountability mechanisms is needed to

counterbalance equity problems raised by this increasing delegation, an issue addressed in Chapter 2.

6. Conclusions

Two-thirds of OECD member countries have introduced some links between performance appraisal and pay in their civil services although only a handful of OECD member countries can be considered to have an extended, formalised PRP system. Countries which have developed the strongest links between performance appraisals and pay are the countries which retain the highest delegation in human resources and budgetary management. Countries with a rather low degree of delegation tend to focus on promotion to motivate staff and introduce the remuneration incentive only for specific categories or for those at management level.

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

The impact of the introduction of PRP has to be analysed according to the multiplicity of objectives given for introducing it. The types of objectives which its implementation is hoped to realise, vary across countries. Nordic countries focus more on the personnel development aspects, Westminster countries focus more on the motivational aspect, others like France and Germany stress the accountability of top civil servants and some such as Finland, Hungary and Italy use it to introduce more flexible and responsive methods of working.

Notes

1. Input: see the definition in the glossary on page 19.
2. Output: see the definition in the glossary on page 19.
3. Outcome: see the definition in the glossary on page 19.
4. The United States already had a PRP system in place for senior officials in 1978, which was extended to mid-level managers in 1981. The system was revised in 1984 and became the Performance Management and Recognition System. It was abolished in 1993. Since then, many US government departments and agencies have introduced performance pay, usually at the management level, following guidelines issued about its implementation from the Office of Personnel Management.
5. In the United States, in 2004, there were less than 40 000 federal employees working under a policy that links their salary increases to their performance (Risher, 2004).
6. Career-based systems: see the definition in the glossary on page 17.

7. In many countries it may well be that failure to get a performance payment would be seen as a punishment. This, however, would appear to punish all those who deliver normal productivity and who may not therefore receive bonuses, as well as the underachievers.
8. These include Australia, Austria, Canada, Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Korea, Netherlands, New Zealand, Poland, Slovak Republic, Spain, Sweden, Switzerland, the United Kingdom and the United States.
9. More than 60% of civil servants are over 40 years old in OECD member countries (OECD, 2002c).
10. In his Safelite study, Lazear (Lazear, 1998) estimated that a high proportion of the increased productivity associated with the introduction of output-based pay (the case concerned fitting windshields on cars) could be explained by differences between the firm's recent recruits and long-established employees.
11. The index gathers responses to 27 questions in the HRM survey linked to delegation in HRM (notably concerning design and implementation of HRM policy, in terms of recruitment, performance management or pay) weighed according to the importance and relevance of the question. Two countries have been excluded from the index, due to lacking data (Netherlands and Turkey).
12. Except at the managerial level (*dirigenza*) where PRP has been widely introduced (for the second level of public managers, PRP ranges from a minimum of 5% to a maximum of 10%, for a top level manager PRP is between 10% and 15%).

PART I
Chapter 2

**Key Trends in Performance-related Pay
in OECD Countries**

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

1. General trends in the overall design of PRP systems

1.1. How and how far has PRP been introduced?

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

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

Method of introduction of PRP	Countries
Law	Germany; Hungary; Italy; Spain; Switzerland; United States.
Collective agreement	Denmark; Finland; ¹ Sweden.
Other methods	Canada (policy advice) ² New Zealand (bargaining parameter) ³ United Kingdom (negotiations with Cabinet Office and HM Treasury)

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

2. Performance-related pay in Canada is a policy that was accepted by the government upon recommendation by an advisory committee responsible for reviewing and monitoring the compensation of executives and heads of departments and organisations.

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

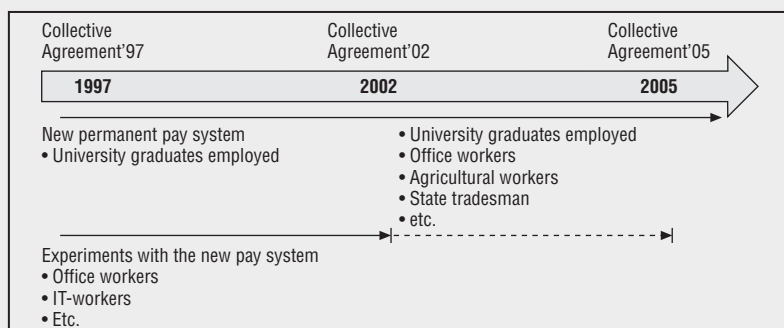
for determining public pay. Where the move to PRP has been negotiated, change has been more gradual than where it has been imposed.

Introducing PRP gradually can be a very slow process. From the examples of Denmark and Finland, it seems that a minimum of eight to ten years will be required for these governments to attain their objective of full coverage of PRP. In Denmark, implementation started in 1997, and will continue until 2005. In Finland, in 2002, 35-50% of the civil service had successfully implemented the

Box 2.1. Introducing PRP: the Danish case

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

Milestones in the development of the new pay system



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

new pay system launched in 1992. The rest of the civil service will implement it at the beginning of 2005 at the latest.

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

On the other hand, taking a radical approach to the introduction of PRP, as in the case of centralised countries, may allow a rapid adoption of the new system. But this approach may cause its own particular problems, see Chapter 3.

The coverage of PRP varies greatly. In Canada, Ireland, Italy, and Norway, PRP is applied at management level only, with Ireland and Norway having it for the most senior officials only. France introduced PRP for directors in six pilot ministries in 2004. Sometimes, however, top managers are excluded from PRP (e.g. Finland). One reason for this is to avoid assessing the performance of those who are political appointees.

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

Box 2.2. Introducing PRP: the case of the Department of Work and Pensions (DWP) in the United Kingdom

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

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

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

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

1.2. Decentralisation of the design of PRP policies

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

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

In addition, the degree of centralisation of PRP policies – i.e. the degree to which their design is elaborated at the central government level and standardised across all government organisations – varies according to the group of employees concerned. Often, a decentralised approach to PRP at the employee level is combined with a centralised approach for senior civil service management. This

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

	Senior management	Employees
PRP highly centralised ¹	Australia; Canada; Ireland; New Zealand; United Kingdom; United States.	Germany; Hungary; Korea; Switzerland.
PRP partially decentralised ²	Finland; Italy.	Australia; Finland; Spain; United Kingdom; United States.
PRP highly decentralised ³	Denmark; Sweden.	Denmark; New Zealand; Sweden.

1. PRP is usually defined in detail in the law: performance appraisal and the nature of the awards are centrally designed.
2. PRP is defined in the law in broad terms, and guidelines for performance appraisals and payments are issued. Within this general framework, individual departments have significant flexibility in areas such as the approach to performance appraisal and the distribution of rewards.
3. Individual departments have considerable flexibility in the design of performance appraisal, size of rewards, form and distribution of payments, etc. The PRP system is not defined in the law and PRP policies vary considerably from one organisation to another.

is the case for instance in New Zealand, the United Kingdom, and the United States. PRP design is established at the central level in detail for senior management, while it remains very much decentralised for employees.

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

1.3. The equity implications of decentralisation and delegation of PRP arrangements

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

In most countries, the line manager is now in charge of an employee's performance assessment. Even though line managers do the assessment, they are usually monitored by higher levels of management. The latter control the

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

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

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

overall implementation of the PRP policy and should ensure there is no illegal discrimination etc. But more importantly, they ensure appraisals set the right individual goals, in conjunction with organisational goals.

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

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

Strong	Relatively weak	Very weak
Denmark	Austria	Australia
Korea	Belgium	Canada
United States	Czech Republic	Finland
	France	Hungary
	Germany	Iceland
	Ireland	New Zealand
	Italy	Norway ¹
	Portugal	Poland
	Sweden	Slovak Republic
	United Kingdom	Switzerland

1. In Norway, PRP is applied for senior officials only. Unions have very little influence on the operation of this PRP system. Unions have a strong influence on setting pay level of employees and on local wage-negotiations, but they have little influence over the system of performance appraisal.

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

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

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

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

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

1.4. PRP: the shift from the individual to the collective approach

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

Several countries have strongly encouraged the move to a more collective approach to PRP within individual ministries. In the United Kingdom, the new performance management systems underline this approach by explicitly encouraging the reward of exemplary team behaviour, not just individual behaviour (OECD, 2002b). The government's Makinson report (Makinson, 2000) recommended that performance awards should be given on a team basis. In the United Kingdom, a number of departments are making the transition from individual to team-based systems during 2004, and performance-related pay will be delivered wholly through the payment of team bonuses in the Inland Revenue as from 2004. In Finland, results-based rewards are applied at the team level within an organisation. In Spain, the productivity bonus is also essentially applied at the team level, when productivity is used for remunerating special performance. In Germany, managers can allocate a bonus at the team level. In Korea, as of 2002, four areas (defence, police, security such as the Presidential Security Service, and railroad service) where output is a group collaboration effort, use a departmental base. In the United States, many public sector agencies, such as the Federal Aviation Agency, have introduced a combination of individual and collective PRP, where bonuses are allocated at the team level. Other countries such as Hungary and Italy, have

mentioned their intention to move to a more collective form of performance pay. Both career-based and position-based systems are showing some movement towards collective forms of performance pay.

2. Performance appraisal systems: highlighting the trends in the criteria and systems used

Performance appraisal is commonly based on job objectives. The process of performance management is usually an annual cycle, where the line manager identifies key objectives for the year with his/her employee(s), generally in line with organisational goals. After a period of time (the “appraisal period”), generally one year, the employee’s performance is assessed by their manager. The evaluation can be based on a detailed grid or list of criteria or can be much more informal. Where PRP is in place, this appraisal then becomes a key element in the performance pay decision.

Some countries also define the standard elements of a job which cover its more important areas of work and which are common to a particular range of managerial or non-managerial jobs. This is the case in Australia, the United Kingdom, and the United States, for instance. In the United States, they are referred to as “critical elements”. The proper development of performance assessment criteria requires this type of extensive job analyses for the family of jobs they are to cover. Standard elements of a job used to exist on their own as criteria for an employee’s performance appraisal, but they are now increasingly combined with job objectives for the performance assessment.

2.1. Increased use of performance appraisal based on job objectives

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

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

Objectives are usually set in a “top-down” manner, with government setting the priorities for ministries and government objectives being disseminated within each organisation and each level of organisation by top

managers and line managers. There are generally four main kinds of targets used in performance measurement. They include:

- Policy priorities directed to achieving long-term outcomes.
- Strategic goals, intermediate outcomes or high level outputs.
- Measures or standards of service quality, often as part of organisational performance agreements, or as stand alone performance contracts for individuals.
- Annual targets, including specification of outputs, processes, management targets (staffing, training, IT use), financial targets, efficiency and productivity targets, and possibly customer service targets.

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

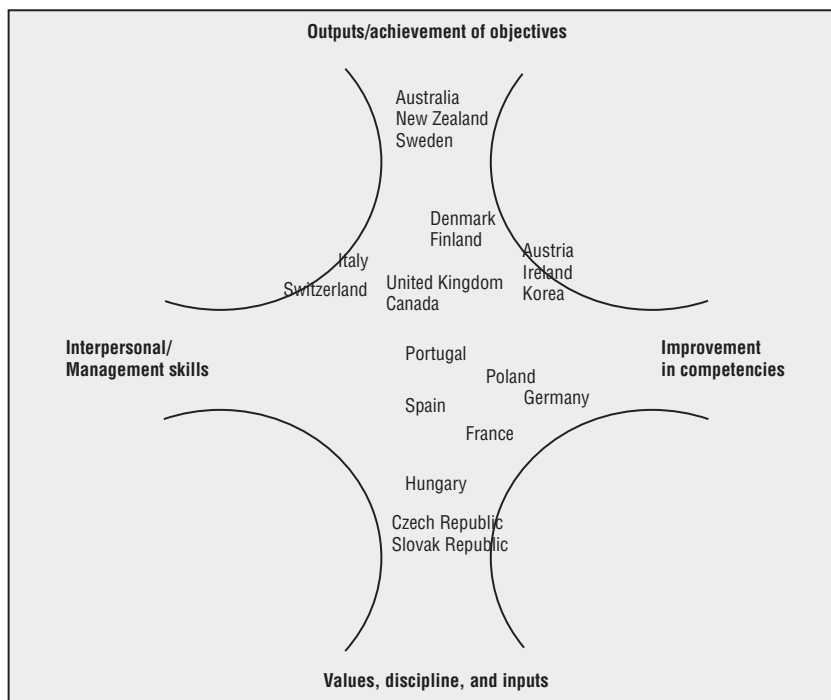
At the employee level, the identification of objectives is generally done through a discussion with the line manager, within the framework of organisational objectives. The degree of formality varies regarding the agreement of objectives – in most cases it is done in writing but sometimes it is done informally (in Sweden for instance). The discussion of the objectives can be the opportunity to assess the employee's development needs (e.g. training, career or mobility, support from the manager). In some countries, personnel organisations or unions have to sign the objectives, as in Denmark. The agreed job objectives then become the key criteria against which performance is appraised at the end of the appraisal period.¹

2.2. What are currently used performance criteria?

The objectives set are not the only performance criteria used. Overall, the most important criteria highlighted in country reports are the following: outputs² achieved which include the specified objectives described above; competencies and technical skills; interpersonal skills and teamwork; leadership and management skills; and inputs.³ Other criteria mentioned by individual countries include for instance ethics (Canada) and innovation (Denmark) (OECD, 2003e).

Figure 2.1 provides an indication of the criteria used for assessing the performance of government employees across OECD member countries. It is based on answers to an open question in the HRM Survey (OECD, 2002a; OECD, 2004) about the key criteria used for evaluation. Countries which use an

Figure 2.1. **Criteria for assessing performance across OECD member countries**



individual performance appraisal system without linking it to pay have also been included in the chart. On the vertical axis there is a distinction between inputs and outputs and on the horizontal axis there is a distinction between attention granted to formal competencies and interpersonal/managerial skills. These distinctions do not indicate a conflict between the two pairs of items, but is a method of presenting, in a graphic way, the overall trends of performance criteria per country.

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

Interpersonal skills have grown in importance with the spread of more flexible, team-based, working practices and the need to be more responsive to

individual citizens' requirements. Associated with these qualities are leadership and management skills. They have a special relevance to managerial staff, but with measures to devolve more decision-making and responsibility to lower levels, these skills also become more relevant to staff at more junior levels in the organisation.

Of course, the criteria described above are not immune from the assessment problems encountered by PRP based on outputs achieved. It is very hard for instance to measure competencies in the absence of formal certification as they are difficult to define in a way that is acceptable to both staff and management (Wolf, 1994). Relying simply on a manager's subjective judgement as to whether an employee has acquired a particular competence can be as problematic as deciding whether an employee has achieved a certain level of output. Hence, the common attachment to relying on the perceived objectivity of certified skills.

Box 2.5. Performance criteria and rating systems: country examples

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

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

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

Box 2.6. Performance agreement for senior civil servants in the United Kingdom

The annual performance agreement for senior civil servants contains both the following:

- Up to four key personal business objectives or targets which clearly reflect departmental priorities for the year ahead and define the in-year deliverables and the way in which performance against these targets will be measured. Objectives should as far as possible derive from published strategic or operational priorities, taking account of the department's Performance Partnership Agreement. They do not cover the whole job. Personal business objectives or targets should be stretching, tightly defined and SMART (Specific, Measurable, Agreed, Realistic and Time-related) with measures for achievement. Where targets extend beyond the appraisal year, appropriate in-year milestones should be devised. Objectives should anticipate foreseeable change. Amendments in-year should only be made in the event of significant shifts in business priorities.
- How the job is to be performed identifying the key competencies, standards and behaviours expected for the individual's current responsibilities in the year ahead, especially in relation to leadership and broader corporate objectives, including diversity. These should take into account the individual's development needs.

Source: United Kingdom, Senior Civil Service, *Guide to Performance Management and Reward in the SCS*, March 2004.

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

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

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

Ten years ago the priority was to develop quantifiable indicators. Today it is well-established theoretically, as well as being the everyday experience of

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

Performance can be more easily assessed for the extremes – the very good performers and the very bad ones. For the majority of staff, it is very difficult to differentiate between performance. This explains the limitations of highly detailed rating systems or scales, where most staff end up being rated in the same category. Given these inherent limitations, differing responses have been apparent from many civil services.

Many countries have moved to more flexible system of rating, where each ministry is responsible for developing its rating policy and more emphasis has been given to verbal assessment and qualitative methods. There has been a move to less detailed grids of rating, based on three points rather than on five, ten or 20 points.

Some countries have even suppressed the rigid grid of rating used for the evaluation. The United Kingdom, for example, has moved to a more informal system of rating for senior civil servants. There, the removal of explicit and numerical performance markings is seen as “a new departure” (OECD, 2002b).

Another response intended to prevent the lack of differentiation in ratings awarded has been the increasing use of quota systems, to specify the proportion of employees placed in the higher categories of the rating scale. This has occurred, for example, in Canada, Germany,⁴ Korea, many departments of the United Kingdom, and the United States.⁵

Forced ranking systems go even further as they specify the proportion of staff to be placed at each rating level. Such systems are based on the assumption that the actual distribution of performance outcomes matches the theoretical distribution which is being applied. This occurs in Switzerland where the Gauss curve has been used to develop the design of PRP.⁶ The rating distribution is controlled at central level.

2.4. Performance assessment as dialogue rather than control tool

The role of the line manager is enhanced in organisations which introduce PRP, because of their involvement in goal setting and in the assessment of the achievement of objectives after the appraisal period. A performance assessment is generally reported through an oral discussion with the line manager, and also in a written report. This is compulsory for instance in Canada, France, Hungary and Switzerland. In Sweden, the system is much

more informal and performance appraisal can be done through an oral discussion only. Generally evaluation occurs once a year – in some countries twice per year (e.g. Korea and New Zealand). In many cases informal discussion takes place during the year to prepare for the final appraisal. In Ireland, there are two reviews, an interim one and an annual one, to ensure that feedback is given at least twice a year. In the United Kingdom, there is a mid-year development review. In most countries employees have the right to question their appraisal and to submit the decision to unions or employee organisations.

The final evaluation discussion tends to be conducted along the lines of a dialogue rather than of a control tool. In this regard, there is a noticeable trend toward the so-called 360-degree feedback system where performance appraisal is made not only by superiors, but also by peers, and/or subordinates. Norway, for instance, has developed an interactive evaluation system, where the employee is required to assess himself before the performance dialogue – and to assess the manager.⁷ Two-thirds of OECD member countries have initiated a move in the direction of 360-degree feedback in assessing individual performance, in most cases still as a pilot experience (OECD, 2004). This is notably the case in Australia, Austria, Canada, Denmark, Finland, France, Germany,⁸ Korea, Mexico, New Zealand, Norway, Sweden, Switzerland, the United Kingdom and the United States (OECD, 2004). It is noticeable that these countries are almost the same as those which have introduced PRP.

3. Performance payments: form and size of payments

When there is a link between performance appraisal and pay, the link varies greatly across countries, with some countries developing a formal and detailed link between appraisal and pay, and others having no requirement to link performance pay awards to formal appraisal. When the link is formalised, there are different ways to determine the size of performance-related payments. The first is a simple scaling of awards based on performance rating levels. The second approach employs a matrix formula in which the size of the performance pay award is determined by both an employee's performance rating and his or her position in the salary range. Awards may be either stated as a fixed cash amount or calculated as a percentage of base salary.

3.1. Merit increments or lump-sum bonuses?

A key issue in the design of performance pay schemes is whether payments are to be in the form of merit increments (added to the base salary of the recipient and which becomes a permanent part of the basic pay) or lump-sum bonuses (one-off payments which are not consolidated into basic

pay, and have to be re-earned during each appraisal period). Both forms of performance payments may be expressed in either cash terms or as a percentage of the basic pay and they can be distributed independently of the level of salary.

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

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

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

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

Table 2.4 summarises the advantages and drawbacks attached to each form of payment and to the size of payments.

3.2. PRP: a small part of total salary

The size of payments across OECD member countries varies greatly, but overall the size of performance payments is generally a fairly modest percentage of the base salary, especially among non-managerial employees. Merit increments tend to be smaller than one-off bonuses, they are often below a maximum of 5% of the base salary. Merit increments vary from a maximum of 3% of the salary in the United States, to a maximum of 50% for top performers in Finland. PRP bonuses, which tend to supplement or replace merit increments, are in general higher than merit increments, due to their less significant impact on the long-term pay bill. The maximum size of bonuses can be as high as 40-50% of the base salary. However, these indicate the maximum

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

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

rewards that can be allocated. On the whole, “low powered” forms of PRP are used, with performance rewards being a fairly modest percentage of base salary, especially among non-managerial employees. Generally, maximum performance payments for government employees represent less than 10% of the base salary. For managers, the size of performance payments is bigger and represents, on average, 20% of the base salary.

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

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

Table 2.5. **Form and maximum size of individual PRP payments**

Merit increments		Bonuses
Australia		<ul style="list-style-type: none"> Departmental secretaries and executive agency heads are eligible for annual performance bonuses.
Canada	<ul style="list-style-type: none"> Progression of 5% per year, up to three years. 	<ul style="list-style-type: none"> 10-25% bonus lump sum.
Czech Republic	<ul style="list-style-type: none"> There are 12 pay grades, each containing five increments. 	<ul style="list-style-type: none"> Bonuses can be up to 100% for grades 9-12 and 40% for grades 1-8. Average bonuses are about 25% of take-home pay but each public institution will vary. The criteria by which these increases are determined do not have to be disclosed and they are granted at the discretion of the minister or organisation heads (OECD, 2003c).
Denmark	<ul style="list-style-type: none"> Decided at the local level by institutions/agencies. 	<ul style="list-style-type: none"> Not centrally determined.
Finland	<ul style="list-style-type: none"> The maximum merit increment (for ultra-performance) has been agreed at between 25% and 50% of the basic salary. The average of individual performance pay in relation to individual total pay varies between 13-20%, whereas the maximum varied between 30-50%. 	<ul style="list-style-type: none"> Bonuses comprise results based rewards (RBR) allocated on a team basis. The average amount of RBR was 1.7% in relation to individual pay in 2002. The range between the agencies was 1-8.3%.
France		<ul style="list-style-type: none"> Indemnities represent about 17% of the remuneration of civil servants, but this number varies greatly by ministry, sector and level of qualifications of staff. Senior civil servants receive higher bonuses than other categories of staff (about 40% of their remuneration depends on these bonuses). Indemnities are not included in basic salary. In 2004, France started experimenting with the introduction of PRP for top level civil servants (director's level) in six pilot ministries (Ministries of Finance, Defence, Interior, Equipment, Agriculture, Civil Service). PRP will be in the form of bonuses, up to a maximum of 20% of the base salary.
Germany	<ul style="list-style-type: none"> Merit increments are known as performance steps. The number of performance steps granted by the employer within one calendar year must not be awarded to more than 15% of the civil servants and military personnel in employment with this employer under remuneration scheme A, who have not yet reached the final basic salary. 	<ul style="list-style-type: none"> Performance bonuses and performance allowances for outstanding special services by civil servants and military personnel in pay grades under remuneration scheme A. Up to 15% of staff can receive these. Performance bonuses shall not exceed the initial base salary of the respective pay grade of the civil servant or member of the military. Performance allowances shall not exceed 7% of the initial basic salary.

Table 2.5. **Form and maximum size of individual PRP payments** (cont.)

	Merit increments	Bonuses
Hungary	<ul style="list-style-type: none"> • Merit increments of up to 20% of salary. 	
Ireland		<ul style="list-style-type: none"> • Bonuses for assistant secretaries of up to 20% of salary. The pool for performance-related awards for assistant secretaries is 10% of the pay bill for the grade on a service-wide basis, <i>i.e.</i> the cost limit applies to all assistant secretaries across departments and not on a departmental basis.
Italy		<ul style="list-style-type: none"> • Bonuses for senior managers. The annual performance-related pay cannot be less than 20% of the annual value of the award for the particular post, within the limits of available resources.
Korea	<ul style="list-style-type: none"> • Merit increments are added to the annual salary of a higher level government employee and linked to his/her performance ratings. Up to 7% of the performance standard amount (nearly the equivalent of half of an annual salary) for those rated excellent. 	<ul style="list-style-type: none"> • Bonuses are paid to government employees annually and designed for mid- and lower level employees. Lump sum bonuses vary in size from 100% to 40% of the monthly base salary per year. • Performance bonuses can be provided in various ways: on an individual basis, on a departmental basis, and on a combination of individual or departmental bases.
Netherlands	<ul style="list-style-type: none"> • Unsatisfactory performers will not receive an annual salary increase. Staff members deemed to be more than satisfactory performers may be considered for an additional increment. A salary from the next scale may be awarded for excellent performance by a staff member who has reached the top of his/her current scale. 	<ul style="list-style-type: none"> • Year-end bonus (one-off supplements). It is not possible to indicate the range because such payments are not regulated or capped. The average award in 2000 was € 1 120.60.
New Zealand	<ul style="list-style-type: none"> • Merit increments (decided by individual departments within the pay range set out in voluntary agreements). 	<ul style="list-style-type: none"> • Bonuses (decided by individual departments).
Slovak Republic		<ul style="list-style-type: none"> • Personal bonus for extraordinary results: 30-70% of the salary of the highest salary category of the salary class within which the civil servant is paid.
Spain		<ul style="list-style-type: none"> • Productivity bonus at the individual or team level. In 2000, the productivity bonus cost represented approximately 9.7% of staff remuneration as a whole. • In the Spanish social security civil service, the productivity bonus represents on average 22.1% of the salary.

Table 2.5. **Form and maximum size of individual PRP payments** (cont.)

	Merit increments	Bonuses
Sweden	<ul style="list-style-type: none"> Under the individual salary systems, each official gets the general wage increase but there is no guarantee of a merit increase. Each individual is placed within a salary range and movement within that range is based on performance assessments. Each individual discusses pay raise and performance with the nearest manager/supervisor and, generally after local negotiations, gets an annual raise according to an evaluation of the performance and contribution during the past year. The local negotiations could set frameworks for groups of professions, departments, etc., but this is not an obligation. 	<ul style="list-style-type: none"> Less than 10% of agencies use bonus payments, but where applicable, bonus payments are more directly linked to efficiency measures and cost savings.
Switzerland	<ul style="list-style-type: none"> Merit increments: from 4.1-6% for outstanding performance (ranked A++). Increase of 3% if assessment is A (good performance). 	<ul style="list-style-type: none"> Bonuses: can reach 12% of salary for outstanding performance. If bad performance, no bonus and after two years decrease of the salary to 94% in the range of salary.
United Kingdom	<ul style="list-style-type: none"> Merit increments. 	<ul style="list-style-type: none"> Non-consolidated bonuses – now being used as one of the main vehicles for delivering performance-related pay to those staff performing above a satisfactory level. Bonus levels vary in different organisations and can be substantial in some and much less substantial in others.
United States	<ul style="list-style-type: none"> In the General Schedule base pay system, an agency may advance an employee who meets a high performance bar – outstanding performance – to the next step of a grade (approximately a 3% increase). Merit increments are based on the manager's annual performance rating and current position in the pay range. A full merit increment is equal to approximately 3% of the average pay rate for that grade. Managers who are rated "unacceptable" receive no general increase. 	<ul style="list-style-type: none"> An agency may grant a cash performance bonus for above-average performance. These bonuses are typically 1-2% of salary. Funding for both the Quality Step Increases (QSIs) and bonuses is provided out of the regular budget for salaries and expenses. This scheme applies to about one million employees. Cash bonuses of up to 10% of base pay can also be paid to managers. In the case of unusually outstanding performance, a department head may pay an individual a larger bonus, but not more than 20% of base pay.

4. Conclusions

PRP schemes have been increasingly adopted and have also been formally extended to all categories of staff (though not to all staff yet in practice), in most OECD member countries, in the past decade. There has been some increase in the use of collective or group performance schemes, at the team/unit or organisational level.

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

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

Performance rating systems are less standardised, less formalised and less detailed than ten years ago. They tend to rely more on dialogue with line management than on strictly quantifiable indicators. They also seek to distinguish only the very good performers instead of different levels of performers. Quotas systems of ratings, as an alternative way of doing this, are becoming more widespread across OECD member countries. In practice, they tend to counteract the trend to less formality,

The size of performance payments varies greatly, but overall maximum size of performance payments are below 10% of the base salary for employees. For managers, the size is bigger and can reach 20% of the base salary. Bonuses are tending to supplement and even replace merit increments.

Notes

1. Locke, Edwin A. and Latham, Gary P. (2002), "Building a practically useful theory of goal setting and task motivation: a 35-year odyssey". *American Psychologist*, 57: 9, Sept., pp. 705-717.
2. Outputs: see the definition in the glossary on page 19.
3. Inputs: see the definition in the glossary on page 19.
4. In Germany, the limit on the proportion of staff who can receive performance pay (15% of staff) is considered de-motivating.
5. In the United States, no more than 1% of the career SES may receive a distinguished executive award each year; no more than 5% of the career SES may receive a meritorious executive award each year.

6. The 2002 rankings were: maxima of 5% of staff to be rated A ++, 25% of staff to be rated A+, 65-75% of staff to be rated A, 5-15% to be rated B and 3% of staff to be rated C.
7. The employee is supposed to evaluate himself and his manager in several ways. Usually there is a formula that can be filled in, one about the employee himself and one for how the employee evaluates the manager.
8. In the Federal Ministry of Interior.

PART I
Chapter 3

**Implementation and Impact of PRP:
Lessons to be Learned**

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

1. Introduction

Few organisations have conducted systematic evaluations of the impact of PRP policies. This is due partly to the difficulty of measuring performance outcomes in the public sector and possibly also because of concerns that negative results may compromise management's position in pay negotiations. Even in the private sector, where quantitative evaluation of performance is easier, there are few studies on the impact of performance-related pay policies. The material upon which the evaluation in this chapter is based, is on the research referred to earlier in this report. .

2. Design and implementation issues: lessons to be learned

2.1. Towards an improved design of PRP schemes

Appropriate design of performance pay schemes requires consultation with staff and this is strongly recommended. A common problem occurs where the design of the scheme is "top-down": that is, based on information from managers alone. This can result in essential information from staff about their work and their attitudes to it, not being taken into consideration in preparing a PRP scheme. This approach can adversely affect how well a PRP policy works as well as set the scene for staff to resist it. Besides, procedural justice theory predicts that staff are more likely to accept changes, even those which are disadvantageous to them, if they feel they have been able to express their views about their work and any proposed changes, and consider that these views have been taken into account fairly. Adequate consultation can help tackle both these potential problems.

It is important to base the design of a scheme at least partially on goal setting – rather than on standard criteria for the job. Goal setting implies a dialogue between line management and employees and greater involvement of staff in the management. The goal setting aspect of PRP is the key element that – in the right managerial framework – can ultimately lead to an improvement in performance as will be further explained.

Developing a simple performance appraisal framework, with no detailed differentiation in the ratings for “average” performers is advisable.¹ Highly detailed and inflexible performance criteria and rating frameworks, though they can be reassuring to managers and managed alike, are often detrimental to the smooth running of a PRP scheme. The lack of discrimination between excellent and average performers in ratings, was reported as one of the major limitations of PRP schemes used in the 1980s. For example, in most PRP schemes in use in the 1980s, more than 95% of managers were rated as “fully satisfactory or better” (OECD, 1993). In the United States, surveys from the 1990s have concluded that the five-level summary rating was too rigid, too complex and demotivated staff, as “better performance [did] not lead to more pay” for top performers as opposed to “average” ones, as they were effectively lumped together.

There are two main reasons for discouraging a detailed performance appraisal and rating framework. Firstly, listing performance criteria cannot cover all the factors affecting performance and may have the perverse effect of encouraging employees to focus on the performance criteria set out as “creditworthy”. Secondly, it is much easier to evaluate extremes of performance (excellent or poor) than the performance of the majority of employees who are working satisfactorily, however complex and formal the performance criteria devised are. It has been increasingly felt that detailed criteria have led to an inappropriate focus on the process of performance evaluation rather than on what the evaluation was meant to achieve in terms of improved performance. The focus should be on the distinction between the average majority and the very good and the bad performers.

Considering the limitations of highly detailed rating systems, there has been a move towards more flexible and less detailed criteria. Another type of response to the lack of differentiation was to move to the use of quotas. Quotas provide the twofold advantage of focusing on good performers and of facilitating the budgetary control of a PRP scheme. The introduction of quotas is an acknowledgement of the difficulty of differentiating between individuals’ performance and a way of formally insisting it take place.

However, quotas introduce rigidity into a system which is trying to move away from that constraint, and it can undermine employees’ confidence that good performance will be rewarded. Quotas are disliked by employees as

arbitrary limits on performance grading that take no account of actual performance. This is especially highlighted by the case of Germany, which has been using quotas and is trying to move away from them. Moreover, quotas involving forced ranking affecting all employees do not make differentiation between staff easier. Some managers, when compelled to undertake forced ranking, rotate the good ratings amongst their staff. In Switzerland, the strict application of the “Gauss curve”² is seen as one of the major problems in operating the PRP scheme there, as it creates a rigid system where line managers are forced to differentiate amongst staff, even in small teams of three or four people.

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

The type of financial incentive selected will also have an effect on the impact of PRP policies. It is advisable that merit increments do not become automatic allowances. This potential distortion has prompted a number of countries to prefer a bonus system to a merit increment one. As Denmark mentioned in one of its answers to the HRM Survey, the bonus should be paid only for exceptional and improved results. The inherent risk of automatically paid bonuses for ordinary results may undermine the intention of introducing performance-related pay. To avoid this risk, PRP policy should be based on goal setting rather than on standard criteria for a job. Indeed, setting clear job objectives prevents automatisisation of performance assessment.

To a lesser extent, the size of the financial incentive also plays a role in the impact of PRP. Evidence from attitude surveys, notably from the CEP surveys, suggests that many staff are not motivated to work harder by their performance-related pay (this issue is addressed in detail in Section 3.2.1). Partly, this is because they consider the current size of payments to be too small to create an incentive. In contrast, awards for managers have tended to be larger, and it is possible that their larger awards account for the greater

success of PRP in managerial grades. However, increasing performance rewards is subject to two caveats. First, it is often easier to identify the individual contribution of managers than it is to identify that of individual non-managerial employees. The second caveat is that greater rewards may bring greater tensions in the workplace around the operation of a PRP scheme.

There is no “ideal” size for a performance payment. PRP must remain a limited part of the salary as the base salary has the more decisive incentive impact. PRP should not be introduced to the detriment of the base salary. On the other hand, performance rewards must not be too limited – and should be well above the level of inflation. In his report, Makinson suggested that rewards be a minimum of 5% of the base salary (Makinson, 2000). Basically, a choice has to be made between distributing higher payments to a small number of staff (as was the case for American nurses and British teachers) or distributing low rewards to a high number of staff. Both options have their advantages and drawbacks (see Chapter 2, Table 2.4). It is worth noting that distributing lower payments to a high number of staff might facilitate the use of PRP as a lever for organisational or management change and that this may, in fact, be the most important impact of introducing PRP (see Section 3.2.3). The money involved in awards is not necessarily a great incentive in itself but it can validate change.

2.2. Implementation issues

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

All PRP schemes involve both “winners” and “losers” and are known by staff to do so. So it is particularly important to make clear that only a small number of employees – the poor performers – will be adversely affected by the new policy.

It is important to define the budget policy prior to the introduction of a performance pay scheme as the financial costs of PRP are often underestimated, thus undermining its effective implementation. In the United States for instance, it is thought that the lack of appropriate funding is the reason for the limited use of PRP: “funds have simply not been available” (Risher, 2004). If PRP is not adequately funded, the disappointed expectations of employees who have been promised money for improved performance and then find it is funded by means of smaller increases in base pay, must be anticipated – together with the likely de-motivating effects. Implementing and administering a PRP policy is costly. Where evaluations have been conducted

in various civil service organisations, they suggest that the cost of PRP can be between 1-5% of the total pay bill.

A requirement that performance-related pay should be cost-neutral may be imposed. This can be achieved by, for example, replacing seniority increments with those linked to performance, or through decreasing the salaries of the worst performing staff. For instance in Switzerland, for a public employee rated B (partially satisfies requirements), the wage is reduced to 94% of the pay band ceiling after a two-year period.

In theory, it is also arguable that increases in salary costs produced by PRP schemes can be funded by increased productivity, as happens in some industries in the private sector. However, it is very difficult to measure productivity in the public service. A number of countries have experimented with sharing cost savings with employees, thereby creating an incentive for efficiency improvements. In Finland, it is required that one-third of any improvement in results should be devoted to staff rewards – under the form of “results-based rewards”.

Linked to the above, is the need to make adequate provision to meet the management costs of PRP which are significant. The time-consuming nature of the work needed to implement performance pay is often underestimated. Time is required to plan, introduce and run the scheme, for example undertaking

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

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

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

Source: Survey conducted in 2001 by the Ministry of Finance, State Employer's Authority and the Danish Federation of State Employees' Organisations.

staff appraisals and, critically, training managers in its operation. A survey from Denmark conducted in 2001 on the effects of PRP, indicates that 56% of union representatives and 70% of managers stated that the most negative effect of PRP was that there was “too much administration related to it”.³ Reviewing its operation regularly is also an added essential cost.

2.3. Management of the PRP policy: objective setting

Setting individual objectives for employees is not an easy task, and if the process is not conducted properly it may lessen any potential positive impact of the PRP policy. The key lesson from the United Kingdom experience for non-managerial employees, is that the main benefits arise from the way performance management enables managers to set goals in agreement with staff, and then evaluate performance against those goals. Some of the usual weaknesses of the objective setting process are described in Box 3.2.

Box 3.2. Common weaknesses of the objective setting process

- *Soft objectives*: a tendency to focus on things that can be easily specified (inputs, processes).
- *Unreadable objectives*: setting complex objectives or unrealistic ones.
- *Unchallenging objectives*: to make sure that they are reached, targets are set which are too easy to meet.
- *Checklist mentality*: setting too many objectives, without capturing the heart of the work.
- *Outdated objectives*: there is a balance to be met between stability and a need to update targets.
- *Objective proliferation*: tendency to keep adding new objectives and indicators over time. It may reflect lack of strategic focus in the contracting process, or a desire to use a large number of objectives as a way to compensate for a poorly functioning incentive system.
- *Information overload*: lack of measurement tools or capacity to deal with or make use of all the information generated through performance measurement activities.
- *Lack of follow-up*: there is a need to ensure adequate follow-up in measuring and evaluating objectives.
- *Inflexible management*: situations arise that cannot be foreseen, where objective setting alone is insufficient to ensure performance. Achieving the required outcomes must be supported by dialogue and ongoing performance management by adaptable managers.
- *Failure of horizontal co-ordination*: while objectives setting may increase vertical co-ordination, it may discourage staff from contributing to corporate issues across work areas (incentives/specification).

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

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

Whether PRP will have a positive impact on staff is strongly related to how well the appraisal process is carried out. It appears more influential than the financial rewards on offer in motivating staff, if done appropriately. The key problem is the difficulty in differentiating between the relative performance of employees, due to inadequately designed performance criteria. This results in problems distinguishing excellent staff from the adequate. The second is the reluctance of line managers to differentiate between their staff succumbing, for example, to pressure from them to be lenient with work assignments and over-generous with performance rewards. To attenuate the problems linked to performance evaluation, it is crucial to base performance appraisal on individual or team targets rather than on standard criteria for a job or comparative performance.

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

2.4. Managerial and contractual problems

Certain preconditions are essential before introducing a performance-oriented culture, pay related or otherwise, without which implementing performance management will run into serious problems. These preconditions are: transparency within the organisation, clear promotion mechanisms and trust in top and middle management. In addition, sufficient

Box 3.3. The case of France: the conclusions of the committee of enquiry into the cost and efficiency of public services (April 2004)

In April 2004 the Committee of Enquiry into the Cost and Efficiency of Public Services – a body connected to the Audit Office and attached to the Office of the Prime Minister – published a report reviewing the state of the bonus policy applied in the civil service and proposing specific reforms aimed at taking merit more fully into account in awarding these.

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

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

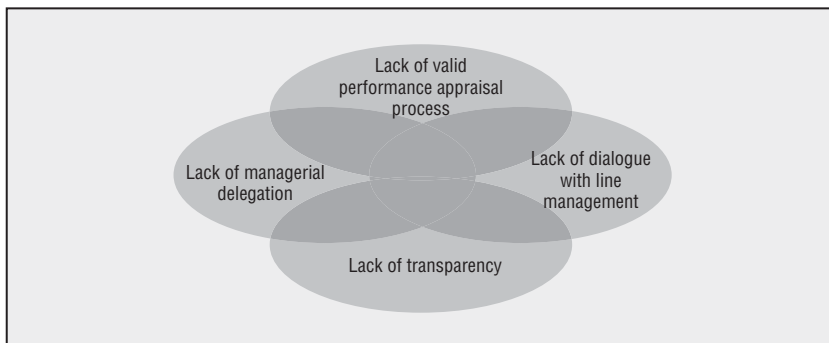
The report recommends strengthening the “appraisal” aspect above all. “An indisputable appraisal system is a vital prerequisite for the acceptance of any [pay] adjustment.” The report therefore suggests that both managers and staff be trained in appraisal techniques. It also pleads for more transparency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

delegation of responsibility for the management of human resources and, in particular, in relation to staff performance appraisal policies should have occurred.

It is absolutely crucial to have a well-defined performance appraisal process along the lines outlined above, based on well identified objectives or criteria, before introducing any link between performance and pay.

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

Figure 3.1. The four missing components for an effective performance appraisal process



Box 3.4. The introduction of PRP in developing countries

A temptation in transitional or developing countries can be to develop performance pay in order to boost public sector performance in a rapid way – or to potentially reduce the size of base salaries. Certain transitional countries have instituted PRP as a large proportion of the base salary – more than 50% or 60% in some cases. Such policies are counterproductive in an inadequate management framework. PRP may, in such situations, increase problems linked to trust and lead to corruption and patronage. It may also lead to widespread dissatisfaction among staff and discourage competent employees from entering the public sector. In addition, where the level of political appointments is high, procedural justice mechanisms may be harder to set. When such mechanisms are limited, the de-motivating impact of performance pay is increased.

2.5. Specific recommendations on the design and operation of performance pay schemes

The following recommendations are made:

- Consult unions/employees' organisations from early on in the preparation of a PRP policy and involve them in its implementation and operation, to ensure that the purpose of the scheme and how it is functioning, is communicated to them.
- Develop a simple performance appraisal framework, with no detailed differentiation of ratings for "average" performers. The focus should be on the distinction between the very good and the poor performers.

- The PRP policy should be based above all on a solid objective setting process. A small number of realistic but not too modest performance objectives should be set. Individual and organisational objectives should be linked. For it to be successful, the introduction of PRP has to be closely aligned to a performance management framework that clearly sets out planned goals, objectives and standards, using a combination of both qualitative and quantitative measures.
- Consider introducing a collective or team-based PRP system or a combination of this and an individual scheme, at the employees' level.
- Careful consideration should be given to both the type of performance awards made (merit increments or bonuses) and their size. It is important to ensure that performance payments do not become automatic annual payment.
- Define the budget policy prior the introduction of PRP and do realistic estimates of its likely costs. Be prepared to devote sufficient management resources to running the system.
- The performance appraisal process is at the heart of the whole system. Seek to ensure that the performance appraisal process is transparent and focused on dialogue with staff, providing them with clear feedback as well as the opportunity to have its results reviewed.
- Ensure line managers are thoroughly involved in the design, implementation and evaluation of PRP system and that performance appraisal is undertaken by the nearest management level. This is because line managers are the key players in the system. Whilst human resources units control the overall running of the PRP scheme, line managers are in charge of the system on a "day-to-day" basis. It is also advised that the management of performance should be reflected in the evaluation of each manager's performance.
- The performance assessment should be based on employee/line manager dialogue, be transparent and rely on well-established procedural justice mechanisms. The feedback on the appraisal should be detailed and clearly explained.

3. The impact of PRP: incentive for change?

3.1. PRP and its operation as an incentive

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

Improved staff motivation was one of the main reasons for introducing PRP, yet most country reports do not mention it as one of the positive achievements of such schemes once up and running. This is consistent with most of the academic research conducted on PRP. Nearly all of the United Kingdom research on employee attitudes⁴ using self-reports of the factors which motivate them, indicate that only a small minority of staff are positively motivated by their PRP scheme.

Research conducted by the CEP in the United Kingdom provides an example of the attitudinal surveys conducted about PRP. It conducted major staff attitudes surveys in the United Kingdom on PRP in 1998 in the National Health Service, in secondary schools and in the Inland Revenue (Marsden, 1998; Marsden, 2004). Overall, despite broad support for the principle of linking pay to performance, only a small percentage of employees thought their existing performance pay schemes provided them with an incentive to work beyond job requirements or to show greater initiative (32% in the NHS, 18% of staff in the Inland Revenue, and 8% of school staff considered PRP was an incentive to work beyond job requirements). Of even more concern to top public management, was the evidence that the performance pay schemes in place were seen by staff to be divisive and to undermine co-operation among staff (86% of staff in the Inland Revenue, 61% in the NHS and 58% in schools). However, a quite substantial minority of line managers reported that PRP had caused many of the staff to work harder (52% in the NHS, 42% of managers in the Inland Revenue and 28% in the Employment Service) and considered that PRP had increased the quantity of work done. Thus for managers in the United Kingdom public service, the picture on motivation has been less negative than for non-managerial employees. In the United States, a 2002 survey by the Office of Personnel Management found that many federal workers are unhappy with the bonus system. Only 47% of workers said awards depended on how well employees did their jobs. Less than a third said their organisation's award programme gave them an incentive to perform their best.

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

How can this limited impact on staff motivation be explained? It seems that while base pay according to the "market" is important, additional

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

Box 3.5. Impact of PRP in the private sector: the example of a survey of PRP in 5 000 private organisations in the United Kingdom

In February 1998, the Institute of Personnel and Development (IPD) – the body which represents personnel professionals – published the results of a PRP survey of 5 000 organisations in the United Kingdom (“Performance Pay Survey”, IPD, 1998). One of the primary reasons for the use of PRP schemes is that they are thought to motivate staff, yet only 21% of organisations in the IPD survey said that these schemes have a positive impact on the behaviour of “high performers”, and only 4% thought that they had a positive impact on the more average performer.

Nevertheless, the majority of employers feel that PRP does have an overall impact on employee performance (74%) by encouraging employees to focus on organisational objectives. Many also feel that they can deliver a clearer message about the importance of organisational performance (69%).

Source: 1998 Institute of Personnel and Development (IPD) survey, www.euro.eurofound.eu.int/.

3.2. PRP and its operation as a catalyst for management and organisational changes

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

3.2.1. PRP: an opportunity for introducing or reinforcing the goal setting policy

Performance pay creates an incentive for management to introduce an effective “goal setting” approach, at the individual or team levels. Of course, it is possible to use the goal setting element of performance management without a specific link to pay. However, it seems that the link with money can be a key incentive to fully endorse a goal setting approach (Marsden, 2004). Evidence from the CEP, as well as from OECD country reports, indicates that introducing PRP works to validate goal setting in a positive way, at both managerial and non-managerial levels, independently of any motivational effect due to the anticipation of increase in pay.

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

Performance pay gives managers an added incentive to manage effectively, so as to achieve their own and their employees’ goals. PRP is an indirect way of empowering managers: if this is not the case there is little justification for the move to pay for performance. Goal setting and appraisal provide the motivation for the kind of one-to-one contact between employees and their line-managers in which the manner of working can be discussed and explained. To do this, dialogue with staff is crucial. It allows staff to be more involved in management issues. For example, a comment from the Swiss country report was that “PRP allows discussion between staff and management. In fact, staff is as much involved in personnel questions as is management”. At the individual or unit level, goal setting works well when accompanied by more interaction between manager and staff member so that any reduction of formal controls is substituted by informal control.

Box 3.6. **The impact of performance pay: the case of Statistics Finland**

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

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

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

Another level at which the performance appraisal element of PRP has emerged as critical lies in the scope it offers to link broader organisational objectives to those of individual employees. Extending goal setting to all levels of an organisation allows a reinforcement of strategic management.

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

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

In addition to its role in strengthening goal setting, PRP can act as a window of opportunity for the introduction of significant managerial changes. This is especially true for service delivery in public services – tax, social security, hospitals – where work organisation can be more directly linked to outputs or citizen demands than core administration. But it can also be true for the core civil service.

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

PRP can be used as a lever for the introduction of more flexible working methods.⁵ For instance, in one of the hospitals studied in the CEP analysis, management wanted to move away from covering extended working after normal hours and at weekends by means of overtime and weekend premium payments. It wanted a system which could require staff to work more flexible hours without the budgetary implications of the premia mentioned above, so it could provide cover in a more patient-centered way. In exchange, it rewarded agreement to such changes with a higher basic salary and performance pay.

PRP can also be a way for service-delivery agencies to move to a more customer-oriented way of working. In the Inland Revenue, one of the goals of the PRP scheme introduced in 1993-94 was to move away from defining job performance by a set of standards designed for a class of job, and move towards individualised objectives that were agreed between line managers and employees. The latter could be more easily adapted both to the abilities of individual employees, and to the varied needs of the different parts of the tax service. In both examples, there is a degree of working more efficiently, but also a significant element of working more intensively when patients' or tax-payers' needs required this. In doing so, public employees have become more exposed to the uncertain timing of citizens' demands, and have less control over their pace and manner of work. Even where such changes are agreed with unions, management has still to make the deal stick on the shop and office floor. A well-designed PRP scheme can assist in doing this.

The introduction of PRP can be used as a way to encourage team working – through collective bonuses or credit given for co-operation in the

performance appraisal. For instance, encouraging different health professions to work together in “care teams” has been one of the ideas that health service management have sought to promote by means of team working, supported by performance pay.

PRP can be the occasion to reform or strengthen the information and communication technology policy (ICT). Many countries have mentioned that the introduction of PRP was the occasion to reinforce the ICT focus in government agencies. It is a kind of bargain: in exchange for better working tools (improved ICT), a performance element in the remuneration is introduced. In Spain for instance, the introduction of PRP in the social security administration was accompanied by a considerable investment in ICT.

Performance-related pay can provide the opportunity to focus on training policies, in order to reward efforts staff make at personal development. This is particularly noticeable in Scandinavian countries, as it is one of the key objectives followed by the PRP schemes in these countries. In a staff survey conducted in Denmark in 2001, 48% of union representatives and 33% of managers stated that PRP gives more responsibility to the individual employee for the development of their own skills. In Hungary, too “an extensive training programme was launched within the realm of the public administration” as a corollary of PRP.

Box 3.7. The impact of PRP: the example of Finland

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

Source: OECD, 2003e, Country Reports on Performance-related Pay (Finland).

3.2.3. PRP and recruitment

It appears that PRP can act as a recruitment incentive. It does this by attracting a different type of person to the public service, those – possibly the more dynamic – who feel they will obtain the better pay available in a more

competitive pay environment. In this way, PRP can encourage a different attitude towards innovation and risk-taking by recruiting staff with a positive attitude towards such issues in the work environment. This positive effect on recruitment was mentioned by Denmark, Finland and Sweden in particular. In Denmark, for 57% of managers and 48% of union representatives, PRP leads to better opportunities for recruitment.

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

3.3. Are team performance-related pay systems effective?

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

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

The United Kingdom moved in 2003-2004 to a more collective approach to performance pay. Interestingly, an interim report⁶ has been conducted on the effects of the first year of the team-based bonus scheme at the United Kingdom Department of Work and Pensions.⁷ The statistical approach taken examines the effect of the scheme by comparing the performance of offices with team PRP with those without team PRP, and netting out factors that may affect performance over and above the impact of the scheme (differences in staffing, labour market conditions, seasonal factors). Interim results have

Box 3.8. Impact of the collective PRP system in the National Institute of Social Security in Spain

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

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

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

found that the scheme had a significantly positive effect on job entries: on average, the effect is of the order of an increase of 11.1%; this effect is smaller in larger offices, and is smaller in districts with many offices. Analysis of behaviour against targets in one region shows some evidence that teams try to hit their targets exactly. These preliminary results have encouraged the British government to continue developing collective PRP systems.

4. Conclusions

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

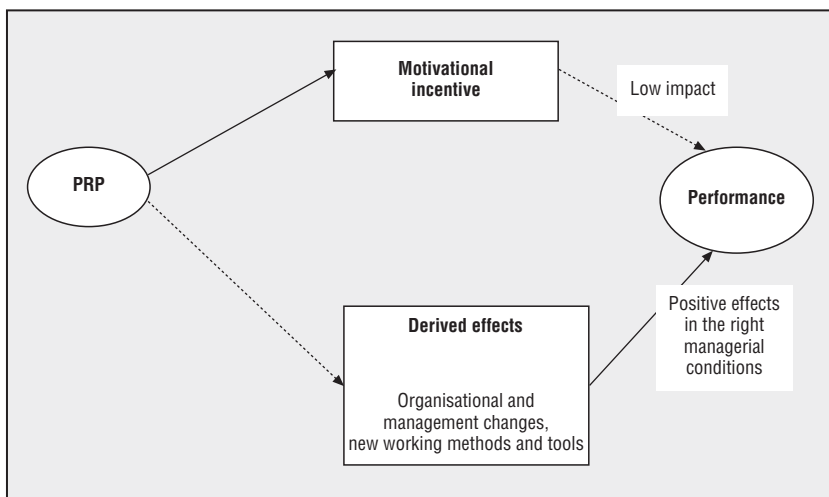
Inadequate infrastructure for performance management (for example, lack of transparency, trust or managerial delegation within an organisation) is a serious obstacle to PRP.

The impact of the financial incentives of PRP appears to be limited and other incentives are more influential in motivating employees, such as satisfactory job content and career development. The significance of PRP has often been over estimated.

However, the processes accompanying PRP have produced positive results, as an impetus to improved goal setting, organisational culture change and management innovation, and thereby to improved performance. Objective setting has to be the centrepiece of the PRP system.

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

Figure 3.2. **The overall impact of performance-related pay on performance**



Recommendations

- **The design of PRP is a trade-off** between various options which have to take into account the background culture of each organisation/country. There is no “best” solution. When designing new schemes, management should consider what will prove acceptable to large numbers of the staff in its organisations. Management should seriously consider team/unit PRP systems for employees, which can be introduced in a less disruptive way and appear to be able to produce more positive results than strictly individualised PRP. The balance of individual and team PRP is a key design issue.
- **The performance appraisal process is at the heart of the whole system.** It is recommended to base performance appraisal on goal setting rather than on standard criteria for a job. Performance rating should not be too detailed and should avoid rigidity. Performance appraisal should act as a basis for ongoing dialogue throughout the year between the manager and the employee. Feedback on the appraisal should be explained and detailed. Transparency in the whole process is the key factor of success. The success or PRP ultimately relies more on the effective measurement of performance process than on the distribution of payment.
- **Implementation problems need to be anticipated.** This implies primarily coordination with staff and unions on the implementation of PRP, the preparation of top and line management, clear anticipation of the budget and costs linked to PRP and of the ways to fund PRP; and of the time and work that the introduction and monitoring of the system requires.
- **Performance pay goes hand in hand with human resources management delegation.** Some delegation of human resources and pay management is crucial for the effective implementation of performance pay. This is because of the close link between goal setting and performance pay. The more successful schemes appear to rely upon a close integration between these two functions, in contrast to more traditional models which tended to award PRP against standardised performance criteria. It is easier to articulate individual employees’ objectives and those of their organisation in a meaningful way if the local management has a degree of autonomy to adapt the scheme to its own needs.
- **Evaluations need to be conducted regularly** and a PRP system needs to be revised from time to time.
- **The significance and impact of PRP should not be overestimated.** PRP is of secondary importance as a managerial tool for improving motivation. Criteria such as satisfying job content, promotion possibilities or flexibility in work organisation come far ahead of performance pay in motivating for staff. The evidence points, therefore, to the need for a broad approach to better performance management as against a narrow preoccupation with performance related compensation.

Recommendations (cont.)

- **PRP should be applied in an environment that maintains and supports a trust-based work relationship.** In such an environment there is a balance between formal and informal processes, with on-going dialogue, information sharing, negotiation, mutual respect, and transparency being prioritised. It is also suggested that PRP requires a mature and well-established civil service culture and a stable political and policy environment.
- **PRP should be used, above all, as a stimulus and a lever for the introduction of wider management and organisational change,** rather than solely as a motivational tool for staff. Pay for performance should be viewed essentially as a management tool. The objectives of PRP should be set accordingly.

Notes

1. Not that it is easy to get even simple performance appraisal criteria right. But detailed criteria have been criticised as being: too focused on targets which can be easily specified such as inputs or processes; too easy to be achieved or too complex; too numerous and lacking in focus; not regularly updated or else added on an *ad hoc* basis without clear consideration of their overall purpose (indicative of a poorly functioning scheme); and generating too much information to be effectively processed. All of which can lead to disenchantment with a scheme.
2. See Chapter 2.2.3. for a description of the Gauss curve – also called the “normal distribution”.
3. Please refer to the case study on Denmark in part II of the book for more information on this survey.
4. Most of the research on motivation has been undertaken in the United Kingdom, and to a lesser extent in the United States. Although there is a considerable body of research which suggests that performance incentives can raise employee performance, as reviewed by Prendergast, much of it focuses on occupational groups for which individual output is relatively easily determined, and by objective measures. Examples include sales staff paid on commission, CEOs, and professional sports players.
5. A good example of this process, from another domain, has been the reduction of working time in France where many large firms have been able to use this as the carrot to trigger negotiations over new, more flexible, working practices.
6. HM Treasury, HM Customs and Excise and the Department of Work and Pensions are jointly sponsoring research into the impact of the Makinson team-based bonus trials (Makinson, 2000) in the major service delivery departments. This research will be complete in April 2005.
7. See the case study on performance-related pay in the UK Department of Work and Pensions in part II of the book.

Conclusion

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

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

The impact of PRP on staff motivation is rather limited, and PRP will never replace a good comprehensive performance management strategy. However, in the right managerial conditions, when PRP is introduced, a window of opportunity for wider management and organisational changes occurs. In implementing PRP based on effective appraisal and goal setting, organisational and cultural changes such as increased employee-manager dialogue, more team work and greater flexibility in the approach to work are set in train. PRP can be the driving force that allows these changes to occur and, at the same time, to enable the renegotiation of the culture at the workplace, leading to an increased focus on getting the job done and thereby to improved performance. Pay for performance should be viewed as a management tool that enables a systematic management by objectives process, and an articulation between individual and organisational objectives.

The transition to performance pay systems is not easy, as it implies much deeper changes in organisational and cultural values. However, if there are numerous difficulties and obstacles, one should not over estimate the effects of the old system – pay based on age scale. Performance-related pay, when implemented in a sound management framework, and as part of a wider performance management strategy, is likely to better serve the needs of government and to better enhance individual and collective performance than pay based on age scale.

It is also apparent from the research that there has been an increase in the use of collective PRP systems for employees during recent years. They

appear to constitute a viable alternative to individual PRP schemes, as they seem to harness the motivation generated by team work. Their full potential needs to be explored further, as preliminary research indicates that they have beneficial effects upon performance. The balance of individual and team PRP is a key design issue.

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

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PART II
Chapter 4

Country Case Studies

Performance-related Pay in Canada

1. General information

- Pay increments based on formal appraisals of performance and competence rather than automatic progression were first introduced in 1964. This original scheme, the Senior Officers Pay Regulations (1964-1967) evolved into the Management Category Salary Administration Plan.
- In 1998, the Performance Management Program for Executives and a separate programme for deputy ministers were introduced as a means to aid in the recruitment and retention of top talent in the public service.
- The goals of the current Performance Management Program are:
 - ❖ to encourage excellent performance by recognising and rewarding the achievement of results that are linked to business plans and government objectives and the demonstration of leadership competencies, values and ethics; and,
 - ❖ to provide a framework within which a consistent and equitable approach to performance management can be applied.
- The salary range consists of a minimum and a maximum rate of pay, and individuals progress through the range by a series of variable increases related to their assessed level of performance. Individuals are also eligible to earn a variable lump-sum payment based on their achievements against pre-determined objectives.
- Compensation for executives and deputy ministers, including variable lump-sum payments, is benchmarked against the private sector for comparable positions.

2. Reasons for introducing PRP policy

- PRP was introduced to enhance senior management performance, accountability and leadership and to ensure that the public service offered a compensation plan to aid in recruitment and retention efforts.

3. Flexibility and control

- The system is highly standardised.
- Guidelines exist for determining merit increments and bonuses.

- Budgets are limited to 7% of the departmental management category payroll.
- In order to ensure that the programme clearly distinguishes levels of performance and makes rewards meaningful, guidelines are issued recommending that no more than 20% be rated as having surpassed their objectives and at least 5% be rated as having not met their objectives.
- A review committee must be in place in each department and an attestation made that all programme requirements have been met before departments are authorised by a central agency to make payments.

4. Coverage of PRP schemes

- Performance pay plans apply to deputy ministers, executives and senior levels excluded from collective bargaining in the federal public service as well as heads of agencies and chief executive officers of Crown corporations that are appointed by the government of Canada.

5. General design of the PRP policy

- Performance of managers is measured against predetermined goals and objectives which are set and measured annually.
- Individuals are required to establish ongoing commitments related to their day-to-day responsibilities. In addition, individuals are required to establish key commitments related to priority areas of focus stemming from the department's business plans and the government objectives.
- The programme provides for range progression of 5% per year through the salary range to reach the job rate (maximum) in approximately three years based on successful achievement of ongoing commitments.
- In addition, individuals can be awarded an annual non-renewable lump sum based on the achievement of their key commitments from 10-25% of their base salary depending on their level and their performance during the review period.

6. Performance appraisal system

- Since 1979 departments have been subject to Treasury Board policy on performance appraisal. Prior to that, departments developed their own performance appraisal schemes.
- Performance measures are required for each objective. Commitments are tied to business plans, corporate priorities, and ongoing objectives.
- Evaluation criteria:
 - ❖ results;

- ❖ display of desired leadership competencies, values and ethics;
- ❖ contribution to the department or public service (corporate contribution).
- Rating guidelines and definitions for a four-level system are issued to departments which may adapt them to their own needs.
- Feedback is provided, orally and in writing, and incorporated into the next performance cycle.
- Some agencies/departments/ministries have adopted the 360-degree feedback system.

7. Performance payment system

- Funding control is set centrally.
- Once funding is transferred, departments control allocation.
- Each performance pay plan establishes a budget (*e.g.* 7% of the departmental management category payroll) from which all performance pay funds are charged.
- The budget fund calculation is approved by the ministers of the Treasury Board, and funds drawn down by individual departments are a charge against this commitment of funds with adjustment to future year's funding addressed annually through the main estimates.

8. Implementation

- The overall management process of the public service has been strengthened, including its ability to clearly translate the government's objectives into concrete and measurable commitments for all senior leaders.
- The ability to respond to changing priorities has been improved through the use of performance agreements and annual targets linked to business plans and government priorities.
- A culture of performance management and the need to regularly review progress against targets has been instilled in the public service.

9. Difficulties and problems

- In order to ensure transparency and equity, the programme is guided by a strong set of guidelines; however, the application of the programme does not always facilitate the measurement of subjective aspects of performance and the need for flexibility.
- It has been difficult to link organisation and individual performance and to measure the results, partially due to the nature of public service work and

the lack of systems in place to track and measure the performance of organisations.

- It has proven difficult to evaluate “how” results are achieved (*e.g.* the display of competencies, values and ethics).

10. Lessons learned and prospects

- Lessons learned from the Canadian public service in regards to such a scheme include the need to establish meaningful performance indicators that are measurable in the public service environment and within the control of the individual.
- Flexibility in programme administration is essential in order to ensure that the subjective nature of performance can be accounted for.
- Communication efforts to the media and the public are important to ensure a clear understanding of the programme and its objectives.
- In addition to the PRP, an extensive public service wide formal recognition programme has been implemented which provides awards to meritorious individuals and teams. These awards are bestowed during a week of celebration entitled National Public Service Week which focuses on recognising the value of services rendered by public servants.

Performance-related Pay in Denmark

1. General information

- The Danish Government introduced performance-related pay in 1987 by establishing a local pay scheme with the intention of individualising the wage payment. In 1989, two PRP schemes were introduced – one covering all civil servants and one limited to senior managers. In 1997 these local pay schemes only represented about 2% of the total wage payment in the Danish State, and the budget dedicated to these policies was fairly low. It was decided to deeply reform the system. A new pay system in the Danish public sector was introduced in 1997.
- The new system was introduced slowly. In the beginning it was effective for academics employed under collective agreements, but most of the unions were not ready at that time to take this big step. A framework agreement was reached with the Danish Central Federation of State Employees' Organisations concerning experiments with the new pay system for the period from 1 January 1998 to 31 March 2001. By collective agreement, in 2002 most of the unions entered the new pay system.

2. Reasons for introducing PRP

The overall objectives of the new pay system are to:

- secure a basis for recruitment and retention of high-calibre employees and balance the pay levels in the public sector with those of the rest of the labour market;
- strengthen the link between pay and the objectives and strategies of the individual institutions;
- strengthen the link between pay and personnel policy in the individual institution;
- reflect responsibility and authority, ensure that pay reflects qualifications, and strengthen the link between pay and performance;
- compensate for hard working conditions (inconvenient working hours, overtime, physical hardships, etc.);
- counteract inexpedient competition between government institutions for labour.

3. Flexibility and control

- Since 1969, the government pay system in Denmark had been based on general, centrally determined “pay runs” (number of years of automatic pay rises), reflecting the hierarchical grading of posts, and the objective job content in relation to educational requirements and responsibilities, with seniority as the dominant indication of the development of qualifications and hence of the grading.
- In the new pay system, the pay runs are generally shortened and pay setting is to a wide extent decentralised. However, overall pay determination is still decided in a centralised manner in a first instance, with national negotiations taking place between the Ministry of Finance and national associations of public sector employees to decide on the level of pay increases, benefit issues, etc.
- The Danish performance-related pay system is intended to be decentralised. The fundamental principle underlying the new pay system is that pay setting – including the establishment of a link between the objectives, personnel and salary policy of the institution – must take place within the individual institutions. Consequently, authority to enter agreements about criteria for allowances, to make advance agreements, etc., should be developed by the individual institution.
- PRP is not defined in any laws. All rules related to PRP have been adopted in the collective agreement with the central employees’ organisations.
- This decentralisation has to be compensated by the comprehensive control of each institution/agency using the new pay system – to avoid competition between government institutions for labour and to avoid having wage increases in the public sector affect the rest of the labour market in Denmark.
- In order to monitor the wage level trends, the State Employer’s Authority has developed a special online statistical tool – accessible from the Internet – called ISOLA. This database has been important for the State Employer’s Authority in order to run, monitor and control the highly decentralised pay system. The system is also vital for local institutions to compare their salary level to that of other institutions.

4. Coverage of PRP schemes

- PRP applies to all staff in Denmark. For some personnel groups, it is voluntary to transfer from the old to the new pay system. For others, it is mandatory.
- PRP can be applied at the individual level, or at the team/unit level. It is up to the department/agency to decide.

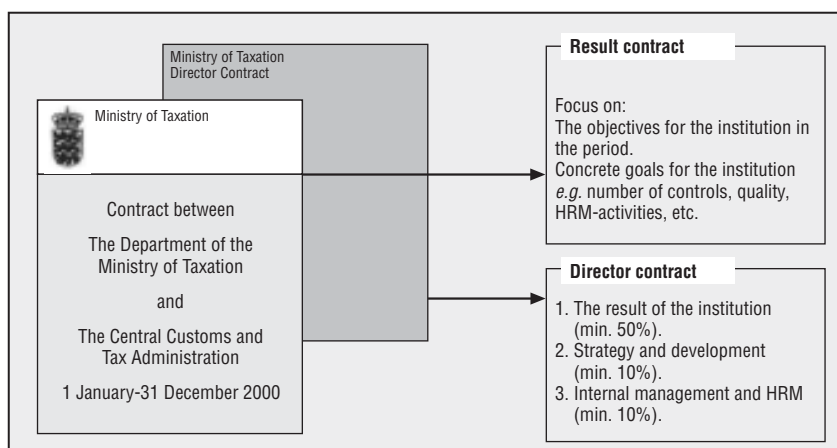
5. General design of the PRP policy

The salary policy normally includes:

- Functions-related allowance: a description of different functions in the individual institution that includes the possibility for an allowance (responsibility for larger projects, mentor, etc.).
- Qualification-related allowance: a description of different qualifications and possibilities for development of competencies that could include an allowance.
- Performance-related pay: possibility to make an individual or group-related result contract in the local institution/agency.
- Salary policy for top managers.

In the Danish Government sector, result contracts were introduced about ten years ago. There are two types of contract: result contracts for the institution and director contracts for the top manager in the institution. The result contract has to be agreed between the ministry (the permanent secretary) and the top manager (the director general) of the institution. These contracts are normally agreed on a yearly basis. In close relation to this result contract, most of the top managers agreed on a director contract. The Ministry of Finance has set up specific guidelines for the content of the result contract. For instance, a minimum of 50 % of the goals in the contract must concern the results of the institution.

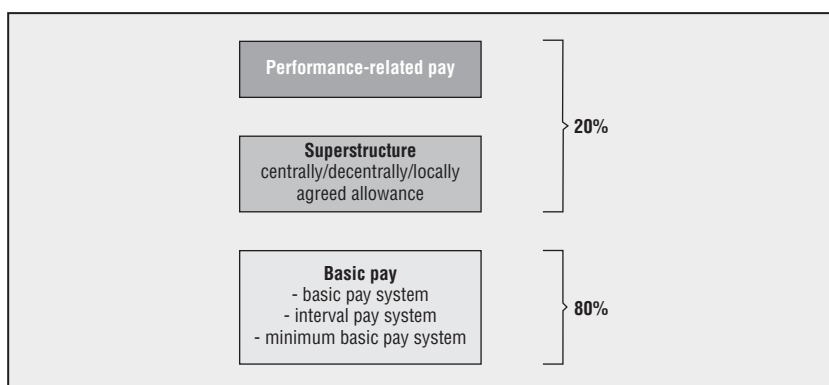
Figure 4.1. **Result contract and director contract**



- Salary policy for all staff: there is no common PRP model across government organisations. However, most PRP schemes across organisations are based on the same three elements:

- ❖ A **basic pay** to be agreed upon centrally between the Ministry of Finance and the organisation negotiating on behalf of the employees.
 - ❖ A **superstructure** which is agreed centrally/locally based on any special functions which are attached to the job or group of jobs and on the employee's personal qualifications and performance. The superstructure also aims to strike a balance between the jobs in question and similar jobs in the rest of the labour market.
 - ❖ A **PRP element** which is agreed at the organisational level and reflects that the employee has met a number of pre-defined qualitative or quantitative targets.
- The final ambition of the new pay system is that up to 20% of the total salary payment in the Danish State should consist of allowances and (directly) performance-related pay.

Figure 4.2. **The three elements in the new Danish pay system**



6. Performance appraisal system

- All allowances are decided on the basis of individual appraisals, based on a dialogue between the employee and the line manager. This salary discussion is integrated into the yearly performance interview. The agreements are agreed and signed by the manager and the union representative/liaison. Some institutions use a kind of balanced scorecard for this appraisal, but normally the rating is much more informal and the salary discussion is only based on the local salary policy.
- The Ministry of Finance has produced a tool to integrate the salary discussion and the yearly performance interview which includes a description of how to integrate the goals of the institution, the personnel policy, the salary policy and the individual goals, competence development for the employee and his/her salary. Before the salary discussion, the

institution can thus first obtain a preparation guide, a conclusion form and a development plan for the employee.

- There are no formal controls on the fairness of the assessment of staff performance or the rating process. But the system is built on transparency, including openness regarding the allowances and the motivation from the manager behind the allowance to the individual employee. Furthermore, the negotiation system gives employees and union representatives a fair possibility to ensure that the employees are treated equally so that the employee finds the assessment reasonable and fair.

7. Performance payment system

- In the new Danish pay system there are no centrally determined levels of pay reward. This question is to be decided at the local level by institution/agencies. All control elements imposed on the new pay system are less restrictive, because the pay-pool system is in principle replaced by individual grants. This means that:
 - ❖ Wage-bill controlled institutions may dispose freely within the wage-bill grant.
 - ❖ Government institutions and institutions operating under a meter system may dispose within the overall finance act grant.
 - ❖ The new pay system entails additional budget responsibility. Consequently, they present an additional challenge to the management.

8. Implementation

- **Communication:** the communication of the new pay system from the beginning of 1997 was in the hands of a special unit in the Ministry of Finance responsible for information about the new pay system, for instance:
 - ❖ development and distribution of a dynamic guide on the new pay system (updated each half year);
 - ❖ folders on the new pay system distributed to all employees;
 - ❖ education of personnel from all HR units in the state institutions;
 - ❖ conferences on the new pay system and local meetings and workshops;
 - ❖ special information for top managers;
 - ❖ courses on the development of local salary policies and courses for managers on handling the new pay system;
 - ❖ general information to the press on the new pay system and on the Internet.
- As from 1999 the responsibility for the information on the new pay system was transferred to different divisions in the Ministry of Finance and integrated

into their daily work. Most of the information was produced in a close dialogue with the central employees' organisations.

- **Adoption of PRP:** since 1997 the number of employees under the new pay system has increased. Since the last collective agreement, the Ministry of Finance has made about 20 new collective agreements with the respective unions/central organisations.
- **Evaluation:** in 2001 the Ministry of Finance and the Danish Central Federation of State Employees' Organisations conducted an evaluation of the experiments on the new pay system in 111 government institutions. Some key results are:
 - ❖ A positive effect of PRP is "more focus on and acceptance on individual appraisal and payment".
 - ❖ PRP strengthens the link between performance and pay.
 - ❖ PRP leads to better possibilities for recruitment.
 - ❖ Only 39% of managers and 23% of union representatives think PRP leads to more focus on results.
 - ❖ PRP does not lead to a better dialogue between management and employees.
- Among the most significant negative effects:
 - ❖ PRP represents too much administration.
 - ❖ PRP creates uncertainty among employees.

9. Difficulties and problems

- The introduction of PRP was a highly controversial issue with the members of the different unions:
 - ❖ not enough money in the system;
 - ❖ no intention of real decentralisation from the employers' side;
 - ❖ local management not capable of handling the system;
 - ❖ not enough information about the system;
 - ❖ resistance against individualisation of the pay system.
- The main problems from the Ministry of Finance's point of view are:
 - ❖ Lack of delegation within the institutions (empowerment of the line managers).
 - ❖ Lack of knowledge/competencies/qualification of line managers to handle the new pay system.
 - ❖ Not enough courage by the line managers to treat the employees differently and make discrimination in the appraisal.

- On the institutional level, the following difficulties often occur:
 - ❖ The salary policy is not clear/operative enough.
 - ❖ No clear link between the goals of the institution and the personnel policy and salary policy.
 - ❖ Not enough information from the management to the individual employee (creates uncertainty).
- From the point of view of the employees and the union representatives, some the difficulties are:
 - ❖ Not enough money in the new pay system.
 - ❖ Resistance against the new pay system among some of the employees.
 - ❖ Too much focus on pay.
- Regarding the direct performance-related pay in the superstructure, some organisations have mentioned problems with the neglect of job aspects not covered in performance goals and decline in team work and knowledge sharing. Other institutions have solved this problem by setting up goals for the whole team and not just for the individual employee.

10. Lessons learned and prospects

- To achieve the full effect of PRP, it is important that decentralisation continues within each institution/agency by empowerment of the immediate line manager.

Performance-related Pay in Finland

1. General information

- In Finland, collective bargaining is the basis of the terms of employment for state personnel. The State Employer functions on three levels in these negotiations: national, central for the state, and agency. For the first two, it is the Ministry of Finance/State Employer's Office (SEO) that represents the employer side. For the third, agencies have the employer's role.
- The new pay system policy dates from the late 1980s. Revising the State Employer's salary and wage policy was part of a wider modernisation reform. The State Employer's Salary and Wage Policy Programme (known more commonly as NPS, New Pay System) was launched in 1992 after several years of preparation.
- Result management as well as result-based budgeting were introduced in the State administration from 1990-95. Agencies had to have applied these systems in order to participate in the performance pay experiment.

2. Reasons for introducing PRP

- The pay scales in the previous pay systems were originally created to favour centralised determination of salaries and wages. In practice, such scales led to interconnected and inflexible pay hierarchies that resisted basing pay on the job demands and individual performance.
- NPS is used to reach the operative goals by establishing and maintaining the general goals of salary and wage policy (good results, incentive, fairness and equality, flexibility, and conformity with the general labour market).
- The Results-based Rewards System (RBR) can be used to encourage employees to think of the common organisational goals, or those of some units/groups, and to generate the overall result. The purpose of RBR is to motivate staff to produce good results, service and quality by working together.
- Pay thus became an instrument of management. Pay relations were to support activity effectively in terms of results and also support personal development. Hiring personnel and pay were to be conceived as investments in labour as a production factor.

3. Flexibility and control

- Individual units have in principle the responsibility for personnel management.
- The division of responsibilities is also valid for salaries and wage policy issues. NPS is considered an important and necessary field where the powers of the State employers must be accumulated to reach the goal. NPS is becoming mandatory for all organisations. This has meant a gradual increase of pressure for organisations and the collective bargaining parties to prepare, negotiate and realise NPS. This movement is about to reach full implementation, as there are provisions about NPS in the central state collective agreement for 2003-04, as well as for the demise of the old pay systems.
- Units prepare, agree and implement NPS within the general framework and guidelines set at the central level. Organisations have the choice of the job and performance evaluation systems and the focuses of the pay policy according to their needs. Once implemented, ministries/units have the responsibility and freedom for the performance appraisal system, as well as for covering the expenses. In other words, they must apply their agreed system within their budgets.
- NPS policies have not been defined in law or regulation. The realisation of the NPS policy – with the exception of the RBR – was to take place by collective bargaining, as salaries and wages are generally based on collective agreements. Expectations of a rapid progression were strengthened when the SEO and the three central state sector employee organisations agreed in 1993 to include provisions concerning the principles of developing the salaries and wages systems towards NPS. The first concrete collective agreements to implement NPS were made in 1994.
- Even if RBR is not directly linked to collective bargaining, principles have been formulated to be applied for RBR systems in agencies. The RBR model is revised each year but the rules are more permanent and meant to be applied for a longer period of time.

4. Coverage of PRP schemes

- The scope of NPS is wide and encompasses all the personnel up to middle managers. Managers above that level are excluded from NPS. Top managers cannot benefit from RBR either.
- Since the launch of NPS in the late 1980s and early 1990s, the target has been to reach full coverage. NPS is intended to be applied in all sectors/activities and on all administrative levels.

- Results-based rewards were paid in 21 central agencies in 2002, and some of these also had district and local level organisations. There are over 60 RBR organisations. RBR were paid to 15 000 people or 12% of personnel.
- There is both an individual and collective component of the PRP policy in Finland. Results-based rewards are allocated at the team level. The result units for which targets are set can either be the whole organisation, or a sub-unit such as a department, individual projects or teams, or combinations of them.

5. General design of the PRP policy

- The three main elements of salaries and wages are: pay by the demands of the job; pay by individual performance; results-based rewards (RBR). There are two rules in sequencing the introduction of NPS:
 - ❖ Pay based on the demands of the job and pay based on individual performance always revised simultaneously, as parts of a collective agreement.
 - ❖ RBR may exist independently of the other two elements, as RBR are not based on collective agreements. There are now ten units which have all the elements of NPS.
- The main elements for determining the criteria by which to assess performance are:
 - ❖ Organisational targets (politically determined).
 - ❖ Collective bargaining process. This process of goal setting is part of the management by objectives and is closely linked to the budget process. In a simplified way, the political decision maker (parliament, government, ministry) sets the goals for the organisation and top management translates these goals into practical activities and delegates to line managers their goals and targets. Via the organisational steps, this chain of delegation reaches every member of staff, with whom discussions on performance and development targets are conducted at the individual level, once a year or more often if needed. These discussions are conducted at every level between line managers and their immediate subordinates. These discussions also assess the previous year's outcomes and performances.
 - ❖ The performance assessment is based on the analytical system that has been thoroughly prepared and tested before the implementation of NPS. All parties must have commonly accepted the assessment systems.
- Results-based Rewards (RBR): RBR is a pay component based on performance which is paid separately for achieving or exceeding targets set

in advance. These rewards differ from other components in the pay system in many ways:

- ❖ RBR are usually allocated for a member of a team/unit or organisation.
- ❖ Payment is subject to achieving or exceeding certain targets, depending on how the targets are set.
- ❖ RBR are paid separately from other pay and less frequently than the regular monthly wage or salary, usually once or twice a year. In pay statistics, however, they are put down as the employee's pay for regular working time as they are mostly earned within normal hours.
- ❖ An attempt has been made to avoid the problem of validity of the targets/objectives in the RBR, establishing a development team which includes representatives of the management and staff, ensuring that staff are committed to the system.
- Financing the new pay system: the funding consists of three main categories:
 - ❖ Central level agreements include certain amounts of funding to be allocated by the units.
 - ❖ The rest of the funding consists of the units' existing appropriations and additional funding in the state budget. These parts of financing are generally quite well secured – as well as financing of the costs of any collective agreement.
 - ❖ RBR must always be financially worthwhile for the organisation. It is recommended that one-third of any improvement in results should be devoted to staff rewards. Another third remains with the employer and the last third can be ploughed back into the work community in the form of development, for instance. In all cases the funding is flexible according to economic constraint.

6. Performance appraisal system

- Individual performance:
 - ❖ The principles and elements of performance assessment are specified for each unit separately, within the general framework of NPS.
 - ❖ Every organisation has a set of criteria for assessing individual performance. Ordinarily three to five main criteria are agreed upon in the collective agreement and a network of sub-criteria as well as their weights are specified. A typical set of criteria would be a variation of “competence, effectiveness, and co-operation”. For management there is also “management skills”. There is generally a set of sub-criteria for each main criterion which are assessed by giving points, and the sum is the individual result of assessment. There are methods to ensure equal

assessment in different jobs and in various parts and levels of the organisation. The collective agreement includes a table defining the pay for the various performances, as percentages of the base salary (which is based on the demands of the jobs).

- ❖ Performance assessment for the pay based on individual performance element is generally based on criteria which weigh towards the identification of critical elements of the job. The choice of these critical elements is based on their relevance for the objectives of the organisation.
- ❖ The employer assesses the performance and decides on PRP. In practice, immediate superiors give their estimates on individual or group/unit performances after having discussed the matter with them. Thereafter, depending on the size and complexity of the organisation, measures of co-ordination are needed to ensure equal assessment. Coordination can be organised on several levels and in different ways. In every case, top management confirms the performance and the pay.
- Results-based Rewards:
 - ❖ The target may be expressed as an improvement in quality or as an improvement in productivity or efficiency. From a managerial viewpoint, RBR are primarily a results-generating tool. RBR must also be viewed as a tool of operational development for the whole organisation, including: ways of reducing costs, saving material, remodelling work assignments, simplifying procedures, reducing absenteeism, developing new products and services, increasing the percentage of outside financing, reducing errors, shortening lead times, increasing the diversity of staff skills, and improving safety.
 - ❖ Result targets should be indicated in terms of key figures. The suitable number of result targets chosen for the RBR system is three to six. If there are only one or two figures, the overall result may be too modest and one-sided, since people inevitably concentrate on doing what is measured and what they will be paid for. If there are too many indicators, the calculation may become too complicated. It is relatively easy to derive applicable indicators from organisational strategies or result targets. The indicators used in RBR systems are listed below. The director general takes the final decision.
 - Quantity of services/products
 - Duration of production/manufacture
 - Quality of services/products (faultless, up-to-date)
 - Economic efficiency
 - Productivity
 - Work productivity

- Amount of incomes
 - Return on invested capital
 - Decrease in deficit
 - Savings in net expenses
 - Trend in expenses
 - Result calculations
 - Level of quality
 - Level of absenteeism
 - Success in development
 - Trend in work load
 - Trend in the condition of safety devices
 - Kilometers of congested roads
 - Number of accidents involving personal injuries
 - Technical faults as a percentage of traffic accidents
 - Queuing time
 - Number of pending permits/applications
 - Customer satisfaction
 - Customer surveys
 - Customer feedback using school grades
 - Monitoring of working hours
 - Working hours invoiced from customers
- In the RBR system, the result matrix, also known as the Riggs matrix, is an example of the reporting and calculation tools used in results-based pay monitoring. The matrix is suitable for the public sector though its contents need to be tailored to suit the particular unit concerned. The result matrix is a table which includes the result factors in the reward model concerned and the indicators describing them.
 - **Rating**
 - ❖ Managers are responsible for the distribution of ratings. The ratings are communicated only to the relevant employee, although employee organisations as well as shop stewards have the right to statistical information on the appraisals.
 - ❖ When performance has decreased, managers must meet with the person to analyse the reasons and try to coach it back up. This may also include relevant training also.

- ❖ The rating system in itself is a significant controlling tool. Employees who do not agree on their assessment can have the issue examined again, and can go to a higher level, and use the shop stewards' assistance. When necessary, a dispute can be referred for negotiations between parties of the collective agreement and in the last resort settled in the Court of Labour.

7. Performance payment system

- RBR are bonuses.
- Pay based on individual performance is a combination of bonus and merit increment based directly on performance ratings, and is partly analogous with basic salary. This link is standardised in each collective agreement. The amount of this pay element is correlated with the individual performance as well as the position in the salary range. The range of pay based on individual performance varies somewhat, depending on specific employer's needs in the organisation and the outcome of the collective bargaining. The maximum pay (for ultra performance) is between 25-50% of the basic salary, (generally nearer 50%). The function between the performance level rating and this pay element is very often strictly linear (for example: 1 point = 0%, 3 points = 25% and 5 points = 50%).
- The average of individual performance pay in relation to individual total pay is currently about 15%. Theoretically, an average of individual performance pay in relation to basic salary should fluctuate around 15-25%, with a maximum between 30-50%. Thus, the average pay based on individual performance in relation to individual total pay should vary between about 13-20%.
- The average amount of RBR was 1.7% in relation to individual total pay in 2002. The range between the agencies was 1-8.3%.

8. Implementation

- Implementation of NPS had a mixed reception. Top management has generally accepted NPS and energetically striven for its implementation, even if sometimes the amount of necessary input was underestimated. For managers, appraising subordinates' performance has been a new and startling scenario. NPS has been approached with wholesome wariness and "need to know more" by staff. The employee organisations have principally accepted NPS.
- In summer 2004, about 40% of the State personnel and half of the agencies had successfully implemented NPS. The remaining organisations will implement it by 2005. The final evaluation of the implementation process must wait until then.

- The results and impacts of NPS have not yet been fully surveyed yet. Audits/evaluations are not compulsory, but they are to be started. Recent evaluation reports reveal that a minority of organisations which have implemented NPS have analysed its effects on functioning or staff.
- An indirect but still very indicative statistical fact is that salaries and wages in organisations that have implemented NPS prove to have been a bit better than in other organisations.
- The overall management process has been improved with NPS. The unanimous message from management has been that when linked with pay incentives and sanctions, the vitality of maintaining good management processes grows, as well as the possibilities of efficient management and leadership. Employers in agencies feel the NPS, PRP and RBR are a very good incentive, for example as a tool of organisational development.
- The introduction of NPS has also resulted in improved staff development and training.
- Employers think that the RBR system has had a fairly beneficial effect on collaboration within the team.

9. Difficulties and problems

- Homogeneity in ratings: in practice, when there is a 1 to 5 point scale, the majority of assessments tends to be three points. The performance distribution may indeed be like that, but this is an issue which is continuously watched in the organisations. Using pre-determined distribution of the rating scale is discouraged by the SEO and the state sector employee central organisations, because that tends to compromise the goals of the NPS.
- Slow process: since the early 1990s, progress towards the realisation of NPS has proved slower and more difficult than perceived at first. In collective bargaining, the principles of NPS are generally accepted, but the concrete issues have been the object of slow and intensive negotiations.
- Financing RBR in certain agencies: it is a problem in the agencies where there is no the chargeable activity. RBR, which are self-financed by agencies, are often considered relatively modest. There have also been difficulties in communicating often enough to staff.
- RBR systems were often very complex at the beginning.
- There are naturally people who are dissatisfied with the ratings or the distribution of rewards. RBR that are considered very modest may also have an effect which is quite the opposite of what was expected, that is, instead of becoming motivated, employees get frustrated and lose their faith in the system.

10. Lessons learned and prospects

- The realisation strategy of the NPS policy has proved to be a long-term project. Without exaggeration the full benefits are thought to be present during a generation's time span. The NPS is a central element in the implementation of the Government Decision in Principle on State Personnel Policy Line. The NPS is the most acute and concrete programme and tool.
- A group-based reward system is the most effective method of reward allocation. This ensures that the benefit of the organisation is not forgotten and that co-operation between different groups functions as desired.
- The SEO and the central state employee organisations have formulated principles to be applied for RBR systems in agencies:
 - ❖ RBR need to be specified for all the members of a group, depending on their joint results.
 - ❖ RBR are a tool of management, but the reward model should be constructed with staff.
 - ❖ The improved results must be objectively demonstrated using specially constructed indicators.
 - ❖ The financing must be ensured.
 - ❖ The result goals/targets of the remuneration model must be developed to response the respective key results.
 - ❖ The functionality and development of the results-based pay model must be followed and evaluated.
 - ❖ It is necessary to inform and involve staff in all phases of implementation of NPS. This increases the transparency and legitimacy of the system.
- Development needs:
 - ❖ It is useful to develop simple PRP models, including at least three but preferably not more than five or six indicators. A model is too complicated if it involves difficult mathematical formulas or if the indicators are unfamiliar concepts to staff. It is also advisable to select matters on which data have been collected previously.
 - ❖ People usually concentrate on doing what is measured. That is why indicators should at least include those that measure economy, quality and quantity, but preferably also an indicator of operational development.

Performance-related Pay in France

1. General information

- The remuneration of civil servants is defined in Section 20 of Act No. 83-634 of 13 July 1983 governing the rights and obligations of civil servants, which defines the elements making up remuneration as salary, residence allowance, family income supplement and, under certain conditions, the new bonus-points scheme created in 1991 and any allowances established by legislation.
- **Primary remuneration:** the index salary. The index salary is the basic pay of civil servants. The salary structure, established pursuant to the Act of 19 October 1946 by a Decree of 10 July 1948, is based on an index grid common to all civil servants. The amount of the salary is set on the basis of the grade and step employees have reached or the position to which they have been appointed. The individual remuneration of civil servants is determined by the occupational group (“corps”) to which they belong, and, depending on their grade within this group, their step, attached to a basic index, determines their position on the index scale.
- **Variable elements:** To this primary remuneration, variable elements are added (for overtime, special constraints, skills, technicality, output, etc.), which are granted in compensation for work performed at the request of the unit head outside normal working hours or in the light of additional work completed or the number of constraints involved in certain jobs, but they may also be granted on the basis of individual performance and evaluations. In this regard, bonuses and allowances that are directly merit-based have been established, such as “output bonuses” for central government civil servants, which are granted on the basis of the performance of qualifying staff. However, these do not include the majority of allowances and are generally granted on a group rather than on an individual basis. Other systems provide for allowances for overtime and special constraints applying to the jobs of certain staff.
- **Restructuring of the index grid: “the Durafour Agreement”.** Developed as part of the policy of renewal of the civil service, the principles of which were defined in the Prime Ministerial Circular of 23 February 1989, the restructuring of the index grid aimed to establish a pay structure better adapted to the tasks of the administration, while preserving the founding principles of 1945. To this end, the Agreement’s objectives were to upgrade substantially the remuneration of

the staff earning the lowest salaries, to open up more attractive career prospects to all levels of staff, and to improve career advancement. The new classification was also designed to take into account more effectively the increasing complexity of the work performed by staff as well as new technical requirements, and to give greater recognition to staff exercising responsibilities and possessing new skills.

- It is in this spirit that the **new bonus-points scheme** (or “NBI”) was established, an innovative salary instrument intended to take into account the fact that staff members may have special responsibility in terms of the duties they perform, the resources they manage or the staff that they supervise or co-ordinate, or the fact that they possess and use special technical skills. To establish the NBI, each ministerial department was asked to make a classification of all senior management posts under its supervision, except for government-appointed posts.
- The last negotiations that ended with the signing of a salary agreement took place in February 1998. Since then, no salary negotiation has resulted in an agreement, and the readjustments of the value of the index point for the civil service have been decided unilaterally by the government.
- In October 2003, the government announced the introduction of individual performance-related pay for senior civil servants at central government level, with a variable component that can amount to as much as 20% of their pay. The reform is being implemented progressively in 2004-05, and is initially targeting directors of central government ministries, on the basis of the conclusions of the Silicani Report of February 2004.¹ As from July 2004, France started experimenting PRP for director's level in six pilot ministries (Ministries of Finance, Defence, Interior, Equipment, Agriculture, Civil Service). PRP is in the form of bonuses, up to a maximum of 20% of the base salary. If successful, PRP will be further extended to all directors in the central civil service and all senior civil servants (*chefs de bureau*). It may further be extended to all civil servants in a later stage.

2. Reasons for implementing the variable pay and merit pay system

- Introduce flexibility into the civil service career system.
- Strengthen a results-based culture in government.
- Increase the accountability of managers and staff.

3. Flexibility and control

- The Ministry of Finance provides budget allowances for performance-related bonuses to the various civil service administrations and occupational groups. Each administration's budget allowance is determined by multiplying the average bonus rate for each civil servant category by the

number of staff in each category provided for under the budget. The bonus budget is indexed to the general salary trend. There are only limited controls on how these funds are used. Each ministry is free to decide how the bonuses should be apportioned among its staff, and ministries can also supplement these funds with their own resources.

- The main methods used to monitor the appropriate use of the system are verifications by financial controllers, audits by the General Finance Inspectorate and parliamentary oversight.
- Bipartite technical committees are consulted regarding the “criteria for apportioning output bonuses”; consequently, there is social dialogue in this field, but only with regard to output allowances, which do not constitute the majority of allowances.

4. Scope

- Bonuses are firmly established in central administrations (ministries), technical bodies and external departments.
- The number of civil servants receiving large bonuses is small. Only 10% of civil servants receive bonuses amounting to 30% of their basic pay, while bonuses account for less than 10% of the pay of 50% of civil servants. Large bonuses mainly apply to the category of senior managers.
- Teachers are in categories that are not covered by a bonus system.
- Part of the remuneration of senior managers is also linked to their post (the new bonus-points scheme, NBI). Initially, this scheme was limited to senior management in the State civil service working in central administrations, decentralised State services and the units with national jurisdiction of each ministerial department. It was planned, in a later phase, to apply the bonus-points scheme to the senior management of other public institutions. The government has not yet made a decision regarding this extension of the scheme.
- The introduction of individual performance-related pay will initially be limited to the directors of central government ministries (2004-05). However, some ministries have gone further by introducing PRP more broadly for staff in 2004 – this is the case for the Ministries of Finance, the Interior, Justice and Infrastructure.

5. General design of the bonuses and allowances system

- On average, allowances represent 17% of remuneration, but the proportion varies across occupational groups and ministries, and there is a wide variation in bonuses from one occupational group or administration to another. In extreme cases, they can be equal in amount to the primary

remuneration itself. For civil administrators, they vary between 40% and 60% of primary remuneration.

- Allowances are established by regulations, all of which are now published in the French Official Gazette (*Journal Officiel*), and each department is alone responsible for allocating them within its own administration. Allowances are usually allocated on a collective basis, and individual differences are not marked. Allowances are awarded in accordance with the management criteria established for each ministry.

6. Performance assessment

- Performance evaluation interviews were made mandatory by the Decree of 29 April 2002, which provides that the evaluation and assessment of civil servants must form part of a consolidated process. Evaluation reports must be counter-signed by the civil servant and his/her immediate superiors. The new legal framework for the evaluation of the work of civil servants, set out in April 2002, will be fully operational by 1 January 2005 and will result in a more objective and transparent evaluation of individual performance.
- Performance evaluation criteria:
 - ❖ Professionalism and technical skills: technical knowledge of the work involved, knowledge of the professional milieu, ability to write clearly, capacity to convince, interest in training and self-improvement.
 - ❖ Methods and results: sense of organisation, method of work, ability to supervise and co-ordinate a team, sense of responsibility and capacity to take decisions, ability to work hard.
 - ❖ Personal qualities and inter-personal skills: good presentation and self-control, friendly and sociable nature, availability and personal commitment, spirit of initiative, self-discipline, punctuality, assiduity.

7. Performance payments

- Indemnities usually take the form of bonuses. Until 2003, bonuses were not incorporated into basic salary, and were excluded from the pension scheme. The pension reforms of 2003 put an end to this system, and bonuses are now included in pensions calculations.

8. Experience with the variable remuneration systems existing before 2004

- New bonus-points scheme (NBI): a first financial assessment of the NBI (conducted in 2003) shows that there are 2 101 senior management posts eligible to qualify for this scheme, and that a total of € 11.6 million have been spent on it. To this sum must be added the budget allowance for military personnel (€ 1.6 million), for the police (€ 1.35 million) and the total

NBI budget allowance (all posts taken together) for senior management (€ 14.55 million).

- Performance-related pay: no comprehensive survey of “performance-related pay” has been carried out, but opinions about it have been expressed in the context of the discussions which have to be held in the bipartite technical committees about the criteria for awarding output allowances, especially when a given administration is reviewing these criteria. There is no doubt that the main advantage of linking pay to performance is that it breaks the link with length of service. Thus, in administrations which have changed the allocation criteria, a young dynamic official can be awarded very much bigger allowances than a longer serving colleague from the same occupational group doing the same job. One of the negative aspects is the natural tendency for systems of ancillary remuneration to converge, with the result that all civil servants of the same grade tend to be awarded allowances that do not vary much from the average.

9. Difficulties and problems

- On 8 April 2004, the Investigatory Committee on the Cost and Performance of Public Services – a body connected to the Court of Accounts and answerable to the Prime Minister – published a report on the allowances policy implemented in the public service, proposing practical reforms to increase the consideration given to merit.²
- The report points out the “extreme disparity” of practices across ministries and even, within the same department, between central and decentralised services, between categories of staff and between occupational groups. Most arrangements amount to lump-sum allowances and are not directly linked to individual performance. In many cases, bonuses are not adjusted in any way and are awarded to compensate for a basic salary which is thought to be too low.
- When adjustments are made, they are not always based on an objective evaluation of performance. Individual evaluations systematically involving annual interviews are not the rule. The report states “the lack of transparency of the system of allowances and the absence of rigorous individual or collective evaluation practices based on explicit criteria, weaken the legitimacy of any adjustment of allowances”.
- The link between the assessment given and the amount of bonuses is very variable also. The lack of transparency and the complexity of the system of indemnity management are often also criticised as obstacles to genuine adjustment.
- The report concludes that, clearly, “the current practices of indemnity adjustment are not evolving in a favourable environment likely to turn this into a real management tool”.

10. Lessons learned and prospects

- The report of the Investigatory Committee on the Cost and Performance of Public Services recommends first and foremost that the “evaluation” aspect be strengthened: “objective evaluation is absolutely necessary if adjustments are to be accepted.” The report recommends:
 - ❖ reliance on the Decree of 29 April 2002 which makes individual evaluation interviews mandatory as from 1 January 2004 and specifies that assessments must be made in the light of these. It therefore suggests that both managers and staff should be trained in personnel management;
 - ❖ greater transparency and social dialogue with regard to remuneration policy;
 - ❖ further clarification of the situation regarding allowances. Remuneration could be made up of three parts: a non-variable basic salary, a second part which varies in line with the importance and nature of the functions performed, and a third part which depends on individual and/or collective service performance;
 - ❖ that the general rules on adjusting allowances be defined at central level, leaving the different ministries with a large measure of discretion in implementing policies;
 - ❖ the rules for adjustment should be adapted to the different categories of personnel, since uniformity is no guarantee of effectiveness. Varying the allowances of senior management is legitimate, for reasons of fairness, consistency and leadership.
 - ❖ The report also recommends profiting from the implementation of the new Organic Budget Law (LOLF) in order to improve personnel management. In the context of this new Law, it will be possible to develop a dynamic of motivation by objectives and to experiment with new forms of collective or individual adjustments. If allowances are to be variable, budget management has to be flexible.
- Depending on the results of the experience with individual PRP for directors in six pilot ministries, that will be evaluated in 2005, the policy might be extended to all senior civil servants after 2005 (*chefs de bureau*) – and later on to all civil servants (on a collective or individual basis).

Notes

1. Silicani and Lenica (Council of State), *La rémunération au mérite des directeurs d'administration centrale: mobiliser les directeurs pour conduire le changement*, February 2004.
2. Investigatory Committee on the Cost and Performance of Public Services, *La gestion des régimes indemnitaires et la modulation des primes – conclusions du comité*, April 2004.

Performance-related Pay in Germany

1. General information

- In the past, public service pay was governed, on the one hand, by the individual circumstances of a staff member (family status, age and seniority) and, on the other, by the requirements of the job. The additional performance-related element of pay was promotion within a given class of service.
- This instrument, however, had only a limited effect, because it was not possible to reward top performers after they had reached the highest grade within their class of service; it was possible to reward top performers only if the relevant posts for promotion were available, which in the past was quite often the case, but recently has become less frequent. Sometimes, staff members who were not among the top performers were also promoted, if the relevant posts were available and no candidates were found who were better suited.
- The Act to Amend the Public Service Law (*Gesetz zur Reform des öffentlichen Dienstrechts*) dated 24 February 1997 entitles the Federal and Land Governments in each case to introduce, by means of legal ordinances performance allowances and bonuses for outstanding special services for their areas. These performance-related instruments make it possible to react directly and quickly in case of better performance and to increase the motivation of particularly skilled and high-performing staff; they supplement the performance steps in the basic salary, which were also introduced with the Act to Amend the Public Service Law.

2. Reasons for introducing PRP

- The reform of performance-related pay is intended to link the pay system in the public service more closely to performance by rewarding performance soon after it is rendered and at a more decentralised level.

3. Flexibility and control

- The general guidelines of PRP arrangements (performance steps, bonuses, etc.) are defined at the federal level. Departments are responsible for designing and implementing their own performance appraisal system.¹

4. Coverage of PRP

- PRP is meant to apply to all categories of staff. It is allocated at the individual or team/unit level.

5. General design of PRP

- PRP was introduced in 1997.
- In order to prevent performance bonuses and allowances becoming set elements of remuneration and to keep them from becoming routine, there are restrictions in the Civil Servants Remuneration Act (*Bundesbesoldungsgesetz*, *BBesG*) with regard to the beneficiaries, the amount and the modes of payment.
- The performance bonus as a one-off payment is the clearest way to emphasise its particular nature as a reward because it is given for a service which has already been provided, and hence does not become a routine additional payment. A bonus may be granted up to the amount of the respective basic starting monthly salary of the civil servant.
- The continuous performance allowance is dependent on a positive performance evaluation, is time-limited (at most 12 months) and is paid monthly up to 7% of the basic starting salary; it may be revoked.
- With reference to the special allowance paid to the staff of supreme federal authorities, performance-related elements awarded to those staff members have been limited to performance steps.
- The Act Governing the Structure of Remuneration (*Besoldungsstrukturgesetz*) of 21 June 2002 created new opportunities to award performance steps, bonuses and allowances in a flexible manner. The federal government implemented these new measures for federal civil servants and military personnel by amending the Ordinance on Performance Steps (*Leistungsstufenverordnung*) and the Ordinance on Performance Bonuses and Allowances (*Leistungsprämien- und –zulagenverordnung*). The new measures took effect on 1 July 2002 and include the following:
 - ❖ Increase of the quota of staff to which performance steps or performance bonuses and allowances may be awarded from 10 to 15%.
 - ❖ Any performance-related pay awarded to a team is counted as only one award with regard to the quota.
 - ❖ Discontinuing the rule that staff members remain at a particular salary step for at least half of the intended time before being eligible to advance to the next step.
 - ❖ Possibility to award additional performance bonuses or allowances, if performance steps are not awarded.

6. Performance appraisal

- Performance appraisals are essential to ensure the legitimacy of personnel decisions. The performance appraisal of civil servants is covered by Sections 40, 41 and 41a BLV, which specify that the aptitude and professional achievements of a civil servant must be evaluated at least every five years and contain a brief description of principles on the performance appraisal of civil servants. Because of the brief wording of Sections 40, 41 and 41a BLV it is necessary to ensure the uniform application of procedures and the comparability of individual appraisals with the help of guidelines specifying the given framework in greater detail (provisions on the appraisal period, specification of appraisal factors and requirements, development of a rating scheme).
- The performance appraisal guidelines of the Federal Ministry of the Interior provide that:
 - ❖ Staff members are evaluated every two years (every three years as from 2005).
 - ❖ Performance criteria are:
 - work results (1.1 quality and usability; 1.2 workload and timeliness; 1.3 effectiveness);
 - expert knowledge;
 - working method (3.1 Independence; 3.2 Initiative; 3.3 Representation of the sphere of competence; 3.4 Service orientation; 3.5 Oral expression; 3.6 Written expression);
 - social skills (4.1 Responsibility; 4.2 Reliability; 4.3 Co-operation and team-oriented action; 4.4 Dealing with conflicts);
 - leadership (5.1 Organisation; 5.2 Instruction and supervision; 5.3 Delegation; 5.4 Motivation; 5.5 Support for staff members).

The Federal Ministry of Interior's rating scheme:

- Rating 1: 9 points: surpasses requirements by constantly outstanding performance
- Rating 2: 8 points: surpasses requirements by predominantly outstanding performance
7 points: surpasses requirements by frequently outstanding performance
- Rating 3: 6 points: meets the requirements in every respect with occasionally outstanding performance
5 points: meets the requirements in every respect
4 points: meets the requirements in general

Rating 4: 3 points: meets the requirements in part, but shows deficiencies in essential areas

2 points: meets the requirements only in part and shows serious deficiencies in essential areas

Rating 5: 1 point: does not meet the requirements at all

Currently the rating 1 can be awarded to a maximum of only 15% of staff members (as from 2005 only 5%) and the rating 2 to only 35% (as from 2005 only 10%).

7. Performance payment

- The Civil Servants Remuneration Act (BBesG) governs the legal basis for performance steps, bonuses and allowances as follows:

Performance steps

- The basic salary shall be divided into steps unless otherwise specified by the relevant remuneration schemes. Progression up the steps shall be governed by the civil servant's age and performance. At least the initial basic salary of the respective pay grade shall be paid. The basic salary shall increase up to the fifth step at intervals of two years, up to the ninth step at intervals of three years, and beyond this at intervals of four years.
- In case of consistently outstanding performance it shall be possible for civil servants and military personnel of remuneration scheme A to advance to the next step as their basic salary (performance step). The number of performance steps awarded by the employer within one calendar year shall not exceed 15% of the civil servants and military personnel in employment with this employer under remuneration scheme A, who have not yet reached the final basic salary. The civil servant or member of the military may advance to this step after one year at the earliest given an appropriate level of performance during this period.
- The decision to award a performance step or to delay promotion shall be taken by the highest responsible service authority or the body appointed by the same. The civil servant or member of the military shall be notified of the decision in writing.

Performance bonus/performance allowance

- The federal and *Land* governments shall be entitled to introduce for their areas, by means of legal ordinances, performance bonuses (one-off payment) and performance allowances for outstanding special services by civil servants and military personnel in pay grades of remuneration scheme A. The legal ordinance of the federal government shall not require the consent of the *Bundesrat*.

- The total number of performance bonuses and performance allowances awarded by the employer within one calendar year shall not exceed 15% of the civil servants and military personnel in employment with this employer under remuneration scheme A. Performance bonuses and performance allowances shall not be pensionable; it shall be possible to renew such payments. Performance bonuses shall not exceed the initial basic salary of the respective pay grade of the civil servant or member of the military; performance allowances shall not exceed 7% of the initial basic salary. The decision to award performance bonuses or allowances shall be taken by the highest responsible service authority or the body appointed by the same.
- Performance bonuses and performance allowances shall be awarded only within the framework of special budgetary provisions. The legal ordinance shall include provisions governing deductions or exclusionary clauses on payments made for the same purpose.

Other incentives

- If a civil servant or member of the military is assigned a special duty for a limited period of time, he or she may receive an allowance in addition to his/her remuneration.

8. Implementation

- The granting of performance-related elements of pay as a means of rewarding excellent performance is applied throughout the federal administration. In 2003, for instance, over 41 000 performance-related elements of pay were given to 550 000 staff members.
- Over € 50 million were spent on performance-related pay. However, this instrument of pay is not applied uniformly by the *Land* administrations; some make vivid use of it while others do not.

9. Difficulties and problems

- During the last legislative term the legal basis of performance-related elements of remuneration was amended by the *Bundessonderzahlungsgesetz* (Federal Act on Special Payments, 2002). This amendment was prompted by a scientific study on the effects of the performance-related remuneration system introduced by the *Dienstrechtsreformgesetz* (Act to Amend the Public Service Law) of 1997.
- The study raised the following points of criticism:
 - ❖ de-motivation of a majority of staff members because of a quota of 20% of staff members per year who may be awarded performance-related pay;

- ❖ lack of binding performance criteria and of objective performance evaluation;
- ❖ lack of information on performance-related elements of remuneration and lack of transparency in the awarding procedure;
- ❖ lack of financial resources and allocation of resources for performance-related elements only during the current year and only for that year;
- ❖ restrictions concerning performance-related pay for top performers because of eligibility criteria (for example for the performance step).

10. Lessons learned and prospects

- In the amendment of 2002 to the provisions on performance-related pay some of this criticism was taken up (increase of the quota to 15%, discontinuing the rule that staff members remain at a particular salary step for at least half of the intended time before being eligible to advance to the next step, transfer clause, improved system to reward teams).
- So far there is no information on current problems and difficulties with the implementation of the new rules.
- Furthermore, the reform of professors' remuneration of 2002 introduced a performance-oriented remuneration system (fixed basic salary/variable performance-related pay). Also in this area it is necessary to await the experience of the *Länder* concerning the implementation of this measure, before any problems and difficulties can be analysed. A thorough evaluation of the model for professors will be made by 31 December 2007.
- On a more general note, the significance of performance-related pay will be enhanced significantly within the framework of public service law reforms that are envisioned by the federal government and the public sector unions (*Eckpunkt Papier "Neue Wege im öffentlichen Dienst"*, October 2004). It is basically intended to structure the pay system according to individual performance and actual function instead of taking into account age and family status. The remuneration will include a basic salary as well as individually and temporarily adapted performance steps, that will be implemented within a variable salary framework ranging from 96% to 104%.

Note

1. The federal and *Land* governments shall be entitled to adopt, by means of legal ordinances detailed provisions for their areas governing the awarding of performance steps and the delay of promotion. The legal ordinance of the federal government shall not require the consent of the *Bundesrat* (the chamber of the *Länder*).

Performance-related Pay in Hungary

1. General information

- Hungary introduced its performance assessment system in 2001 when the Civil Service Act was amended, creating the performance-based pay system. In practice this legal instrument was first introduced in 2002.

2. Reasons for introducing PRP policy

- The primary aim was to improve the performance of civil service personnel and to develop their competencies.
- Basic objectives included: encouraging effective work methods, strengthening motivation, emphasising accountability and responsibility, aiding the integrated development of personal and institutional interests and objectives, and defining and improving accurate training strategies via the development of a performance-based and outcome-oriented organisational culture.

3. Flexibility and control

- The basic features of the regulation are uniform. The Civil Service Act provides the framework regulation.
- Performance assessment is obligatory for central and regional public administration organisations and local governments (municipalities).
- Beyond complying with statutory requirements, it is the given public administration organisation which decides upon the actual realisation, bearing full responsibility for its decision.

4. Coverage of PRP schemes

- The system embraces the vast majority of civil service personnel from interns to department heads.
- Rules pertaining to performance assessment shall not be applied in case of administrative state secretaries, deputy state secretaries, political lead consultants and political consultants.

5. General design of the PRP policy

- The performance assessment system is based on three components:
 - ❖ The definition of the key objectives of the public administration organisation.
 - ❖ The definition of personal criteria. The person exercising the employer's rights¹ defines in writing the criteria for the civil servant for the coming year on the basis of the defined key objectives.
 - ❖ The assessment of the civil servant's performance on the basis of performance criteria by the person exercising the employer's rights by the end of the current year at the latest.
- The performance of civil servants is annually assessed in writing by the person exercising the employer's rights on the basis of defined performance criteria and with a view to the job description and key objectives of the organisation.
- The outcome of performance assessment may influence the remuneration of the civil servant. The head of the organisation exercising his non-transferable rights may alter the rank-based remuneration of the civil servant by plus or minor 20% (maximum) for the following year on the basis of the results. However, it is not obligatory to alter the basic remuneration of the civil servant.

6. Performance appraisal system

- In accordance with the Civil Service Act, the key objectives are annually set by ministers or the heads of public administration organisations. In the case of local governments, key objectives are set by the body of representatives. When defining the key objectives, the content of the Government Agenda shall be considered the standard.
- The employer shall take into consideration the job description of the civil servant. Linking this to the key objectives of the organisation guarantees that the employer sets performance criteria which are real and achievable and relate to the job description of the civil servant being assessed. When defining personal performance criteria, clear definitions ensure that responsibilities are set and performance is assessed in a quantitative and identifiable manner, both for the civil servant and for the person conducting the assessment.
- The person exercising the employer's rights provides a written assessment of the performance of the civil servant. Performance assessment shall not take place if the civil servant works less than six months in the current year. The written assessment report shall be handed over in the framework of an oral interview.

- Discussions shall become a regular element in the daily management activity. This formal process provides an opportunity for the evaluators and the persons being assessed to sit down, think and work out a consensus in connection with performance. The process enables the HR department to collect and analyse assessment information from all areas of the organisation.
- A ranking report shall contain the description of the performance assessment process and its related evaluative statements. Performance assessment and the ranking procedure related to achieving a higher rank every four years should be based upon each other. While performance assessment of civil servants is performed on the basis of clearly stated performance criteria, the ranking procedure contains a complex assessment of individual skills, competencies and personality traits besides evaluating the professional performance of the civil servant.
- The civil servant may request the involvement of a pressure group operating in the organisation which can make comments on the statements of the ranking. There is no such option for the performance appraisal. Decisions concerning the ranking or the performance appraisal can be sent to court if no agreement is reached. Concerning ranking, civil servants shall only bring an action on account of false or incorrect statements of fact, or in order to eliminate requirements which infringe the personal rights of the civil servant.

7. Performance payment system

- Merit increments: plus or minus 20% of the salary.

8. Implementation

- An extensive training programme was launched and numerous national conferences held. The introduction of the performance assessment system was preceded by the publication of a performance assessment guideline for civil service personnel and by organised professional conferences.
- It is too early to speak about substantial changes.
- Top management has little experience with the performance assessment system. It is not yet integrated into the culture of public administration. This is why the assessment process has become rather formal in a number of public administration organisations; it does not represent real outcomes in a number of cases, but mainly nominal information. There were a number of cases where significant steps had been taken from the beginning in order to conduct performance surveys on the basis of appropriate professional performance assessments, which bears positive implications for the future.

- A number of public administration organisations have developed their own internal norms. This improves the objectivity and transparency of assessments, taking local conditions into consideration.
- Comprehensive, public statistical data about the operation of the system are not available and experiences so far are based on only two years of assessments.
- It is apparent even now that the system has induced positive changes in the civil service. The system may be improved after gathering sufficient experience and summarising the outcomes. Discernible improvements have appeared regarding the system of individual job descriptions. Since the system was introduced, job descriptions which had been outdated and disorderly have been revised, made clear and transparent in almost all organisations.

9. Difficulties and problems

- Formality is a difficulty which can be felt in a number of organisations, but this could be due to the short interval since the instrument was introduced.
- The greatest problem seems to be the lack of a separate financial allocation for public organisations to back up the possible $\pm 20\%$ fluctuation in remuneration; therefore the possible alterations must be financed by public organisations themselves from their own budgets.
- Short- and mid-term organisational objectives are hard to translate at individual levels, making it difficult to harmonise organisational and individual objectives. It would be worthwhile to consider the introduction of a competence criteria system which would help to identify the most important professional criteria in relation to a given job and which criteria should be further improved by the civil servant. However, to introduce such a system would require even more detailed job analysis structures.

10. Lessons learned and prospects

- The introduction of performance assessment enables the civil service in Hungary to accomplish its aims for the purpose of which this instrument was devised: to ensure the development and operation of an effective and efficient state; to increase the professional level of work; and to promote the change of organisational culture.

Notes

1. Employer's rights are exercised by the head of the organisation who may confer the employer's rights in writing on a superior leader of the civil servant. The conferred employer's rights must not be conferred to a third person.

Performance-related Pay in Italy

1. General information

- In the early 1990s there was a strong need to reform public administration. The reforms had two main objectives: reduce overall costs and improve the effectiveness and quality of the services provided. Several initiatives were adopted to ensure: a more transparent and accountable administration (1990); an administration closer to citizens and their expectations, strengthening the role and tools of local authorities in delivering public services (1990) and introducing “Service Charters” (1994); a more flexible and efficient use of human resources in the civil service, with the reform of the senior civil service and the application of civil law to civil servants (1993 and 1998). Performance-related pay policy was implemented in this context in the 1990s especially through Law No. 29/1993 and the collective agreement 1998-2001 for managerial staff.

2. Reasons for introducing PRP policies

- Introduce management by objectives into the public administration, to ensure policy effectiveness.
- Promote the efficiency of services and favour improved service delivery through the evaluation and payment of specific allowances according to individual merit and performance.
- Encourage economic progression and widening of professional expertise.
- Performance appraisal also represents an occasion for critical and dialectic confrontation with the results of administrative action: the evaluation of performance allows examination of the validity, value and merit of public programmes and activities. The most important aspect of the PRP system is as a resource for future decisions, ensuring important information about results obtained in the past.¹
- The PRP system also allows:
 - ❖ orientation and motivation of managers in order to identify priority objectives, reach results and strengthen their responsibility;
 - ❖ improvements in job satisfaction;

- ❖ availability of reliable and comparable elements in order to improve administrative action;
- ❖ coherent remuneration in order to realize result-oriented management.

3. Flexibility and control

- PRP is disciplined by law and by collective agreements. Dispositions concerning the PRP system have been established through law and collective agreements since 1993.
- The law states that public administrations create internal services in order to evaluate the trend of offices and behaviour of managers. The system, which is still in the first phase of its application, has been recently reviewed (Law No. 286/1999) giving a substantial boost to management control, providing for the evaluation of public managers and introducing strategic control. All government bodies, local and central, are required to set up a strategy and performance appraisal.
- In addition, the collective agreement 1998-2001 for managerial staff refers to criteria and methods for evaluation and to the structure of remuneration of managers.

4. Coverage of PRP schemes

- The current PRP system is based on the evaluation of the individual performance of managers. PRP is applied to the managerial level only.²

5. Overall design of the PRP system

- Managers' remuneration is defined through collective contracts, and additional remuneration is related to responsibilities and duties attributed to the post. According to the collective agreement 1998-2001, a part of managers' remuneration is linked to performance. The structure of additional pay for managerial staff in ministries is made up of the following: i) remuneration linked to the post (depends on the particular responsibilities and duties relevant to the post); ii) performance pay (linked to the results achieved by managers, following an evaluation).
- For managerial staff at the director-general level, fixed remuneration is defined through individual contracts. Additional remuneration treatment is also determined in individual contracts and is connected both with the level of responsibility of the post and the results achieved.

6. Performance appraisal system

- The performance appraisal is centred on "annual directives". Annual ministers' directives set out and specify the priorities, objectives and

responsibilities within each ministry. Managers participate in the identification of achievable objectives against which their performance is assessed by evaluating results obtained and the appropriateness of operational decisions, including the use of available resources.

- Different managerial levels are continuously involved in the definition of objectives and priorities that will be transferred into concrete actions. The annual directive adopted by each ministry must consider the contents of the Prime Minister's annual directive for management in ministries, which defines primary and strategic objectives, such as simplification, reduction of expenditures, quality of services and electronic administration. Ministries' directives state specific programmes and projects, which are in line with the indications contained in the single document of the Treasury for economic and financial planning, and to identify qualitative and quantitative indicators of time and results.
- The performance appraisal system is currently being implemented in public administrations and is based on verifying that managers have reached the objectives assigned. The evaluation concerns the performance and organisational skills of each manager individually. It also takes into account the efficiency of the administrative action and the links between costs and results obtained (management control).
- The evaluation process is carried out by:
 - ❖ the staff of the director-general's office for state administrations;
 - ❖ the head of department or other superior general directors for director level staff;
 - ❖ the minister, on the basis of the indicators furnished to him/her by the unit carrying out the self assessment for managers of sectors which comprise various units and which include many director-general offices.
- The evaluation process also acts as a precursor to the application of sanctions.
- A central unit for assessing policy and programme effectiveness has been established at the Prime Minister's Office. The technical-scientific Committee on Evaluation and Strategic Control coordinates the appraisal systems of public managers in each ministry and gives advice. The unit undertakes evaluation and strategic control among public administrations.
- The Department for Public Administration plays a supporting role for other administrations, ministries, regions and local authorities for the creation of programming, planning and controlling systems.
- Negative administrative results or non-reached objectives result in the cancellation of the appointment and the appointment of the manager to another post, in the same or another administration. In the case of non-observance of the directives given by the competent organism or in the case

of several negative evaluations, the manager can be excluded from the appointment to other posts equivalent to the one annulled for not less than two years. In the case of particularly serious situations, the administration can decide to rescind the individual agreement with the manager.

- Individual performance appraisal involves a system of rating. Each public administration adopts a performance appraisal system for managers. Generally, the rating is characterised by an evaluation and a point scale, but these are not uniform within the public administration.

7. Performance payment system

- For management staff not at director level, the individual variable part of the remuneration consists of the pay award tied to the specific post, which is variable, and the performance-related pay. The first of these is scaled in remuneration bands set by the individual administration, the second is determined by the collective agreement as a variable percentage of the annual value of the award for the particular post. The collective agreement fixes the minimum of this percentage.
- Since 1998, there has been a tendency to increase the percentage used to calculate performance-related pay in relation to the award for the particular post, in order to give more importance to the performance and responsibility of the manager. In particular, the national collective agreement 1998-2001 for band I of management staff established that resources of not under 15% of the total available for performance-related pay and particular post awards are destined for PRP for management staff not at director level. The same contract stipulates that the annual performance-related pay cannot be inferior to 20% of the annual value of the award for the particular post, within the limits of available resources.
- For management staff at director level, the award for the particular post and the performance pay are entirely personalised. These are established in the individual contract, with reference to the level of responsibility attributed to the post and to the results achieved.³
- In any case, a positive result of evaluation leads to a bonus that does not represent a stable increment of managers' remuneration.

8. Implementation

- It is not easy to assess the implementation of the PRP system because it is at a relatively early phase of application.
- The system has the potential to improve performance by providing managers with a mechanism for the structured review of performance. In fact, this is still characterized by the interpretation of laws in a formalistic

sense, which focus attention on guaranteeing the equal treatment of employees rather than on the necessity of assuring a rational motivation and valorisation of human resources.⁴

- The document produced in 2001 by the technical-scientific Committee on Evaluation and Strategic Control in public administration⁵ shows that there is a great disparity between laws and reality in public administration. Despite credible initiatives, a general lack of culture hinders the application of performance appraisal. In particular, the lack of a results-oriented culture clearly appeared in the lack of indicators for performance appraisal.
- Nevertheless, in general a great interest exists in Italy for the PRP system, but it is still applied in a non-homogenous way, characterised by steps forward than pauses, depending on the cultural background of the Italian public administration.
- The implementation of the process will need a long time, it must be absorbed and tested in the public administration at central and local level. In addition, the implementation of the system is influenced by a different level of economical and social development between the north and the south of Italy.

9. Difficulties and problems

- Some past experiences show that negative consequences are possible: excessive competitiveness in particular can damage any constructive collaboration within human resources.⁶
- On the basis of debates and experience, difficulties also occur with the indicators adopted and the way managers are evaluated. Often it is not easy to evaluate the achievement of objectives that cannot be measured in quantitative outputs, thus showing that there is a lack of objectivity during the process.
- In addition, discrimination in the evaluation process is possible, with negative effects on the motivation of managers and their autonomy in management, thus showing a bureaucratisation of their activities.
- So far, the following difficulties in the implementation of the PRP system have been encountered:⁷
 - ❖ *Systems*: the insufficient diffusion of planning and control systems does not permit the effective management of objectives;
 - ❖ *Resources assigned*: generally there is no proportion between results established by the political authority and resources actually assigned, which are insufficient;

- ❖ *Responsibility*: if an objective is not reached, the manager could be sanctioned by the political authority, and this is not taken into consideration in points 1 and 2;
- ❖ *Trade unions*: trade unions do not accept evaluation and remuneration systems as adequate in evaluating differences among productivity and professionalism;
- ❖ *Low incentives*.

10. Lessons learned and prospects

- The first critical element in guaranteeing the transparency of the process is a clear and detailed description of objectives that have to be reached by managers and indicators that will be used during the appraisal process. In addition, the results of appraisal should be communicated and, in accordance with Law No. 286/99, managers must be involved in the process.
- The system also needs to include practical training on evaluation, involving all managers.
- It seems that quality could be more adequately assured if there was a convergence of individual action on innovative and strategic subjects, implementing specific themes through the modality of team-working. The concept of team results connected to a bonus represents a new operative modality in a new general context.⁸
- According to debates and experiences noted, the PRP system is applied with greater efficacy at local rather than at central level because of the proximity with citizens, the latter being the final beneficiaries of administrative action.
- The main challenge for the future is to achieve a greater internal cohesion and the homogenous application of the system.

Notes

1. Gianfranco Rebora, Guerini e associati, *“La valutazione dei risultati nelle amministrazioni pubbliche. Proposte operative e di metodo”*, 1999.
2. The Law No. 165/2001 states that managers are divided into two bands: first and second level directors. The level characterises the type of office to which the director can be appointed and the remuneration to which he/she is entitled.
3. For diplomatic and prefectorial careers, additional pay is personalised to a small extent, with reference to the indicators for additional pay that are required by each administration, within the limits of their available resources and therefore subject to second level contract agreement.
4. *“Il controllo interno nei Ministeri. Primo rapporto. Maggio 2001”*, by the Committee for the Coordination on Evaluation and Strategic Control in State Administrations, Dipartimento per l'Informazione e l'Editoria, May 2001, p. 16.

5. *“La valutazione dei dirigenti nelle amministrazioni centrali dello Stato. Appendice al primo rapporto del maggio 2001”*, By the Committee for the Coordination on Evaluation and Strategic Control in State Administrations, 2001, p. 5.
6. *“Il controllo di gestione negli enti locali”*, by Formez, 2002, p. 132.
7. *“Il controllo interno nei Ministeri. Primo rapporto. Maggio 2001”*, by the Committee for the Coordination on Evaluation and Strategic Control in State Administrations, Dipartimento per l'Informazione e l'Editoria, may 2001, p. 17.
8. *“La valutazione e lo sviluppo delle risorse nelle pubbliche amministrazioni”*, by Carlo Lefebvre and Giovanni Raspino, *Il Sole 24 ore*, 2002.

Performance-related Pay in Korea¹

1. General information

- The Korean Government introduced an annual merit increment programme and a performance bonus programme in 1999. The Civil Service Regulation for Pay (Article 39) and the Civil Service Regulation for Allowances (Article 7) allow performance-related pay to those with excellent job performance.
- The Korean civil servant's pay is composed of base salary, allowances and welfare expenses.
 - ❖ **Base salary** is the regular pay by grade and step according to the degree of responsibility, difficulty of the position, and length of service. It accounts for approximately 50% of monthly pay, depending on the rank in the organisation. There are 12 base salary schedules by job category.
 - ❖ The **allowance** is an additional remuneration paid separately according to the position and living conditions of individuals. Allowances are broadly classified into three categories: common allowances, special allowances, and extra work allowances. There are five types of common allowances (seasonal, diligence, seniority, family support, and managerial allowances). Also, there are three categories of special allowance (hardship post, high risk, and special task allowances) and three types of extra work allowance (overtime, midnight work, and holiday work allowances).
 - ❖ The **expenses** paid for civil servant's welfare include meal, grade, household support, commutation, traditional holiday bonus, and non-vacation payments.

2. Reasons for introducing PRP policies

- The traditional pay system based on seniority was high cost and low efficient. There were no incentives to encourage high performance.
- The main objective of the new system was to introduce the principle of competition to the public sector and improve the productivity of the government through the pay-performance link.

3. Flexibility and control

- The system is designed and applied at the central level.

4. Coverage of PRP schemes

- All categories of staff are covered by PRP schemes, with two different systems applying to top level staff and mid managers and below.

5. General characteristics of the PRP policy

Table 4.1. PRP policy in Korea

Annual Merit Increment Program (AMIP)	Performance Bonus Program (PBP)
<ul style="list-style-type: none"> • Yearly stipend system. • Application: director and above in each ministry • Variable part of pay performance-related • Four categories of pay rate decided by performance appraisal based on management by objectives (MBO) • Increased variable portion of pay is added to fixed portion the following year • Excellent performer (top 20%) = 7% of performance standard amount in each grade; outstanding performer (21-50%) = 5% ; normal performer (51-90%): 3%; unsatisfactory performer: 0% • Ministers appraise the performance of director generals and above within their ministry annually 	<ul style="list-style-type: none"> • Application: division director (grade 4 level) and below • Form of payment: lump sum bonus • Bonus amount: excellent performer (top 20%): 100% of his/her standard salary; outstanding performer (21-50%): 70%; normal performer (41-90%): 40%; unsatisfactory performer (below 91%): 0%. • Supervisors appraise employees' performance annually (Jan.-Feb.)

6. Performance appraisal

- Two measures are used: MBO for higher-level employees and performance appraisal rating for mid- and lower-level employees. In addition, 360-degree feedback is used for supplementing existing appraisals.
- **Appraisal by MBO** – Management by Objectives (MBO) is a planning and appraisal tool that has different variations across organisations. MBO was introduced in March 1998 and tested from July to December of 1998. After pilot studies it was implemented government-wide in January 1999 as a tool to encourage high-level officials competency.² MBO is based on evaluation by the degree of goal accomplishment. For example, each unit goal has a weight: strategic goals (1.2), main goals (1.1), and basic goals (1.0). Those who are under appraisal by the MBO must prepare three to seven goals to fulfil for the year. Each goal is classified as follows: i) the strategic goal assigned to the level of the director-general; ii) the main goal assigned to the level of the division-director; and iii) the basic goal assigned to the level of the assistant director. Such goals are set based on performance indicators and the emphasis is on outcomes. In the beginning of a performance review period, the employee and supervisor discuss performance objectives and meet to

record results formally. Results are then compared against objectives, and a performance rating is determined based on how well objectives were met. Objectives are evaluated at the end of the year in terms of accomplishment of objectives (60%) and characteristics of objectives (40%: importance of objectives, degree of difficulty, and measurability of objectives).

- **Performance appraisal** – Most agencies utilize the appraisal results as basic data for the promotions and performance bonus. According to the Regulation for Performance Appraisal, the performance appraisal includes three major areas: performance (quality and quantity of performance, timeliness of task accomplishment, and process improvement), ability (IT literacy, familiarity with a task, judgment, planning, professional certificate, and required fluency of a specific foreign language, if any), and attitude (lateness, absence, discipline, and kindness towards the public). Three areas have different weights: performance takes the largest proportion (60%), followed by ability (30%) and attitude (10%). In order to provide flexibility in performance appraisal, the Regulation for Performance Appraisers can evaluate subordinates based on five categories (excellent, outstanding, normal, unsatisfactory, unacceptable).
- **360-degree feedback** – The Korean Civil Service Commission (CSC) and the Ministry of Government Administration and Home Affairs (MOGAHA) have developed a formal policy on 360-degree assessment. This policy supports the use of multiple raters as an effective method of assessing performance both for developmental and appraisal purposes. The central government revised the Civil Service Employment Decree (CSED). CSED was revised to state that 360-degree feedback could be used not only for promotions, but also for pay step increases, performance-related pay, training, position assignments, and other personnel practices.

7. Performance payment system

- There are two forms of PRP schemes used in Korea: merit increments and bonuses. Merit increments are added to the annual salary of a government employee and linked to performance ratings of division directors (grade 4 level). Bonuses are paid to government employees annually and designed for mid and lower level employees.
- **Merit increment** – The appraisal grade has four categories from S to C as shown in Table 4.2. In Korea, Grade 1 is the highest level (assistant minister level) while positions of deputy ministers and ministers are politically appointed. The amount of performance-related merit increments are calculated as base pay multiplied by performance pay rate. It is noteworthy that the performance-based annual salary is not paid to

10% of the civil servants who belong in the bottom rank with Grade C as shown in Table 4.2.

Table 4.2. **Appraisal grade, payment scope, and performance pay rate**

Appraisal grade	Excellent (S)	Outstanding (A)	Normal (B)	Unsatisfactory (C)
Payment scope	Upper 20%	21~50%	51~90%	91~100%
Performance pay rate	7%	5%	3%	0%

- **Performance Bonus Program** – The Korean Government has a similar system that follows the most common form of bonus payment based on an annual bonus through appraisals of performance for the year. This program applies to all civil servants from division director (grade level 4) and lower levels, in whole categories. In determining the bonus scope, bonuses for civil servants in Grade 3 (division director level) and 4 are based on the MBO; while bonuses for those in Grade 5 or lower are determined by the performance appraisal system.³ This will be granted as a lump sum bonus and will vary in size from 40-100% of monthly base salary per year.
- Performance bonus can be provided in various ways: i) individual base; ii) departmental base; and iii) combinations of both. Performance bonus by an individual base is the most common form at present. When an individual differentiation in task fulfilment is extremely difficult and teamwork is essential in daily duties, performance bonuses can be allocated by a departmental base. As of 2002, four areas (defence, police, security such as the Presidential Security Service, and railroad service) where output is a group collaboration effort, use a departmental base. Also, performance bonuses can be distributed by a combination of both bases, but this is not used at present.

Table 4.3. **Appraisal frame for the performance-based bonus program**

Appraisal grade	Excellent (Grade S)	Outstanding (Grade A)	Normal (Grade B)	Unsatisfactory (Grade C)
Scope	Upper 20%	21~50%	51~90%	91~100%
Performance bonus rate	100% or more	70%	40%	0%

- The main method for mid- and lower level employees is performance appraisal. The head of an agency or ministry can use other appraisal methods in addition to traditional performance appraisals if necessary. So methods such as 360-degree feedback are used, but it is not mandatory if there are special circumstances.

8. Implementation

- Recently, PRP and MBO faced serious criticism from government employees. First, these new systems were not well prepared prior to implementation. They were suddenly introduced in 1998 and were implemented government-wide in 1999. Second, many officials lacked in-depth understanding about the nature of these systems and the difficulties setting performance objectives. Third, people dislike to evaluate as well as to be evaluated in general. The seniority-based system is still prevailed in many Korean organisations so that it is hard to change perception and behaviour in the short term. Fourth, it is difficult to develop performance objectives and performance indicators because the nature of public affairs is often hard to quantify. Fifth, these systems appear to require more paperwork and increase both pressure and stress. PRP and performance measures must be improved in order to alleviate complaints and discontent. It will take time to succeed so it is necessary to make continuous improvements based on both domestic and international partnerships.
- PRP is a newly introduced system in Korea and only recently embraced in the private sector. Intensifying competition at home and abroad forced conglomerates to introduce merit pay programs to improve performance. Amid the proliferation of performance-based incentives, regular bonus payments were gradually giving way to performance-linked, differential bonus programs. The government had almost no experience with it up until the late 1990s. This lack of experience might lead to confusion and conflict in implementing PRP programs in government.
- Union resistance: The Civil Service Commission recommends agencies not allocate an equal amount of performance bonus to government employees without differentiation by performance. Schoolteachers under the Ministry of Education and Human Resources demand to have performance bonuses as allowances that do not differentiate among government employees. Korea Teachers and Workers Union (KTU) refused performance bonuses in 2001. Conflict with teachers' unions was one of the major stumbling blocks in full-scale implementation of PRP. Teachers basically want to receive additional monetary returns, but KTU refused to have PRP because it is based on differentiation of performance. In February 2002, KTU demanded government to distribute it to all teachers as part of an allowance or abolish it.⁴
- Egalitarian culture – When someone receives better treatment, particularly in a homogenous society such as Korea, it often accelerates sensitivity among members of society. Such an egalitarian culture is very pervasive in Korea. There is little doubt that policy makers know that PRP should be large enough in order to motivate government employees. But in the process of personnel

policy making, such an idea could have been intervened by demands of fellow government employees for sharing such fruits more equally. Authoritarian regimes in the past also affected reinforcement of such egalitarian culture. Under dictatorship, people demanded democratic values such as equality and fair representation without discrimination. Such sentiments seem to accelerate egalitarian culture in Korea's modern history.

- There are other factors that affect PRP success. For example, the seniority system would be another major barrier for full-scale materialization of the PRP program in government. Seniority is a major factor in determining pay.

9. Difficulties and problems

- Employees may receive merit increases even if performances do not warrant them, because supervisors want to avoid creating animosity among employees. Therefore, poor performers may receive the same pay increase as exemplary performers, and poor performers may come to view PRP increases as entitlements. Consequently, superior performers may question the value of striving for excellent performance.
- Employee's job performances tend to be assessed subjectively, based on supervisors' judgments. PRP programs rely on supervisors' subjective assessments of employees' job performances. Supervisors are subject to a number of errors which often undermine the credibility of the performance evaluation process. Performance evaluation processes that lack credibility do little to create the perception among employees that pay reflects performance. Accurate and comprehensive performance measures that capture the entire scope of an employee's job are essential to successful PRP. Unfortunately, developing performance measures for every single job is not only difficult but also expensive.
- PRP programs may not always influence employee motivation positively as intended. Employers and employees may differ in what they see as large enough merit increases to motivate positive behaviour. For example, increases diminish after deducting income taxes and contributions to pensions. Assuming that an employee receives a PRP increase once per year, differences in employees' monthly pay checks may be negligible.
- At present, the performance-related annual merit increment is not very attractive. In other words, differences between one in the top category "S" and one in the bottom category "C" are not significant. Those with the highest appraisal grade would have pride and honour, but monetary return is not large enough.
- Because PRP programmes focus mostly on individuals, they do little to integrate workforce members. With limited budgets for merit increases, employees must compete for larger shares. Competition among employees

is counterproductive if teamwork is essential for successful projects. Merit increases are best suited for jobs where the employee works independently. When people perceive competition as a personal war it is counter-productive for human relationships in an agency.

10. Lessons learned and prospects

- Human resource management for high-level positions should be well developed, but it is not in Korea. MBO was recently adopted as an evaluation tool for higher-level officials. Accordingly, more strategic HRM is necessary for higher level officials in the future. As a potential alternative, the American model of the Senior Executive Service (SES) or the British model of the Senior Civil Service (SCS) that uses the competency framework can be benchmarked for further development. The Korean Government has been preparing for a new system similar to SES or SCS. It will be enforced in 2006. In doing so, performance management can be improved for high-level officials and such development could affect mid- and lower level employees in the long run. Higher-level officials must demonstrate a model for mid- and low-level employees.
- Link performance appraisals to business goals: The standards for employee performance judgment should be linked to the competitive strategies an agency has engaged.
- Allowances are overdeveloped: base pay accounts for approximately half of the monthly pay, while allowances and other welfare expenses take the remaining half. Under this circumstance, government employees are likely to perceive PRP as an allowance. In order to avoid such a situation, allowances must be integrated with base pay as much as possible in the near future. Also, the pay level must be adjusted in the future because it is lower than other neighbouring countries such as Japan, Hong Kong, and Singapore. Particularly, the pay level of higher level officials is relatively low in Korea. Accordingly, government employees have general discontent with the government pay system and such situations generate distrust between workers and management, as well as dissatisfaction with the current pay system including the PRP program. Pay systems need substantial improvements in order to build up trust with the pay system and make PRP successful.
- Government employees often complain about performance appraisal and performance measures. The biggest problem of the move to a meritocracy is that subjective to measurement where doubt undermines the system. During performance appraisal meetings with employees, supervisors should discuss goals for future performance and employee career plans more seriously. When performance deficiencies are evident, supervisors

and employees should work together to identify possible causes to develop an action plan to remedy these deficiencies.

- Job analysis is vital to organisations that wish to establish internally consistent compensation systems. Supervisors that create objective performance measures use job descriptions which note the duties, requirements, and relative importance of a job within an agency. Supervisors can match performances to these criteria. This approach may help reduce supervisors' arbitrary decisions about merit increases by clarifying the standards against which performance is judged. The Civil Service Commission established the Job Analysis Division in 1999. Several agencies (for example, the Ministry of Foreign Affairs and the Trade, and the Korea Meteorological Administration) have had job analysis with consultation with the Civil Service Commission. It is expected that such activities could contribute to development of a more rational HRM in the future. Since 2003, Civil Service Commission have been analysing the jobs of all high-level positions in the whole government as prerequisite procedure for the introduction of the higher civil service system.
- Managers tend to evaluate subordinates too leniently with little differentiation between high and low performers. The tendency of Korean managers towards lenient employee appraisal and the use of traditional seniority-based reward systems are no doubt related to the harmony-oriented or paternalistic Korean culture. Harmony is one of the most emphasized values in Korean agencies. Most managers are more inclined to maintain harmony by producing lenient appraisals of subordinates than to arouse conflict and tension through critical or negative appraisals. At present, PRP difference between top and poor performers in the Korean Government is not substantial. Merit increases should consist of meaningful increments. If employees do not see significant distinctions between top performers and poor performers, top performers may become frustrated and reduce levels of performance. When agencies' merit increases don't clearly reflect differences in actual job performances, they need to provide alternative rewards. For example, fringe compensation can complement performance-related pay (PRP) increases.
- Supervisors need to take on a coach's role to empower workers. It is important to find a way to embed individual-based knowledge in the agency, making it accessible and useful not just to one unit or function but to the entire organisation. As coaches, supervisors must ensure that employees have access to the resources necessary to perform jobs. Supervisors-as-coaches should help employees interpret and respond to work problems as they develop. Empowering employees in this fashion should lead to more self-corrective actions rather than reactive coursed action to supervisory feedback.

- In an environment of secrecy and authoritarianism, employees and unions lack the information necessary to determine if pay actually links to job performance. Trust is difficult to build when decisions are kept secret and employees and unions have no influence on pay decisions. For performance-related pay (PRP) programs to succeed, therefore, employees and unions must clearly understand what they need to do to receive merit increases and what the rewards for performances will be. Open communication helps employees and unions develop reasonable expectations and encourage them to trust the system and those who operate it. Government must communicate with employees and unions about the fact that workers must be willing to adjust in order to meet various challenges such as new technologies and new work processes.

Notes

1. This case study is based on the Korean contribution to OECD (2003e), Country Reports on Performance-related Pay. That contribution draws on the report prepared by Professor Pan Suk Kim, Professor of Public Administration, Yonsei University entitled *Strengthening the Pay for Performance Link in Government: A Case Study of Korea*, PUM/HRM (2002) 10.
2. In the past, there was no performance rating for Grade 4 or higher-level officials. Those who are in Grade 4 had annual evaluations in terms of behaviour but did not have a performance rating.
3. The Korean civil service has 9 grades: Grade 1 is the highest, while Grade 9 is the lowest.
4. Historically, public unions were under-developed in the Korean Government except medical technicians, and postal and railroad workers. Since 1998, the Workplace Council for lower level government employees is legally organised, although its status is not yet a public union. Furthermore, KTU, formerly an illegal organisation, was legally authorised as a public union for schoolteachers after the Act for Establishment and Management of the Teachers' Union was passed in the National Assembly on 6 January 1999. Currently, KTU's position is to abolish the performance-based bonus program or to make it a typical allowance that does not differentiate employee performance.

Performance-related Pay in New Zealand

1. General information

- Since 1988, the New Zealand public service has undergone considerable change through restructuring and creation of a new legislative framework covering public service management. A key aspect of the changes introduced was that every ministry or department has become an employer in its own right. Input controls such as staff ceilings and standard pay, based on occupations, were replaced by output budgeting and public servants were employed by each department under general labour law.
- Individual ministries introduced performance-pay schemes as part of this general set of reforms. New Zealand was at the forefront of introducing performance-related pay to the public service, along with the United Kingdom.

2. Reasons for introducing PRP policies

- To give autonomy and flexibility to departments as part of wider reforms;
- to improve movement between public and private sector labour markets;
- to improve the effectiveness and accountability of public sector management.

3. Flexibility and control

- There is no standardised system of performance pay.
- Within broad provisions, departments are free to design their own systems and must fund them from their own budgets.
- There is no centralised oversight of the operation of departmental performance pay systems.
- Control is through the overall financial accountability of the chief executive officer who must ensure that there is adequate budgetary provision including for any performance payments.

4. Coverage of PRP schemes

- PRP schemes potentially apply to all staff including chief executives.
- The health and education sectors overall are not covered by a national collective agreement (but groups within them are covered).

5. General design of the PRP system

- Remuneration strategy: Remuneration systems need to be tailored to the specific needs of each department, focusing on contributing to achieving outcomes and maintaining/improving output performance by: i) developing and maintaining the organisational capability to achieve the outcomes set out in their statements of intent; ii) providing incentives and opportunities for employees to develop required skills/expertise, and/or to improve performance. Departments should work closely with the State Services Commission in planning for collective bargaining.
- Departments set remuneration levels taking into account factors such as: i) market demand for the relevant skills/capabilities, experience, and responsibilities; ii) recruitment and retention factors; iii) ability to pay within approved baselines; iv) comparisons with other groups within the department; v) any future government policies aimed to achieve equitable outcomes for employees generally or for particular groups of employees; vi) other factors relevant to the particular department.
- The remuneration policy for departmental chief executives, set by the State Services Commission and determined in agreement with the government, is designed to:
 - ❖ link public service chief executive remuneration to a comparator market of the wider state sector;
 - ❖ strengthen the link between chief executives' performance and their remuneration.
- A budget constraint is a key factor in the determination system. Each department's chief executive is responsible for managing the overall budget. Departments have regard to the government's "bargaining parameters" (see below).

6. Performance appraisal system

- Overall based on recognition of performance and/or competencies.
- Design of performance appraisal decentralised at department level (general guidelines below).

7. Performance payments

- Merit increases (decided by individual departments within the pay range set for positions).
- Bonuses for one-off achievement.
- The government's bargaining parameters include the following.

In general terms:

1. Performance which meets the normal expectations of the job should be recognised by salary rather than by lump-sum, one-off, or at-risk payments (“lump-sum payments”).
2. Salary increases (rather than recurrent lump-sum payments) should be given to employees who year after year exceed the normal expectations of the job.
3. Departments with existing contractual arrangements to make lump-sum payments (other than the exceptions below) should have a strategy in place for negotiating/phasing out such arrangements as opportunities arise.

Exceptions to this general approach:

1. Lump-sum payments to recognise instances of excellent or exceptional performance (e.g. exceeding normal expectations) or exceptional contribution to the organisation (e.g. very high workload). Only a small proportion of employees should receive such payments in any one year.
2. Contractually based higher duties or extra duties allowances.
3. Policies which envisage a lump-sum payment to recognise improved performance over a one-year period with incorporation of the payment into salary when the improved performance is sustained (e.g. over a two- or three-year period).
4. Lump sum payments available to high performing or “fully competent” employees at the top of a salary range as part of a strategy for retaining staff or recognising or enhancing performance/skills/capability.

8. Implementation

- PRP is implemented in almost all the public service departments.

9. Difficulties and problems

- Like all remuneration systems, performance-related pay is crucially dependent on how effectively it is applied.
- The main area to attract criticism (particularly political comment) has been one-off performance payments.

10. Lessons learned and prospects

- The New Zealand experience with basing remuneration on performance or levels of competency (or a mix) has been very positive. The one exception is Police – a career service – that is moving back to a more length of service basis. This system led to clarification of job goals and greater accountability of staff.
- In the last five years there has been increasing emphasis on competency basis and some agencies have moved away from pure performance basis.

- The New Zealand experience with one-off performance pay or bonus has been more mixed. Some agencies have retained some remuneration at risk and potential for performance incentive pay, some use it for selected positions, some use this form of remuneration very rarely. The government's policy is for departments to move away from this sort of remuneration. In part this also reflects political pressure following concern about poorly justified payments of bonuses to staff in some non-departmental public organisations.

Performance-related Pay in Spain

1. General information

- The first important constitutional reform for the civil service that modifies the system established by the 1964 Civil Servants Act. One of the most important reforms introduced was the modification of the civil service salary structure. It introduced an equalitarian principle for basic remuneration in all public administrations and classified remuneration in two categories: basic and complementary. Some bonuses are assigned in order to remunerate different particularities (both personal and job related) that are:
 - ❖ general position allowance (remunerates the level of the position);
 - ❖ specific position allowance (considers specific conditions for some positions: special technical difficulty, special devotion, high degree of responsibility, conflict of interests, or positions that are exceptionally dangerous or arduous);
 - ❖ productivity bonus (remunerates specific performance or working behaviour).
- The productivity bonus is not subject to negotiation with trade unions. In the units in which the modality of productivity bonus by special performance is applied, the trade unions know and participate in the design of the system.

2. Reasons for introducing PRP policy

- The intent of introducing this bonus was to introduce remuneration techniques used in the private sector.

3. Flexibility and control

- At the beginning of each fiscal year, the Ministry of Finance issues a resolution fixing the productivity mass for each ministerial department or autonomous organism. During the year, the productivity mass can be adapted to the number of staff. For such adaptations a module per each effective in the classification groups A and B is used. The Ministry of Finance determines the amount for the global credits allocated to the productivity bonus, adapting it to the number of effectives and the achievement degree of the objectives fixed for each programme (State General Budget Act for the year 2000).

- Inside this total salary mass, the different departments and organisations are free to design and develop their own systems of performance and productivity-related pay. Each department determines the criteria for the individual amounts of the productivity bonus.
- Global credits have not suffered any significant cuts related to economic restrictions; even the salary mass for this allowance has more weight today in the whole structure of the remunerative system than when it was created in 1985.

4. Coverage of PRP schemes

- The productivity bonus can be used in all public administrations – central, autonomous and local – although it is generally used in the central administration.
- The productivity modality for remunerating achievement by objectives is applied in specific sectors, for example: social security, State Traffic Office, hospitals, police, penitentiary institutions, labour inspection, researcher staff from the High Council for Scientific Research, university professors.
- The productivity bonus is applied to a high percentage of civil servants in groups A and B. The percentage of groups C and D is much lower and, in general, the productivity bonus is not based on performance assessment but on longer working hours. There are two important exceptions: the Social Security and the Police offices, which have their own systems, based on performance by objectives and are linked to collective performance assessment at the team/unit level. All categories of staff are included in these schemes.

5. General design of the PRP policy

- The different departments and organisations are independent in the design and development of their own productivity and performance remuneration systems. There are models based on assessing either individual performance or team/units.
- Team/unit PRP is the majority when productivity is used for remunerating special performance.
- The main characteristics legally configuring the productivity bonus are the following:
 - ❖ It remunerates any special performance, extra activity and interest or initiative used in doing the job.
 - ❖ The global amount cannot exceed a certain percentage of total personnel costs in each programme and each organism.

- ❖ The amount of PRP has to be known by the other civil servants in each department or organism concerned, as well as by trade unions representatives.
- General guidelines for the productivity bonus are the following:
 - ❖ extra activity (longer working hours) = more than 50% of the productivity bonus global salary mass;
 - ❖ special performance (affects specific sectors) = 32% of the performance bonus total salary mass;
 - ❖ other purposes = 14%.
- The Civil Servants Act also establishes that the amount will never exceed a certain percentage on the total personnel costs of each programme and of each organism which will be determined by the Budget Act.

6. Performance appraisal system

- There is no standardised performance appraisal system. Each department has the responsibility for developing its own system. Once the global amount or salary mass for the productivity bonus has been fixed, each department enjoys wide independence to establish individual criteria for each civil servant.

7. Performance payment system

- Productivity bonus

8. Experience

- In 2000, the productivity bonus cost represented approximately 9.7% of the remunerations as a whole, with percentages ranging from:
 - ❖ 7.7% in the ministries;
 - ❖ 7.8% in the autonomous organisations;
 - ❖ 11.4% in the entrepreneurial business public agencies;
 - ❖ 22.1% in the social security.
- No evaluation of the results at the central level.

9. Difficulties and problems

- The application of the productivity bonus by special performance is limited as it only affects specific sectors. In most cases the productivity bonus has been linked to the extra activity (longer working hours) and it is almost a fixed amount related to this criteria. At the same time, there are different amounts of the productivity bonus by working hours in separate ministerial departments for equivalent positions.

10. Lessons learned and prospects

- No information.

Performance-related Pay in Sweden

1. General information

- Until the late 1980s, the central government was characterised by a rigid pay and grading structure. Pay agreements were highly centralised and negotiated increases were applied to the entire civil service. A gap soon emerged between the public and private sectors. Low-skilled public sector workers were overpaid and high-skilled public sector workers were underpaid compared to the private sector. This imbalance caused large tensions between the two sectors.
- In 1978, an element of decentralised bargaining for pay was introduced (up to 1% at the local level). In 1985, parliament passed the Government's Personnel Policy Bill, declaring that the employer policy in the state sector shall give priority to results and efficiency over other considerations. From 1980-89 a new budget system was introduced, replacing detailed annual appropriations by performance control and frame budgets. In practice they work as yearly cash limits for the agencies' expenses.
- In 1989, the universal grade system was abolished and gradually replaced by a system for individually differentiated pay at agency level. In the early 1990s, Sweden was hit by a severe economic crisis, resulting in the launch of a crisis programme, involving substantial cuts in public spending. As a result, during the last 15 years, some 20% of public sector employees have been made redundant. In 1994, the government took the final step in the process of devolving employer responsibilities to executive agencies. Full autonomy in employer policy matters was granted to heads of agencies.¹
- The centrally negotiated and individual and differentiated pay system was implemented around 1990 and is today well established throughout the civil service. Since 1990, the public sector has been using this system when recruiting as well as when deciding pay increases for already employed individuals.
- The Swedish system may be considered a form of pay for performance, but without a standardised evaluation system. There is no uniform system of PRP. Nearly all agencies use some kind of performance appraisal or evaluation dialogue once a year to review performance and potential future tasks, results and training needs.

- The Swedish Agency for Government Employers (SAGE) is a special body which represents government agencies in collective bargaining. SAGE is a government agency to which the government has delegated employer responsibility since 1965, but since July 1994 it acts on behalf of instructions from its member agencies. At the top of SAGE is an Employers' Council to which members are elected by the agencies. Formally the government appoints the members to the Employers' Council, who decides upon the orientation of employer policy and sets membership fees – by which SAGE is fully funded – in proportion to agencies' payroll expenditures. The SAGE Board is the supreme executive body which plays a central part in wage negotiations with the trade unions. The director-general, as executive head of the agency, is appointed by the Board. SAGE develops employer policies in different fields and serves its members with experts and consultation. Policies are discussed and formed by members in meetings and networks. All central government agencies must be members of SAGE, the Government Office included.

2. Reasons for introducing individual and differentiated pay

- Individual and differentiated pay was meant to link pay more closely to performance and other merit criteria.

3. Flexibility and control

- Legislation concerning labour is largely discretionary – i.e. collective agreements may be substituted for legislation. Most terms of employment are laid down in collective agreements.
- The remuneration system is highly decentralised. Agencies are almost completely autonomous in matters related to employer policy. Each agency decides pay, promotion, hiring and firing, etc. The only requirement is that agencies must have the skills required to accomplish the outcomes demanded by the government.
- TNS (the occupation-based statistic job classification system, started in 1991) is a statistical tool that enables pay analyses and statistical comparison within the government sector. In 2003 a modernised and further developed system BESTA was introduced and helped to increase the number of agencies partaking in the statistics.
- Since 1997, the government monitors agencies' employment policies by using a system with annual reporting of competence planning, salary level and development, gender distribution, age structure and staff turnover.

4. Coverage of PRP schemes

- Most employees of the Swedish Government are under individual pay systems, except senior government officials – including university

professors, and directors-general – who were taken out of the collective bargaining system. Their salaries are now set on an individual basis either by a review board or directly by the government.

- Employees at all levels may be covered by performance rewards systems as part of their local collective agreements. There are however some exceptions among the police, armed services, and judges.

5. General design of the PRP policy

- Every individual salary is negotiated at local level and is open to public scrutiny.
- Pay should be individually determined and differentiated. The main factors taken into account when determining the pay of an individual employee are: the degree of difficulty of the work performed, the quality of the individual's working performance, and the market value of the work in question.
- Local management and local trade unions consider the need for pay increases due to higher skill, more qualified assignments, higher work demands, higher competence and responsibility, promotion and performance. The results of pay determination should stimulate development and commitment, promote appropriate pay differentiation, and be regarded as fair related to work results and performance.
- The system demands that management develop local pay policies that are generally transparent and recognised by most staff. A typical local pay policy:
 - ❖ focuses on the agency's activities and objectives;
 - ❖ supports the agency's ability to recruit and retain staff with adequate skills;
 - ❖ clarifies how pay determination can motivate, develop and engage staff in good work performance;
 - ❖ defines criteria for pay determination;
 - ❖ includes the means to prevent discrimination.
- Local agencies categorise the different positions according to function, responsibility, etc. In order to do this they often conduct pay surveys and market analyses.
- Base salary is the major bulk of compensation for employees in central government. Overtime and holiday compensation and compensation for unsocial working hours may form an additional minor part of the monthly income. A few groups of employees have special allowances due to the nature of work, but this is fairly uncommon.

6. Performance appraisal system

- There is no uniform government staff evaluation system in Sweden.

- Nearly all agencies use some kind of performance appraisal or evaluation dialogues once a year to review performance and potential future tasks, results and training needs.
- The government engages in annual objectives and results dialogues with the directors general, focused on fulfilling of objectives, new objectives and areas for development.
- All agencies are expected to maintain a yearly development dialogue between each employee and manager/supervisor. Most agencies use the 360-degree feedback system where the employee gives feedback to the manager and vice versa. Evaluations have shown that the dialogue could often be further improved by being more connected to the current aims and should be more straightforward about actual performance and expectations.
- At the agency level, it is natural to link activity planning to individual performance and competence planning. Management by objectives, combined with individual planning at all levels through the yearly development dialogue, creates well functioning links between individual and organisational performance.
- Merit ratings are typically based on tasks undertaken and on identified job outputs and outcomes. Wage agreements can establish the basic criteria for salary differentiation.
- Supervisors are expected to inform their subordinates of their individual wage increase, explaining it in terms of job performance.
- Interviews in connection with wage negotiations are a system for evaluation. The ultimate test of staff skills and competence must be if the agencies fulfil their tasks with good efficiency.

7. Performance payments

- There are three types of agreement negotiated at the agency level within a few framework agreements covering the entire central administration. The basic agreement and the general agreement are negotiated at the central level between the Swedish Agency for Government Employers and the central unions. The basic agreement deals with the negotiation procedure, is valid over time, and must be confirmed by the government. The general framework agreement deals with overall salary levels and other general conditions.
- Local agreements determine the individual pay and other local conditions of employment and are negotiated at the agency level between management and union representatives. There are no centrally determined pay scales or remuneration schemes. Pay increases are based on an evaluation of the qualifications, results and work performances of each individual employee. Local agreements are seen by most staff as the most important. The agencies are fully responsible for the results and

consequences of their collective agreements. Adjustments of their budgets which are not specified in different cost items are not made automatically, but through an index reflecting the change in the labour costs in the industrial sector. There is no financial compensation for agreed pay increases which are higher than the index. In this case, agencies then have to reduce their costs, either by giving notice to staff or by other means.

- In the latest framework agreement the social partners has agreed to an increased use of no minimum level. The agreement proposes that the individual level of pay should be set in a dialogue directly between the line managers and their subordinates.
- Where applicable, performance rewards are more directly linked to efficiency measures and cost savings.

8. Implementation

- More than 90% of Swedish Government employees are on individually differentiated salaries.
- Individual pay determination is much appreciated among employees and employers alike.
- Director-generals are well aware of their role as employers. They carry their responsibility for employer policies very well.
- Recruitment and retention of good managers is believed to have improved under the individual salary setting scheme.
- Performance rewards are believed to have ranged from 0 to over 30% of base salary in agencies with performance reward schemes.

9. Difficulties and problems

- There is a perceived risk of wage inflation if agencies start to gamble that the government cannot accept cutbacks in staff (i.e. police, judges, prosecutors...) and will be forced to compensate them. It is not yet a problem, and may never be. But it would undermine the decentralised system if it became a reality.

10. Lessons learned and prospects

- The division of functions between the government and agencies facilitates a clear separation between:
 - ❖ pay increase – and budget appropriations;
 - ❖ staffing policies – and labour market policy;
 - ❖ available resources – and new unplanned activities;
 - ❖ recruitment – and politics.

Note

1. There is no civil service career track in Sweden. The same labour legislation applies in both the public and private sectors. The Public Employment Act contains few special provisions for the public sector, mainly in the form of rules relating to hiring and firing procedures, disciplinary responsibility and additional activities harmful to confidence.

Performance-related Pay in Switzerland¹

1. General information

- A PRP prototype was launched as far back as 1996. It was in fact already legally possible at the time to refuse a real wage increase by virtue of a clause concerning a so-called “negative” element. Managers who had already experimented with this side of staff management said that they wanted to be able to reward outstanding performance. As a result, a specific legal norm was established laying the foundations for the introduction of performance-related pay which was, in principle, to be available to staff at all levels.
- Following the implementation of this norm, and within a context of wholesale legislative reform, PRP became enshrined in Acts of Parliament and subordinate legislation. The Law relating to Confederation staff (LPers) was adopted by Parliament on 24 March 2000 and came into force on 1 January 2002. It ended the automatic wage increases to which civil servants had until recently still been entitled.² The federal Chambers were in favour of the PRP principle.

2. Reasons for introducing PRP

- The previous pay system allowed for a virtually automatic pay increase every two years for all staff, until their wages reached the ceiling of their respective pay bands. The possibility to adjust this increase on the basis of performance did exist, but as there was no obligation, it was not much practised. The shift in attitude is the result of a combination of factors: political action, control committee reports, and the political will of both the Federal Council and the Federal Personnel Office.

3. Flexibility and control

- The pay system is the same for the whole Confederation (except for the Federal Department of Foreign Affairs which has some specific rules). Performance-related pay is defined centrally, its principles being enshrined in legislation and its implementing directives. The implementation of PRP, on the other hand, is decentralised in that individual managers have responsibility for applying it to their own staff.

4. Scope of PRP policy

- There is a single implementing provision for PRP embracing all posts.
- The system is applicable to all Confederation staff on an individual basis.

5. Overview of PRP policy

- The PRP principle is defined in the first paragraph of Article 15 of LPers, which states that “Wages shall be based on the function, experience and performance”. Wages therefore rest on three pillars, of which performance is an integral part, while the others are defined in the subordinate legislation. Other performance appraisal systems did exist before the arrival of PRP, but they had almost no impact on wages. Nowadays, the government’s performance management strategy focuses mainly on the “performance” component. This represents part of the employee’s total wage.
- Staff pay bands are determined by three different bodies, depending on the employee’s position in the hierarchy.
- Appraisers have a certain amount of flexibility in that they are the ones to determine the percentage pay increase for employees whose performance is considered to be “highly satisfactory” or “excellent”.
- Performance-related pay is incorporated into the regular pay system, with each administrative section having its own budget. This budget can be cut. A budget for performance deemed to be “outstanding” is also available, and this too can be cut.
- Pay increases based on performance can vary from 2 to 6%. An important point to note is that, while it is true that basic wages (pay band) are determined by the job description, the percentage of a pay increase is not solely the reflection in money terms of a performance. Experience also plays a role in wage increases. When employees have reached the top of their wage range and their performance is deemed “highly satisfactory” or “excellent”, they can be awarded a financial bonus by their superiors. However, this is not an obligation.
- Acquired experience also plays a role in pay rises. When staff arrive at the maximum of their salary bracket and their performance is considered “very good” or “excellent”, top management can award them a monetary bonus. But it is not obligatory.

6. Performance appraisal

- The targets set for employees are agreed between the latter and their immediate superiors.
- First there are targets that are performance-related and that enable work to be geared to objectives and results. Such targets might for example take the

form of a particular project or of parts of routine tasks that are especially important during the year in question.

- The next set of targets relates to employee conduct, covering certain personality aspects and working methods. Matters considered here include vocational skills, personal skills, inter-personal abilities and the art of leadership. These behavioural objectives set out the preconditions for successful employment, supplementing the performance-related targets.
- Performance and behaviour are treated as two distinct categories for the purposes of employee appraisal. Managers work together to decide on the percentage to be attributed to each target and category according to their relative importance (weighting). For example, managers are free to assign “high priority” status or a high percentage to a particular target. Equally, they can discard a behavioural target if they think it irrelevant in a given instance.
- Interviews take place throughout the year to monitor performance and check that employees are not perhaps falling short of targets.
- The formal process of performance appraisal takes place shortly before the end of the year and is conducted in writing, using a form whose main components are drawn up at central level. The employee is free to prepare for the interview by carrying out a self-appraisal, which can subsequently be compared to the appraisal done by the manager.
- The system is based on a scale of five criteria ranging from A++ (far surpasses requirements) to C (does not satisfy requirements). The intermediate grades are: A+ (comfortably surpasses requirements), A (totally satisfies requirements) and B (partially satisfies requirements). To avoid preponderance in any one category, the Federal Council has weighted the grades using the Gauss curve and determined value ranges for each of them. The application of these value ranges is decided centrally. This system guarantees maximum transparency of the results, while respecting the rights of the individual (data protection). If an employee disagrees with the results of an assessment, the next manager in line can be asked to conduct a second appraisal.

7. Performance payment

- Financial rewards gained under performance-related pay consist of wage increases based on merit and bonuses.
- ❖ **Merit increments:** the PRP relating to each wage band is summarised in Table 4.4.
- ❖ **Bonuses:** Performance bonuses can also be awarded. This type of remuneration is left entirely to the discretion of managers. Whereas pay increases are always dependent on the end-of-year rating, performance

Table 4.4. **PRP relating to appraisal ratings**

Appraisal rating	Annual wage increase The percentages below are applicable until the wage band ceiling is reached	Complementary bonus once the ceiling is reached
A++ Far surpasses requirements	From 4.1% to 6%	Complementary bonus of up to 12%
A+ Comfortably surpasses requirements	From 3.1% to 4%	Complementary bonus of up to 6%
A Totally satisfies requirements	3%	No complementary bonus
B Partially satisfies requirements	2% Up to 94% of the pay band ceiling	Nothing in employee's pay to offset inflation. Wage reduced to 94% of the pay band ceiling after a two-year period.
C Does not satisfy requirements	0% ¹	¹

1. For performances awarded a "C" rating, there is no pay increase. Remuneration to offset inflation is only granted in exceptional circumstances, such as for financial hardship. If action taken to help the employee progress, a shift to a less demanding post or other such measures fail to bring about an improvement in performance, the contract is terminated.

bonuses can be awarded at any point in the year regardless of the rating. Last, it should be noted that the law provides for the awarding of one-off financial or in-kind bonuses. The size of the increases (as of A+) is normally decided by individual departments, as are performance and one-off bonuses. The qualification in itself can not be contested; on the other hand, the financial repercussions (on salary) of a qualification can be contested.

8. Implementation

- PRP was brought in at the same time as the new law on state employees and was part of a process of wholesale revision of legislation in this area. As was noted earlier, performance pay extraneous to the "normal" wage was not a completely new concept for federal employees. They had long been aware of imminent changes, and of PRP in particular, because parliamentary debate on the subject had been widely covered in the media. Upon the Federal Chambers' approving the law, unions acquired the requisite number of signatures to hold a referendum, the motion of which was rejected by federal vote, and the law duly won employee approval.
- An appraisal of PRP implementation was carried out very soon after the law came into force. An interim report on how the quality of the new pay system was to be ensured followed in early 2003.

- The majority of people canvassed after the new pay system was introduced thought that the use of different performance appraisal techniques was a positive thing. They saw it as a sign of change and of a departure from the image of the dyed-in-the-wool civil servant towards one of entrepreneurship based on modern public management techniques. Government employees are consequently optimistic that PRP will be the vector for a system allowing flexible performance assessment. However, given that the system has to be cost-neutral, employees have doubts as to whether the new system will be applied in its entirety. They are also concerned about whether performances will be correctly ranked. On this point, managers have remarked that if targets are to be properly assessed they must be set with care. However, it is clear that there will always be a certain degree of subjectivity.
- Table 4.5 gives the target figures, determined by the government, for managers to aim at when giving ratings, as well as the figures actually achieved. The results provide a good starting point for future action.

Table 4.5. **Target figures for ratings**

Appraisal rating	C	B	A	A+	A++
Target figures (%)	0–3	5–15	65–75	10–25	0–5
2002 figures (%)	0.2	3.3	75.2	20.2	1.1
2003 figures (%)	0.2	2.9	76.2	19.8	0.9

- Six months after the first compulsory annual appraisal, the majority of employees felt that a performance-linked pay system was a good thing. It gives employees and management the opportunity for open discussion, promotes results-oriented work, and encourages communication. It also means that both employees and managers have to deal with personnel tasks.
- The second general evaluation shows a tendency to qualify staff in a much less differentiated manner.

9. Difficulties and problems

- Those questioned on the subject think that the time that has been spent implementing PRP is out of proportion with the end result. Some of the problems indicated are:
 - ❖ the fact that PRP is linked to the Gauss curve;
 - ❖ the difficulty of unifying appraisal methods;
 - ❖ the incompetence of some managers;
 - ❖ the negligible impact on salaries;

- ❖ the fact that the public service culture is not amenable to performance-related pay.
- These are the only conclusions it has been possible to draw at this stage.
- According to the initial results of the survey, it would appear that decentralisation has led several different ways of applying PRP which could render the system less effective. Some employees criticise the linkage to the Gauss curve. In fact, the scope for wage increases linked to PRP is limited, compared to the previous pay system, and budgetary constraints restrict the freedom of managers to award bonuses. A significant flaw in the system, which should be closely monitored, is the rigid application of the Gauss curve to groups of three to four people. This is clearly a problem, and moreover is inconsistent with its intended use by the Federal Council, which had established the weighted value range principle as a basis for its implementation (see above). More and better information and indeed training are therefore imperative and are in fact scheduled.

10. Lessons learned and prospects

- Given that the system has only just been introduced, no extensive reforms have yet been envisaged.
- A PRP system which genuinely allows for the awarding of pay increases and sizeable bonuses is probably a good thing. However, like all administrations, the Confederation is faced with budgetary constraints. If on top of this, other measures are taken affecting pay, staff could become de-motivated very quickly and this could rapidly result in a vicious circle situation. Given that appraisals will continue anyway, the grades awarded to employees might start to fall.
- PRP is generally applied only on an individual basis in Switzerland. When a team is rewarded, different instruments are used, such as performance bonuses.

Notes

1. This document deals only with PRP as used within the Confederation, at federal level.
2. It should be noted in passing that the new law did away with the idea of the civil servant and of fixed-length appointments, replacing it with that of the “employee” plus a basic contract of indefinite duration.

Performance-related Pay in the United Kingdom

1. General information

PRP in the UK civil service

- The policies of previous administrations to decentralise civil service management by creating free-standing agencies, and to reward all staff according to their performance, distinguish the civil service pay practices from much of the wider public sector, such as local government and the National Health Service. The two distinctive features of civil service pay are: i) the delegation of pay, grading and performance management arrangements to departments and agencies for staff below the senior civil service; and ii) the near-universal application of individual performance pay.
- Prior to delegation, HM Treasury centrally determined the pay, grading, terms and conditions of employment for all civil servants in negotiations, with unions. Individual departments had no control over the terms and conditions of their staff. The delegation of pay and grading regimes to departments and agencies began in the early 1990s. At the same time, performance-related pay was introduced to achieve a closer link between performance and reward for individuals and groups of staff. Departments received full delegation to develop terms and conditions for their staff in 1996.

History of PRP

- In 1955 the Priestly Royal Commission pronounced against merit pay for the civil service because of the difficulty of assessing individual contributions. The Fulton Committee took the opposite view in 1968, but review by civil servants again concluded against the introduction of merit pay. During the 1970s both the Top Salaries Review Body and the House of Commons Expenditure Committee supported merit pay. In 1982 the Megaw Inquiry produced a recommendation to introduce performance-related pay. This provided a “more fluid decentralised arrangement embracing regional differences, productivity incentives and rewards related to performance”.

The Megaw report was viewed with great hostility by the unions and it took years before any union made a deal which reflected these new ground rules.

- In 1985, a three-year experimental performance bonus scheme was established. The scheme was not a success: staff thought it unfair, the award criteria unclear and that it reduced morale and was de-motivating. Nonetheless, useful lessons were learned.
- In 1987, an agreement with the professional civil servants' union, IPCS, to introduce above scale performance-related range points was reached. Agreements with the other civil service unions followed. However, union acceptance was essentially grudging, with most unions taking the position that only by accepting performance-related pay arrangements would extra money be released for their members' pay rises. The schemes introduced at this time were largely built around, and did not replace, the existing incremental scale arrangements.
- The first Citizen's Charter White Paper (1991) spoke of the "powerful effect" performance pay can have. The White Paper promised to extend rewards for performance and penalties for failure as part of the normal package of pay and conditions for civil servants. The cost of performance rewards would be paid for by real productivity increases.

Reform of pay and performance management systems

- Sir Richard Wilson's Civil Service Reform Report (1999) required departments and agencies to have reviewed and implemented reforms to their pay and performance management systems by April 2002.
- Sir Michael Bichard's supporting report – Performance Management – focused on better business planning and sharper performance management. It recommended that pay be used positively to provide strong incentives for high performance, with the highest performers and those responsible for delivering key business objectives being best rewarded. In practice this implies a further widening of pay differentials between the best and other fully satisfactory performers. The report also argued for greater use of non-consolidated (variable) pay to reward good performance (individual and team bonus schemes).

Civil service trade unions

- Apart from the senior civil service, where an independent pay review body operates, civil service unions are recognised for pay negotiation purposes in all bargaining units. Union membership in the civil service is about 60%. The union leadership wishes to see a return to centralised pay arrangements.

2. Reasons for introducing PRP policies

- To make pay more responsive to the market and to enable departments and agencies to have greater control over their pay bill, while avoiding pay increases which were incompatible with government policies for the economy and public spending.
- To ensure that value for money was obtained by promoting the delivery of high quality but affordable public services and rewarding good performance and penalising bad.
- To increase transparency.

3. Flexibility and control

- The system was originally centralised with a trend to increased decentralisation in the past ten years. In 1994 the government announced its intention to extend its policy of delegation to all departments of staff below the senior civil service and to replace the existing national pay frameworks.
- A condition of delegation was that all departments had to review their pay and performance management structures in order to ensure that they developed systems best suited to their business needs. In developing their own systems, departments are required to have regard to the four key principles set out in the Civil Service Management Code (CSMC):
 - ❖ better value for money from the pay bill;
 - ❖ improved flexibility in the pay system;
 - ❖ better budgetary control of pay costs;
 - ❖ an effective link between pay and performance.
- The Cabinet Office is the custodian of the CSMC and all civil service organisations are bound by the Code. The delegated pay proposals that are developed by departments and agencies are to be used as a basis for subsequent departmental negotiations through the annual pay remit process. Officials review proposals taking into account: improved service delivery; affordability; equity and fairness.
- The senior civil service pay and performance management system is centrally managed by the Cabinet Office. The arrangements came into effect in April 2001 with the first payments under the new system made from April 2002.

4. Coverage of PRP schemes

- PRP policy applies to all categories of staff.
- Senior civil servants' pay is managed directly by the Cabinet Office.
- PRP policy can be applied both at the individual and collective (team/unit) level.

5. Overall design of the PRP policy

- There are varying practices across organisations. However, a condition of delegation is that departments and agencies must provide a close and effective link between pay and performance. The civil service reform programme gave departments and agencies a good opportunity to modernise their reward systems. Broad principles were set out for civil service organisations to incorporate.
- Current practice varies greatly within the civil service, with departments and agencies encouraged to align their reward strategies with their own business objectives. Current pay systems typically involve pay ranges (including a minima and maxima) set by grade, target rate and non-consolidated bonuses.
- For senior civil servants, the new pay system introduces a mixture of both consolidated base pay awards, and non-consolidated bonuses which have to be re-earned each year. The system makes pay dependent on in-year delivery, not time served. Pay awards are directly based upon an individual's contribution to his/her department's success relative to that of his/her peers. Success will be judged each year against public service agreements, business plans, and the new senior civil service competence framework.

6. Performance appraisal system

- Most departments and agencies set pay ranges by grades. These are set in order to relate to market pressures and/or recruitment and retention factors. Pay ranges are generally re-valued on an annual basis to meet needs and keep in line with market pressures.
- Most departments are designing reward systems in support of business needs.
- Most departments and agencies provide progression to a target rate. Progression times vary according to pay range with junior grades generally progressing to the target rate or maxima in less time than senior grades. Target rates are set in accordance with what is considered to be the market median for the job and are generally positioned between 80% of the pay range and the maximum. Once at the target rate, it is generally the case that only the best performers can receive consolidated payments past this point. Progression mechanisms vary between organisations.
- Departments may also vary starting pay to reflect particular skills or pay in previous posts. High performers will not necessarily be the best paid in their grade. Departments are working hard to develop progression arrangements that are robust against equal pay challenges.

7. Performance payment system

- Non-consolidated bonuses are now being used as one of the main vehicles for delivering performance-related pay to those staff performing above a satisfactory level. Bonus levels vary in different organisations and can be substantial in some and much less substantial in others.

For senior civil servants

- The system is only a framework; there are no proposals on the size of the bonuses. The range of bonuses available will be recommended to government by the Senior Salaries Review Body (SSRB).
- For 2003-04 the average earning increase for SCS base pay should be 3.5% and the bonus pot is funded at 4% of the SCS pay bill. Final decisions on the levels of base pay and bonuses are taken each February.
- The overall SCS pay bill increase for the 3 800 odd SCS members is approximately £10 million and the bonus pot costs around an additional £10 million.
- There is a clear framework to ensure that bonuses are targeted, well differentiated and of a meaningful size. Those individuals making the least contribution will not be eligible for a bonus.
- The bonus scheme was phased in over three years to spread the cost of its introduction.
- The new pay arrangements have improved the pay progression for many and provide better rewards for excellence, but the regime is tough on the poorer performers. The best 25% of performers will move quickly to a market-based target rate with bonuses on top of 5-20% linked to delivery of key targets. The bottom 5-10% who deliver least will stand still, or take a real terms pay cut. This group are targeted for change to develop them or move them out.
- Salaries for all but the best will be capped below the pay band maximum. The 15% of SCS staff likely to be above the target rates see no real terms pay progression unless they are among the top 25% of performers.
- The new system introduces market-facing pay rates to help bring in and reward talent. The introduction of a target rate, which all effective performers can reach, related to 80-90% of the market median means that departments will be able to compete more successfully for talent; the target rate will also support increased interchange with the wider public sector.
- SCS pay accounts for less than 1% of the total civil service pay bill and other pay will not be affected by the changes to the SCS pay system.

- The changes to the pay arrangements have not added to public expenditure, and they have capped consolidated earnings growth at a lower level than the previous pay system, other than for sustained high delivery.
- The Senior Salaries Review Body continues to provide independent advice to the government on SCS pay.

8. Implementation (see section 10)

9. Difficulties and problems

- **Management capability:** This has been a consistent concern of HR managers. Performance management systems are robust (Equality in Performance Review Research, 2001), but there are concerns over the operation and management of these systems. Improving management capability is one of the biggest challenges for departments and agencies to achieve. A report to the Civil Service Management Board in 2003 recommended “more active organisational and personal performance management – including greater transparency in expectations and regular honest feedback, based on better evidence, more clarity on how we will reward people who perform, and a simplified appraisal process” as part of a wider programme of improving leadership capacity.
- **Flexible funding:** financial differentials between levels of performance, in cash terms, are not meaningful enough and offer little in the way of motivation. Due to funding constraints, departments and agencies are not able to provide adequate financial incentives for staff to want to perform at the top level. Staff may feel that the incentive to “go the extra mile” is not offered. It is felt that performance-related pay is not as effective as it could be. Departments and agencies also have difficulty measuring the impact of a performance-related pay system on the achievement of organisational objectives.

10. Lessons learned and prospects

- The government considers pay delegation an important tool to facilitate improvements in delivery and productivity by providing individual departments and agencies with the flexibility to offer reward packages that support their business requirements. Permanent secretaries/chief executives can determine how best to recruit, retain and motivate their staff and they have the ability to control their pay bill, which forms a very significant part of most departments’ or agencies’ total costs. Delegation has allowed for variation, trial and development in business units to enable the development of the appropriate mix of total rewards. People with expertise and local knowledge are now making decisions. Hence, delegation directly supports two of the Prime Minister’s four principles of public

services reform, namely devolution and delegation to the front line and greater flexibility.

- It is accepted that delegated pay has its problems – some differences in pay and conditions are difficult to explain. This has been highlighted where departments have merged as part of machinery of government changes.
- Cabinet Office, with the help of key stakeholders, is currently working up practical proposals to improve the workings of the delegated arrangements within which departments can operate.

Design

- The design of the reward system should reflect the nature of how work is actually carried out and also the culture and direction of the organisation. Performance-related pay schemes are used to align employees' performance with organisational objectives, to create a clear line of sight between individual objectives and achievement of organisational goals.
- It is important to pay attention to the culture of the organisation. If an organisation has a team-based culture, individual rewards may not be suitable.
- It is important to keep schemes fresh – management needs to find ways of re-launching and updating schemes to keep staff interest and enthusiasm high. Systems need time to “bed in” before benefits can be recognised and/or realised. Constant change can be destabilising.
- Financial incentives motivate employees where there are clear links between effort, performance and reward, coupled with meaningful rewards.
- Performance-related pay is easier to use when effort and/or outputs are easy to measure.
- Research is necessary when designing or implementing a new reward strategy. It is important to find out what has (or not) worked well in other organisations of a similar nature and learn from their successes or failures.
- Non-pay rewards – ranging from managers saying “thank you” to more elaborate recognition ceremonies – cost little and are effective ways of rewarding staff. There is scope to expand the use of non-pay rewards in the civil and public services. While the civil service has significant discretion to use non-pay rewards, it seems that they are not used as frequently as they could be.

Implementation

- There are a number of important elements that make rewards schemes work well, including:
 - ❖ transparency;

- ❖ employee involvement;
- ❖ sense of fairness;
- ❖ realistic and clear goals;
- ❖ proportionality of the reward to the effort required;
- ❖ high degree of employee control over the measured outputs; and
- ❖ impartial and high quality people management.

Performance management system

- An effective performance management framework is fundamental. This involves measuring performance, including prompt feedback of achievement and publicity to all staff about the results to which they have contributed. There should be a clear line of sight between individual and organisational objectives.
- Too great a link between the performance management system and pay can serve to undermine the former as it can lead to reluctance to identify performance failings. A balance needs to be struck between striving for consistency and comprehensibility and simplicity.
- Leadership must be capable of providing direction and clarity of objectives, and needs to embed this into how the organisation works. The management capacity to apply the framework effectively must be in place. This will often require a major capacity building/training commitment, backed up with a strong HR capability, which is closely connected to the business/delivery planning function.
- As well as rewarding good performance, an effective performance management system also needs to deal effectively with poor performance.

Other factors

- Pay is not the only motivator: The Audit Commission's 2002 report on recruitment and retention showed that many people join the public sector to "make a difference"; and that pay was listed well behind factors such as bureaucracy, paperwork and workload as reasons why people leave the public sector.

Challenges and prospects

- **Performance bonuses should be non-consolidated** and clearly separated from base pay; they should be paid by reference to achievement against targets in the public service agreements; they should be awarded on a team basis; and should be large enough to create real incentives – at least 5% of salary. Financing the bonuses should include arrangements to be agreed between the departments and HM Treasury, under which the surpassing of

targets, for the organisation as a whole, would result in the release of additional funds for performance awards.

- **Team/unit PRP:** HM Treasury, HM Customs and Excise and the Department of Work and Pensions are jointly sponsoring research into the impact of the Makinson team-based bonus trials (Makinson, 2000) in the major service delivery departments. This research will be complete in April 2005.

Performance-related Pay in Chile¹

1. General information

- In 1998, Chile introduced performance-related pay (PRP) in its public sector management, reinforcing the modernisation process begun in the early 90s. The reform process was similar to those of developed countries, except it took place in an economy with no fiscal deficit and with the participation of the public sector workforce unions. Chile's reform process can be divided into two stages – the initial stage, from 1998-2002, and its consolidation, beginning in 2003. There are two main PRP tools: PRP applied at organisation level and expressed in Management Improvement Programs (MIPs) that give employees a financial incentive to meet management objectives; and PRP for team work, applied on a decentralised basis by the head of each organisation.

1998-2002

- The introduction of PRP schemes began in 1998, as a part of the civil service reform and basically was applied at the organisations and the individual members of staff levels, and allowed a regulated growth in pay rates, creating a modernisation allowance.
- MIPs: The PRP at organisation level (agencies) was introduced by 1998, giving employees a financial incentive to meet management objectives. Compliance with the annual MIP gives agency employees a 3% salary increase the following year, provided the agency has met at least 90% of the annual objectives. The increase is 1.5% if compliance is between 75-90%.
- During the program's first years of operation, a high percentage of the indicators expressing the management objectives were related to the agencies' routine activities, were based on processes, and set low targets. In 2001 the MIP program was modified and the focus was sharpened so that the program would contribute to developing strategic areas for public management. The modifications focused on the adequate operation of areas and systems to guarantee better overall management.
- The development of managerial systems is ordered in stages and each stage has defined technical requirements. Agencies are responsible for formulating their MIPs and carrying out all the activities defined for each stage involved. They must annually identify the stage they must reach by the end of the

following year for each area and system. To facilitate internal and external coordination, MIP coordinators have been named in each agency.

- The head of each agency must apply a participatory process for preparing MIPs, informing staff at all levels of the proposal and also on how objectives are being met. The regulations require him/her to hold working sessions for information and consultation with employee associations, to gather suggestions and comments for both preparation and evaluation of the MIP.
- MIP institutional framework includes an Inter-ministerial Committee, with members from the Ministry of the Interior, Finance and Presidency, charged with ensuring the coherence, technical quality and level of demand for the agreed management objectives. Each year, the Committee approves the Framework Program, each agency's MIP formulation and fulfillment. The National Budget Office, which is member of this committee, is responsible for developing the program technically and operationally.
- The Government General Internal Auditing Council plays an important role at the verification stage. The task of the agencies' own auditors is to check and confirm the fulfillment of management objectives included in the MIPs, based on defined means of verification.

2003

- A new law, the New Deal on Employment and the Senior Public Management System, came into force in 2003. The aim is to develop an integrated policy on public sector employment through improved incentives and major changes in the mechanisms for appointing senior civil servants. The main objectives of the new staff policy are:
 - ❖ To modernise and professionalise the civil service career structure with better systems for entry, promotion, training and retirement.
 - ❖ To introduce more performance incentives and mechanisms for decentralised decision-making on pay structures and policy.
 - ❖ To establish a new institutional framework, the National Civil Service Office, dependent on the Ministry of Finance, to strengthen decentralised implementation of the new HRM policies.
 - ❖ To develop an integrated system of senior public executives to provide central government with teams of leading, efficient professionals.
- Specifically, the new law strengthens the PRP scheme with higher incentives in the pay structure and increments for excellence at the organisational level; sets up a permanent system of voluntary retirement incentives; and, in 2004, increases the modernisation allowance by 8%.
- Other innovations in the variable component include replacement of the individual performance merit increment with one for collective performance or **team work** to be awarded on a decentralised basis on the strength of their fulfillment of work unit management targets.

2. Reasons for introducing PRP

- To reward good performance by individuals and organisations, raise the quality of public services, increase salaries, and motivate civil servants, guarantee better overall management. Specifically, the main reason for introducing MIP was to create a model for improving performance in agencies, strengthening managerial systems including budget management. The main reason to create PRP for team work was decentralising the financial incentives management.

3. Flexibility and control

- There are two PRP schemes, MIP which is centralised and team work which is decentralised.
- In the PRP for team work scheme, the head of each organisation will be responsible for annually defining the teams, units or work areas according to functional or territorial parameters, or both. Territorial parameters may be applied nationally, by region or by province.
- The head of organisation will set the targets and their indicators, which must be linked to organisation mission, strategic objectives and relevant products, and be validated in the management planning and supervisory system of the MIP. The targets will be set jointly with the teams, units or work areas in a performance agreement to be signed by the head of organisation with the respective minister.
- Target fulfilment will be verified by the internal auditing unit of the relevant ministry. The task of setting objectives and indicators is thus carried out by a different authority (head of service) than that responsible for monitoring and supervising.

4. Coverage of PRP schemes

- MIPs are currently being applied in 89 centralised and 90 decentralised agencies. Another eight agencies are carrying out MIPs but their institutional incentive mechanism is governed by other laws. PRP schemes for team work are being applied in 117 agencies.

5. General design of the PRP policy

- In the beginning, there was only one PRP tool: the modernisation allowance which consisted of three components:
 - ❖ Base increment: The fixed component, paid in all cases to all employees (5.5% of pay in 1998, 6% from 1999 to 2002, 8% in 2003, 10% in 2004).
 - ❖ Individual performance increment: PRP applied to each employee, awarded on the basis of individual performance ratings (4% for the 33% of

highly-rated staff in each workplace; 2% for the second, lower-rated group, up to a total 66% of the best-rated. Those in the low performance group did not receive increments). This allowance was awarded from 1998 onwards, but it was eliminated in the New Employment Deal, after the civil service staff associations argued that an individual allowance undermined team work. From 2004 it will be replaced with an increment allowance for teams.

- ❖ Institutional performance increment: PRP applied at organisation level expressed in Management Improvement Programs (MIPs).
- **From 2003 onwards** new elements were added.
 - ❖ Allowance for collective performance: PRP for team work, applied on a decentralised basis by the head of each organisation. As from 1 January 2004, target fulfilment by such groups in the preceding year will give the staff involved a 4% rise where compliance is at or above 90%, and a 2% rise where the level is below 90% but at or above 75%. No increment is payable for performance levels below 75% of targets.
 - ❖ Annual prize for excellence in public organisations: This prize will be awarded to the organisation with the best results (achieved 100% or above of its MIP targets) in terms of productivity and quality. The prize will consist of a 5% increment on the same base as the modernisation allowance. The National Civil Service Office will be responsible for managing and awarding the prize.
 - ❖ Senior executive allowance: With the implementation and development of the Senior Public Management System in 2002, top executives will receive a senior executives' allowance, of which a percentage is variable, awarded on the basis of performance and target fulfilment set out in a specific performance agreement. The aim is to ensure that central government institutions can count on managers who meet a series of conditions. The system is based on entry through open public competition, on the principles of transparency, equity and merit.
 - ❖ The new system covers civil servants in senior posts as heads of public organisations whose functions are chiefly the execution of public policies and the provision of services to the community. Political authorities are excluded, along with the heads of services responsible for formulating public policy who are covered by the existing regime for direct Presidential appointments. Only 28 organisations remain outside the system, and 80% of service chiefs will be chosen through public competition.
 - ❖ From 2004 onwards senior civil servants (heads of organisations and second level managers) will receive a senior manager's allowance, which is partially performance linked, according to the following formula: i) a

maximum 20% increment for meeting 100% or more of the targets and
ii) 50% of the maximum for meeting between 80% and 100% of targets.

- ❖ The performance agreement for the head of organisation is made with the respective minister, and for the second level (middle) managers, with the head of organisation. The agreements will include programme/sector targets as well as goals for progress in organisational development, such as those in the current MIP.

6. Performance appraisal

- For MIPs, the definition of the means of verification for completion of each stipulated stage, for each of the systems incorporated into the Framework Program. The definition is documented and all agencies advised of it.
- Verification of compliance of the MIPs as a government-auditing objective, in accordance with the definition of the Government General Internal Auditing Council (CAIGG). This process is included in the annual program of each institutional auditing unit.
- The function of each agency's internal auditor is to verify that the management objectives of the MIP are being achieved, a process which is done on the basis of defined means of verification.
- In the case of the Internal Auditing system, the CAIGG ruled that ministerial auditors would verify the fulfillment of commitments of each MIP agency. The Under-Secretariats in each ministry, who are responsible for the Internal Auditing, are audited by the CAIGG itself.
- The use of existing information systems has been integrated into the process of evaluating compliance of management objectives of each MIP.

7. Performance payment

- In 1998, the pay structure for central government workers could be broken down into a) base pay (73%); b) non-permanent personal allowances (24%) such as regional weightings, seniority, and overtime payments; and c) PRP (4%). The pay structure was modified with the increase in the modernisation allowance, once the second stage of the reform comes into effect. In 2004, allowances will be: a) 70%; b) 22%; and c) 8%.

8. Implementation

- PRP schemes for team work have had a successful implementation but there are records for one year only (2003). According to information from the National Budget Office, in 2003, 95% of the teams achieved a compliance at or above 90% of targets. Another 4% of the teams achieved a compliance below 90% but at or above 75% and only 1% had a performance level below

75% of targets. These results are comparable to the first year results of MIPs (1998). Additionally, 67% of teams which achieved the highest rate of target fulfilment achieved the highest rate on their MIP. 60% of the agencies which have PRP schemes for team work organised their teams according to functional parameters rather than territorial ones.

- MIPs have had a longer implementation time. In 2003, 75% of the agencies (132 of 176) achieved a compliance at or above 90% of targets, 20% (36) achieved a compliance below 90% but at or above 75%, and 5% (8) had a performance level below 75% of targets. 85 agencies (48%) achieved 100% of target fulfilment. Despite those figures, the number of agencies which achieved a compliance at or above 90% of targets diminished from the preceding year. In 2002, 79% of the agencies fulfilled the highest rank. Causes of this could be the increasing level of exigencies of MIPs, which are designed to achieve rising developments of managerial systems.

9. Problems met

- Before 2001, during the first years of the MIPs, a high percentage of indicators related to the agencies' routine activities, based on processes, and low targets were set. Commitments were not comparable in terms of relevance to the agency's mission or the level of demand required to meet them. Unequal degrees of effort were thus rewarded equally, which is undesirable in the case of a financial incentive. These results were due, among other factors, to an uneven level of management within the agencies, and to inadequate technical work in setting and verifying commitments.
- Although there have been advances in socialising and internalising performance indicators as a management tool within the agencies, these are often drawn up by a reduced group of staff, and the effort is not sufficiently shared with other members of staff on whom the results depend. Nor is best use made of the indicators in analyses and decision-making within the agency.
- A general evaluation of the PRP for team work is in progress and that work will identify the problems.

10. Lessons learned and prospects

- The MIP management tool has not only reinforced the incentives for more effective and transparent management, but also forms a base from which to extend these efforts. In the short term, progress in meeting basic management system targets gives staff a financial increment. In the medium term, organisations that meet comprehensive targets can guarantee a level of management responsibility which could give them differentiated institutional status. On the matter, the Ministry of Finance

has tied the MIP fulfillment, plus other financial discipline requirements, to grant flexibility, eliminating some kinds of controls of a financial-operational nature, like the pre-established regulation on cash surplus transfers, and integrating budget sub-items for operational expenses, in order to allow organisations to reallocate resources autonomously within the authorised overall appropriations.

- A significant challenge will be to apply the new PRP for team work, which it is hoped will strengthen decentralisation and staff commitment to organisation goals. The performance allowance for heads of organisations should recognise the achievement of strategic goals set in the respective performance agreements. This makes a proportion of senior managers' pay variable and performance linked, helping ensure that the organisations are headed by competent, committed professionals.
- Work must continue on reviewing aspects of establishing MIPs in each organisation, and encouraging participation in, diffusion to and comprehension of the programme by employees and different managerial levels.
- The results of the assessment process are commonly related solely to the payment of performance allowances. But they can and should be used for a variety of purposes, such as decisions on promotions, discovering training needs, planning overall training, supporting employees' professional development, strengthening relations with an immediate superior and encouraging better performance on the job, justifying disciplinary action, or providing information on which to base decisions to let staff go.

Note

1. Chile is an observer to the OECD Public Governance Committee.

PART II
Chapter 5

**Case Studies of Performance-related
Pay Schemes**

Performance Pay for School Teachers in England and Wales*

In many countries, school teachers constitute one of the largest groups of public employees. They contribute a key public service whose performance is of concern to children and their parents as well as to the national economy, and their salaries represent a significant part of the public sector pay bill. It is therefore not surprising that a number of governments have given thought to how to change the design of the teachers' pay system in order to assist other educational policies. The recent reforms of teachers' pay in England and Wales, which came into effect in autumn 2000, provide an illustration of performance pay and performance management in state primary and secondary schools, of what can be achieved and of some of the difficulties to be resolved.

The new teachers' pay system: its aims and its design

The new pay system for teachers in England and Wales introduced a number of innovations. As initially proposed in the 1998 government Green Paper (*Teachers: meeting the challenge of change*), it contained four key principles:

- Reward teachers for excellence in the classroom.
- Performance management for all class teachers, with annual performance reviews.
- Performance threshold assessment in order to progress to the new "Upper Pay Spine" (UPS) with PRP.

Two key elements in the initial conception of performance included:

- Link with pupil progress.
- "Tapering" of the UPS whose stages should be increasingly difficult to pass.

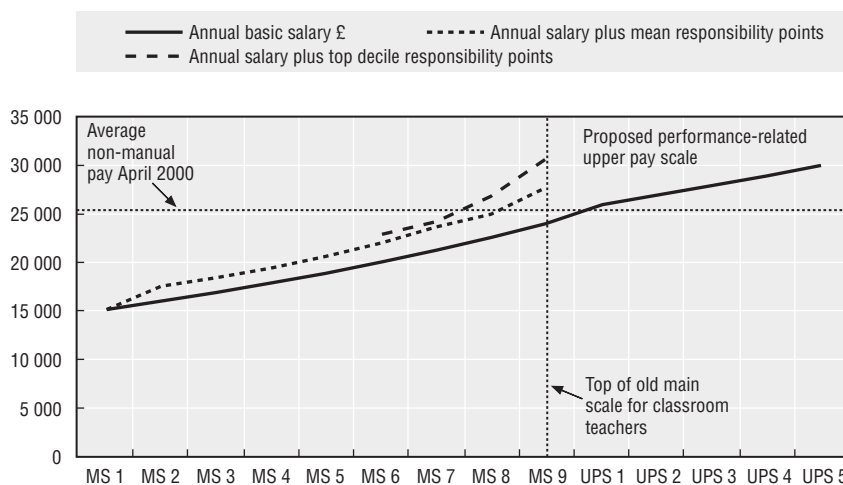
Thus, the new system seeks to encourage teachers to focus more on developing the academic performance of their pupils and to integrate their goals with those of their schools. The new system also seeks to address the failings of the previous pay system and pay levels which were widely seen as responsible for recruitment and retention difficulties and for diverting teachers

* Written by Professor David Marsden, London School of Economics. A fuller account of the analysis in this paper will be published in Marsden and Belfield (2005).

away from their classroom duties because of the dysfunctional nature of the system of allowances which had grown as a result of labour market pressures.

The background to the change and some of its details are shown in Figure 5.1. To the left of the vertical dotted line, one may see the salary progression for classroom teachers under the old pay scale, from the moment of hiring as young graduate to the top of their scale, seven to nine years later. During this period, they would progress from being newly qualified to becoming experienced teachers. At this point, as can be seen from the horizontal dotted line, experienced teachers would still earn less than average white collar pay. To address recruitment and retention difficulties, the government could have raised the whole pay spine for all teachers, but the budgetary cost would have been very high, there being nearly half a million teachers. It chose instead to extend the existing pay scale by introducing the new “Upper Pay Spine” (UPS), and to make progression along it dependent upon a teacher’s performance. Movement onto the UPS came with a £2 000 a year pay increase.

Figure 5.1. **The old and the new classroom teachers’ pay spines**



Source: Department for Education and Schools: School Teachers’ Pay and Conditions Document 2000; Responsibility points from School Teachers Review Body report 2000, and New Earnings Survey, April 2000.

At the same time, the government introduced performance management in schools involving annual performance reviews for teachers with their management, in which they would agree objectives for the coming year, and then be assessed on how far those of the previous year had been achieved. Moreover, these reviews were to take place within the context of performance targets for schools as for the whole educational system. Thus, the performance review created a forum in which teachers could agree objectives with their line manager, which would fit into the wider goals of their school.

For example, a primary school might have the objective of ensuring that 50% of year 4 pupils attain a given level in certain subjects, but the head noted that in some subjects the school's pupils were ahead of the target for that year and in others they were behind it. In the review, the head and the teacher could agree to prioritise the weaker subjects for the coming year, and to set targets accordingly. In the course of the review, the head and the teacher might look at how to translate this global objective into shorter-term plans for pupil development and also look at any additional training needs of the teacher.

To pass the “threshold” assessment, teachers have to demonstrate a range of teaching and class management skills, and the transition might be thought of as involving upgrading to the status of a senior teacher. Further progression above the threshold was initially intended by the government to involve increasingly demanding standards.

The new system is intended to tackle two key weaknesses identified in the former system. The first concerned the recruitment and retention difficulties arising from the low levels of pay at the top of the classroom teachers' pay spine – below average non-manual earnings at the time. In response to these retention problems, head teachers used whatever instruments they old pay system made available to them and so, quite naturally, many used the allowances they could pay teachers in order to boost their pay. Payments for additional responsibilities are also displayed in Figure 5.1, showing how much they boosted the pay of those with the average amount, and top decile, of such allowances at each point on the old pay spine for those receiving them. Although very few did so at the lower points of the main teachers' scale, at the top of the old pay scale, 60% of teachers received such payments. Thus, although the responsibility payments enabled head teachers to resolve their immediate problems of staff retention, they diverted teachers away from their core teaching activities. Although such payments had originally been intended to reward teachers for taking on management duties, in practice this was often not the case, and “stationery management” has become a popular illustration of such duties among teachers.

Thus the key tasks of the new pay system have been to improve the rewards for teachers for their work in the classroom, and to support a system of performance management in order to align better the goals of individual teachers and those of their schools.

Has performance pay worked?

Whether or not the new pay system has worked can be considered from three main angles. Has it worked:

- as a motivator?
- as a part of performance management?
- to improve school management?

A panel survey of teachers and schools carried out by the Centre for Economic Performance provides some answers to these questions. The panel started in 2000, just before the new scheme was implemented in spring 2001 after the first threshold assessment results had been announced, and again in summer 2004 after the second round of the Upper Pay Scale results were known. The survey was based on a self-completion questionnaire mailed to teachers and heads in their schools (for details see Marsden, 2000). Table 5.1 shows preliminary results from the three waves, and from the panel sample relating to teachers' views about the principle and the operation of their pay scheme. The figures are from each wave, and the final column shows the panel response, based on the same individuals in each of the three years.

Table 5.1. **Classroom teachers' responses to the CEP questionnaire survey**

Classroom teachers	Disagree	Neutral/don't know	Agree	Panel agreement (percentage)
The principle of relating teachers' pay to performance is a good one.				
1	63	13	24	25
2	54	15	32	32
3	43	19	39	39
The salary levels above the threshold are too low to make me want to work harder in order to get them.				
1	16	51	34	37
2	22	40	38	38
3	26	35	38	38
Managers will reward favourites.				
1	15	33	52	54
2	27	35	39	39
3	46	33	21	21
Quota/inadequate funding.				
1	4	17	79	81
2	45	34	21	22
3	5	16	79	79
Targets set more clearly.				
2	29	29	42	38
3	23	27	50	50
More aware of school's targets in development plan.				
2	47	28	25	26
3	40	26	34	35

Source: Details of the survey method can be found in Marsden (2000), and in Marsden and Belfield (2005).

Both classroom teachers and their heads started from a position of opposition to the principle of linking pay to performance in schools, yet by the third wave in 2004, although many remained sceptical, the initially strong opposition appears to have subsided. This may be due in part to their experience with its operation, and the fact that almost all teachers who applied to pass the threshold were successful. Although this might seem like a successful bribe, one should remember that head teachers have their own separate scheme, in force since 1991, and their initial opposition has also subsided, turning to overall support.

Despite reduced teacher opposition to the principle of linking pay to performance, there is no sign of an increase in the perceived motivation effect of the higher rewards of the Upper Pay Scale, with the “disagrees” and “don’t knows” heavily outnumbering the “agrees”. Greater familiarity with the operation of the scheme has reduced suspicion of favouritism, but teachers remain very sensitive to fears about the government’s willingness to continue funding performance pay directly rather than leaving it to individual schools’ budgets. The sharp rise in the “agrees” that there is a quota in 2004 followed public discussions on this question.

Perhaps the most significant change for the future of school management lies in the replies about target setting by managers and the increased awareness of the targets outlined in the school development plan. This should be set against the failed attempt to introduce appraisal for classroom teachers in the early 1990s. The improvements in target setting as judged by teachers are echoed in the replies from their head teachers (Table 5.2), and heads are notably more positive about the contribution of the new system to better goal setting and improved middle-management in schools.

Performance management can be seen as part of a greater whole if one considers the importance of school targets, results and league tables. The latter give head teachers an external benchmark against which to judge the performance of their schools as they can compare their own performance with that of similar schools in the same locality. Parents can also view individual school results on the official government website, and they are widely published in local and national newspapers.

The third wave of the survey also probed the methods by which schools sought to improve their academic performance, one of the government’s objectives behind both performance management and the “quasi market” stimulated by school indicators and league tables. Head teachers were asked, in the context of league tables, about the methods they used to produce better academic performance in their schools. 95% said they discussed ways of improving their school’s performance in group and department meetings, and established targets. More specifically, 60% sought to learn about practices in

Table 5.2. **Head teachers' responses to the CEP questionnaire survey**

Head teachers	Disagree	Neutral/don't know	Agree	Panel agreement (percentage)
The principle of relating teachers' pay to performance is a good one.				
1	52	13	35	45
2	30	19	51	50
3	24	12	64	63
Hard to relate work to individual performance.				
1	11	12	77	76
2	30	17	53	53
3	38	18	44	43
Targets set more clearly, as in school development plan.				
1	27	20	53	59
2	7	8	85	83
3	6	9	85	85
Make staff better informed about school's objectives.				
2	34	22	44	63
3	20	23	56	63
Increased importance of good middle management.				
2	15	21	64	63
3	11	22	67	69
New system aims to raise pupil achievements.				
1	36	27	37	
2	25	26	49	
3	27	29	44	

Source: Details of the survey method can be found in Marsden (2000), and in Marsden and Belfield (2005).

schools that performed strongly in league tables. In terms of specific actions, 57% said that they had increased the academic content in courses covered by tests, 41% had devoted more resources to teaching test skills in these courses, and 30% had put more resources into subjects, such as maths, covered by the tests, at the expense of other subjects.

Thus, one can see that although performance-related pay in schools may not have had any strong effect on teachers' motivation, or been seen as an important incentive, performance management, which it supports, would appear to be influencing the way in which teachers and schools think about their objectives and seek to respond to those set by government.

An important consideration is whether this is the outcome of the design of the scheme, or whether it owes its emerging success to the development of a dialogue on performance management with teachers' representative

organisations: the classroom teachers' unions and the head teacher professional associations. The scheme has changed in several respects since its first introduction, key changes being the high percentages passing the threshold, the abandonment of the principle that movement along the upper pay spine should be progressively more demanding ("tapered" in the jargon) and adaptation of the notion of pupil progress to something much less dependent on test results than initially proposed. It is possible that the government would have made these changes anyway in the light of opposition from teachers and their heads, but it is also true that the teachers' unions and the head teacher associations voiced their concerns very strongly about these issues, and pressed the government to make changes. Moreover, the survey results indicate that many teachers attribute these changes to the action of their representative organisations. Thus, one could argue that this element of employee voice and influence has helped to build the confidence of teachers in the fairness with which the new system is operated (Marsden and Belfield, 2004). This contrasts with the strong perceptions of unfair operation noted in surveys of the civil servants' PRP schemes in Britain during the 1990s (Makinson, 2000). From late 2003, the government and the majority of the teachers' unions have been working together on subsequent changes to the scheme in a manner not seen since the abolition of collective bargaining for teachers in 1991. This opens up scope for the unions to play a key role as guarantors of the "procedural justice" of the performance management scheme, something seen to be lacking in the earlier civil service schemes, and something that management cannot easily achieve on its own as it cannot be its own judge and jury.

A final question is whether the survey results above demonstrate that performance management is slowly taking root in schools, or whether teachers and their heads are just good at filling in forms. Some early analyses of the CEP data suggest that schools may have responded in different ways. In some, the head teacher may have behaved a bit like a shop steward, keen to ensure that her or his staff got the pay increase from the government. When faced with retention problems, one can imagine that many heads would do this. In others, the head may have seen the new pay system as an opportunity to change the way the school is managed. These options are not mutually exclusive as it may be hard to undertake any reforms if a school cannot retain its staff. These themes will be pursued at the CEP.

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The National Institute of Social Security (INSS), Spain

The policy – a quarter of the salary of its staff is performance-related. INSS is an entity attached to the Ministry of Labour and Social Affairs. INSS manages and administers the economic benefits of the Social Security System and the recognition of the right to health assistance.

Setting objectives

- Performance assessment is carried out by considering the fulfilment of the objectives reached by the provincial offices. These objectives are established in four main areas: human and material resources, attention and information, economic and budgetary management and service management.
- Objectives aim for the best service delivery to citizens (quickest recognition of their pensions and benefits), as well as the highest quality in its procedure, with an inferior number of mistakes and better assistance and information. The objectives should be reached with the least economic cost which is measured by the efficiency rate.

Performance appraisal

- Performance is assessed against these objectives. The productivity assessment is based on monthly data sent by the provincial offices, as well as on the explorations on the benefits procedure by the INSS computer centre. The main person in charge of executing objectives at such centres is each provincial director, but there is guidance and control by the deputies directorate-general.
- Objectives are set at the collective level. There is no individual PRP in INSS.
- There is an individual assessment for the unit head, who can receive the pay of a monthly productivity bonus for greater commitment.
- 35% of staff can perceive a monthly productivity bonus because of special performance.
- All provincial directors are informed of the annual objectives at the beginning of the year and all employees are informed about productivity by

achievement of objectives, the objectives fixed for the provincial offices and in particular those fixed for the management areas where they work. A publication is produced which is distributed to all the offices and circulated among all their staff. It can also be found on the Internet.

- Trade unions are informed about the objectives set, as well as on the results reached by the offices. They are also given the list of the 10% of the civil servants who, that semester, have improved in 30% the productivity bonus.
- The different management areas share the global productivity rate (IGP), 100% of the points that can be reached by provincial office accomplishing all the objectives fixed.
- Each management area fixes a score for each of the objectives. All of the points reached in fulfilling the objectives in each management area will be added and annexed to the points received in the other areas and to those by the efficiency rate.
- The results reached by the management area are monthly, but the assessment is made every six months. In September, the first semester results are analysed, and in March the previous year's second semester is analysed. The results are transferred to a ranking which determines the settlement and payment for each civil servant. This is done with high precision since the measurement of the objectives is made according to the fulfilment degree from 0 to 100.
- The directorate-general has the responsibility of assessing performance and fulfilment of objectives, and the responsibility for the assessment of the efficiency rate falls upon the Deputy Director General of Benefits and the Deputy Director General for Human and Material Resources.
- The final resolution for the ranking is responsibility of the director-general, under the guidance of the Social Security Secretariat and the Labour and Social Affairs Under-Secretariat. Any civil servant can state his/her disagreement with the result obtained.
- The National Institute of Social Security holds a meeting every year for reporting the objectives established for the current year. Annual meetings are also held with the provincial directors to analyse the setting of new objectives or if it is considered necessary to eliminate any objective.

Performance payments

- Bonus.
- The payment of the productivity bonus is done through a grid which is based on positions within the agency. The amount of the productivity bonus is proportional to the level of the position occupied.

- Productivity for achievement of objectives is paid to all employees, except those excluded for disciplinary reasons or lack of co-operation and performance.

Implementation issues and problems

- All personnel know the productivity bonus well and are implicated. The bonus is systematically received in October and March.
- Management by objectives was accompanied by a strong training policy aimed at all personnel and with a great investment in ICT.
- The principal criticism, mainly coming from trade unions, is that high-level civil servants usually receive a semester bonus much higher than those in lower levels, since the amount of bonus is linked to position. Therefore the unions propose a linear payment for this productivity.

Difficulties, problems

- In some cases, the objectives are excessively ambitious, therefore it is very difficult to reach them. On the other hand, there are some objectives that can be more easily reached.
- The main problem is the difficulty of assessing the individual performance, since there are no exact tools.
- There is no doubt that PRP meant a remunerative incentive for all personnel and improved delivery of services to citizens.
- The productivity by the achievement of objectives is highly appreciated by all personnel. It is an important incentive for most personnel. Staff are motivated by seeing their office ranked in an outstanding position.

Impact

- By implementing PRP, management processes were extraordinarily improved.
- The best result in this field is the greater link between individual objectives and the objectives to be achieved by the provincial office as well as a better control by the person in charge of each management area.
- PRP has increased internal collaboration within the team and also within management units since measurement is made on the results of each office as a whole.
- The cultural change has been very deep, mainly from implementation since 1990.
- PRP cost is included in the budget. It has been and is the budgeted one.

Lessons learned, challenges and prospects

- There is a good combination of individual and collective PRP.
- The amount has a great influence when motivating the civil servant.
- No changes have been envisaged in the social security system of PRP, although other entities have spoken of the possibility of payment on a monthly basis, instead of each semester.
- It would be advisable to carry out an optimal measurement of individual performance, much more exact than the current measurement.
- The main challenge is to introduce individual objectives without causing a change in the system for measuring and achieving collective objectives used by the management units.

Ministry of Defence, United Kingdom

Coverage

All civilian staff in central MOD negotiations: both non-industrial and industrial, and the Warships Support Agency (for its industrial staff); around 66 000 people.

Highlights

i) Reform of pay and performance management systems through a four-year deal, which will facilitate change and delivery. The new pay arrangements will:

- Be transparent;
- Have good base pay progression to target rates of pay, which support the equality agenda; and
- Use growing bonus payments to reward good performance and incentivise staff.

ii) Development of a single status workforce, removing the current distinction between “white” collar and “blue” collar. Closer alignment between the two pay systems, based on the same principles of pay bands, progression and performance bonuses.

Costs

The paybill increases were 3.4% in 2002 and will be 3.25% in years 2-4. The increases were used in the following way in 2002:

- Funded consolidated increases of 2.5% to all staff whose performance was at least satisfactory.
- 0.10% for pay band shortening of non-industrial bands (threatened equal pay action).
- 0.6% to increase further the bonus arrangements for non-industrial staff increasing the pot to 1% of paybill and starting a bonus pot for industrial staff.
- 0.2% to address structural (and some equal pay) issues for industrial staff to maintain the goodwill with the introduction of a new pay and performance management system.

Additional spending was funded from savings within the existing pay bill and other efficiency savings.

Detail

MOD's 24 000 **industrial staff** were previously paid on spot rates (i.e. no pay progression) and had no appraisal system and no performance pay. In 2002, the ministry established a harmonised grading structure, pay bands (linked to the non-industrial arrangements) and, from 2003, an appraisal system. Non-consolidated bonuses, based on relative performance, will be paid to 50% of staff from 2004.

The **non-industrial** pay system has changed significantly since 1996. Significant further changes were agreed as part of the 2002 round. In a four-year deal, MOD will:

- introduce better pay progression;
- build significantly on the current 0.4% bonus pot, increasing it to 2.6% of the pay bill by 2005-06;
- end the outdated "box mark" appraisal system. In future, different levels of performance will be rewarded through a system of relative assessment, similar to that introduced for the senior civil service.

The pay system will have:

- Fixed steps to a target rate of pay, set below the maximum.
- Staff moving up one step a year as part of the annual pay award to the target rate.
- The steps to be revalorised annually, broadly in line with inflation.
- A bonus pot, agreed in the annual negotiations, delegated to the top-level management areas to be distributed to staff according to criteria applied locally, within a common framework determined at the centre. Bonuses will be distributed on the basis of judgments about relative contribution. Key criteria are:
 - ❖ Cash distributed evenly between pay bands.
 - ❖ 50% of staff to receive bonuses.
 - ❖ Payments for each pay band set by the centre.
 - ❖ Top 10% of performers receive bonuses 50% greater than the standard bonus.
 - ❖ Management areas to ensure fair, reasonable and equality-proofed outcomes.

The Department for Work and Pensions (DWP), United Kingdom: An Example of Team Pay

Background

Following the publication of *Incentives for change: rewarding performance in national government networks* (the Makinson report) in January 2000, the then Department of Social Security gave an early commitment to implement a team bonus scheme across the whole department. A small project team was set up working out of the Performance Management Section but with links to Pay within HR.

Early work focused on taking the recommendations of the Makinson report and seeking to map the necessary conditions for incentive schemes against the current state of the Department. The project concluded that following Makinson's recommendations to the letter would not be possible, and consequently the DWP as it was now called developed a framework of principles using the recommendations in the report as an aspirational ideal and setting out minimum standards for any scheme.

Key characteristics

There are ten sites spanning discrete business areas covering 35% of DWP staff comprising 52 teams with a varying number of staff in each team (the smallest with 150, the largest with 3 000).

In the main, DWP schemes have between four and eight targets. Where possible, targets set were beyond initial agreed targets (i.e. performance beyond PSA levels).

All schemes maintain a balance of different targets to ensure that there is not too much emphasis on a single area of business.

Each target has a percentage of the overall bonus opportunity attributed to it, with the bonus payments being paid as a percentage of the fixed bonus value for each grade.

A series of rules for bonus eligibility were devised. This included provisions for part-time staff, staff on sick leave, those leaving teams, etc.

Selection of trial sites

Towards the end of 2000, the Department decided to try out team bonuses in discrete areas. These were:

- The Child Support Agency (approx. 10 500 staff – split into seven teams).
- The Child Benefit Centre (approx. 2 000 staff in one team).
- The Early Office Infrastructure programme – a project replacing front end IT across the DWP (approx. 150 staff in one team).

The Department of Social Security merged with Employment Services and parts of the former Department for Education and Employment to form the Department for Work and Pensions. Early plans to roll out team bonuses across the Department from April 2002 were reviewed, and a revised incremental approach was agreed with HM Treasury, along with a further seven areas within the new DWP:

- 17 Pathfinder Districts of Jobcentre Plus (approximately 19 000 staff – from a total of 80 000).
- Pension Service Empower (approximately 2 000 staff from approximately 20 000 – leading edge call centre areas).
- Debt Management Services (approximately 2 500 staff).
- Disability Carers Directorate (approximately 8 500 staff in 6 teams).
- The Appeals Service (approximately 2 000 staff in one team).
- New Tax Credits project (approximately 150 staff in one team).
- Pension Credit project (approximately 200 staff in one team).

The DWP found that it was not always possible to have teams based on individual offices because of the availability of reliable management information. There were also other considerations, which lead to selection of larger teams than envisaged by Makinson. Examples include:

- The need to avoid compromising any key organisational changes within the organisation – *e.g.* within the Appeals Service a single team was adopted, despite having a clear structure based on geographical teams, in order to avoid reinforcing a potentially redundant team structure following impending reorganisation.
- The need to ensure that team bonuses do not compromise delivery of objectives – *e.g.* within the Disability Carers Directorate one team (of approximately 2 500 staff) was again subdivided into geographical locations but management felt that setting up individual teams could undermine co-operation and reduce flexibility to move work between sites.
- Design of rules will also impact on team size. In the DWP qualification and entitlement rules mean people are paid pro-rata for the time they spend in each team. A bonus scheme of hundreds of very small teams may become too bureaucratic.

Target setting

For the most part the DWP designed schemes which conform to Makinson's principle of setting a small number of incentive targets. As a general rule, DWP schemes have between four and eight targets, and all schemes try to maintain a balance of different targets to ensure that there is not too much emphasis on a single area of business.

The DWP has supported Makinson's aim that bonuses should be paid for efforts beyond the normal expectation (i.e. performance beyond PSA levels). Where possible, targets have been set beyond initial agreed targets – e.g. the Child Benefit Centre set targets which provided performance beyond agreed operational targets, as did Debt Management Services and Disability Carers Directorate.

In some areas of the organisation, the aim was to introduce reforms or modernisation initiatives, so in such areas it was recognised that introducing change (which would normally result in reduced performance) while maintaining performance levels would require special effort.

Projects proved to be most difficult to define stretch. Although having clear objectives and milestones, delivery of these on an earlier timescale may not be desirable due to the potential impact on other programmes.

Issues

Aside from specific design issues, there were some general cultural and organisational issues which impacted on the introduction of team bonuses.

Management information systems

Automated management information is preferable because it is generally more accurate but this creates a tendency towards larger teams as most management information systems are designed to provide accurate information at district or regional level. For example, in Jobcentre Plus it was important to include a target for monetary value of error, but measuring this at district level would compromise the validity of the data. To solve this problem, Jobcentre Plus created a shared target which produced a sample that was large enough to allow robust measurement.

The DWP has also run schemes where measurement of targets has not been through automated systems – particularly in project areas. These have ensured that a robust process of reporting against milestones has been in place: for example, DWP projects use the PRINCE II methodology to ensure projects are managed in a controlled way.

Trade unions

DWP trade unions have a long-held principled opposition to any form of performance-related pay, and their messages have continually downplayed the positive elements of team bonuses and focused on the less positive aspects. It was particularly difficult to secure agreement on a staged implementation which by definition means that large parts of the organisation would not have access to this “extra” element of pay.

To counteract this opposition, the DWP consulted at all stages and also incorporated team bonuses into the general negotiations on pay to give an additional lever.

Alignment with pay

The Makinson report also makes recommendations about the underlying base pay structure, pointing out that people should first be effectively and fairly rewarded if bonuses are to work.

The DWP therefore made significant steps to restructure base pay over two successive pay rounds in conjunction with introducing team bonuses. Remit proposals to HM Treasury coupled team bonuses and pay restructuring as two parts of an overall strategy.

Continuing from this, the DWP has now formally incorporated team bonuses within the pay and reward policy area.

Allocating bonuses in full public view

Paying bonuses as a public sector organisation means that there is a potential for scrutiny possibly beyond that which is applied to private sector organisations. Bonus payments must be seen to be fair and, above all, rightfully earned. All DWP bonus schemes complied stringently to the general principles of corporate governance, and performance against targets was validated externally of bonus teams. Processes and payments in the first year of operation were scrutinised by internal audit to ensure probity of action.

Successful elements

Achieving staff buy-in

The Makinson report highlighted that performance pay within civil service organisations had been discredited in the eyes of staff. In addition the high-profile opposition of trade unions, has contributed to a general culture where staff are openly sceptical about performance-related pay.

The DWP has coupled introduction of team bonuses with a greater emphasis on performance management culture, ensuring that team bonuses are seen as a key tool within performance management. At the same time, communications

focused on the difference of new team bonuses compared to the old systems, particularly selling the messages of team performance, delivery of objectives and increased bonus amounts (5% as opposed to less than 1%).

Dialogue with trade unions

While the trade unions have not dropped their opposition to performance-related pay, and are never likely to, the fact that DWP has managed to introduce a substantial bonus scheme into the DWP counts as some success. A key reason for this success has been the ongoing consultation with the trade union's side, so that they are kept apprised of all plans and proposals. This helped to engender a relationship based on mutual respect and allowed some pragmatism on both sides rather than becoming an argument entrenching in two opposite philosophical camps.

A successful tool to overcome initial opposition was to couple reforms of the basic pay structure with introduction of a team bonus. Maintaining team bonuses as a separate negotiation element would simply have led to the trade unions holding a line of opposition on principle.

Incremental approach

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

An incremental approach also allowed the DWP to select or avoid areas of the organisation. For example, the DWP did not introduce into areas operating under legacy arrangements organisations which were due for modernisation, e.g. much of the Pension Service. Instead team bonuses were targeted to incentivise modernisation by introducing schemes in Jobcentre Plus Pathfinders and Pension Service Empower where bonuses will figure as a key part of the performance management culture.

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

Treasury commitment – pump priming

A critical success factor for the DWP was the ability to secure additional money to fund bonuses in the first two years (pump priming). This was particularly useful in establishing buy-in: it was helpful in gathering volunteers to run with team bonuses in the initial phases.

Critical to securing additional funds was the maintenance of an open and honest dialogue with Treasury colleagues, coupled with the ability to show real progress against desire to implement team bonuses.

Sharing thoughts with other organisations

The DWP found it extremely useful to share development ideas and thoughts on a regular basis with the other government departments that were seeking to implement team bonuses based on Makinson's recommendations (Customs and Excise, Inland Revenue, Employment Services). At the same time, the DWP also researched the approach to team bonuses in other organisations.

Less successful elements

Planning framework still not ideal

Early work on scoping team bonuses quickly established the strong links to the planning cycle. The DWP still needs to ensure greater cohesion between the development of plans and the development of team bonus targets.

Limitations of management information

The DWP's management information (MI) systems are still in need of improvement. Good quality, validated MI is not always available at the required level, and this leads to larger teams where the motivational effect may be diluted. The DWP continues to work on improvements to MI and in future intends to be able to measure performance of smaller teams.

Bottom-up limitations

Development of incremental arrangements in smaller pockets allowed the DWP to make progress on introducing team bonuses without compromising the performance of areas where change was expected to be highly disruptive. However, the down side of this is that targets are developed from a bottom-up perspective rather than slotting into a holistic framework of targets driven by the overall public service agreement. Where possible this has been mitigated by aligning team targets to specific targets in the public service agreement /SDA but this has not always been viable.

Funding

The Makinson report indicated that one source of funding ought to be from recycling financial gains accruing to the Exchequer as a direct result of improved stewardship of programme expenditure or other economic gains which stem from DWP actions. There has been little success to date on this front.

Evaluation

The DWP carried out a qualitative study of the initial Exemplars: a baseline study taking place in autumn 2001, with a post payment study carried out in summer 2002.

Broadly the attitude to bonuses (i.e. that bonuses have a positive impact on motivation, work behaviour, planning and organising work, etc.) was reasonably positive and the second survey showed a significant upward trend. Significant numbers of staff said that the team bonus scheme did not make any difference to their day-to-day approach to work but conversely they seemed to think it did affect their colleagues.

On the face of it, the private consultants who carried out the evaluation were disappointed in the results, and in defining a successful scheme would have expected a much larger improvement. However, the culture of the civil service is extremely sceptical of any form of performance pay and it is not surprising that the initial reactions are somewhat less than would be expected in a commercial organisation. In addition, although many staff claimed that the bonus did not motivate them, analysis of more specific questions about work practices (e.g. whether people are more focused on targets, whether there is a better focus on the team, etc.) suggests that rather more staff have changed practices than are willing to admit. Therefore it is crucial to have a clear and understandable baseline from which to gauge success.

Final thoughts

Clear policy needed early

The DWP experience shows that a clear policy on implementation and principles is needed from an early stage. The earlier managers begin to think about how schemes will be designed, the better they can fit in with organisational objectives and the policy must provide the steer before managers can begin to design schemes.

Visible and active senior support is critical

It is critical that leaders of the organisation show a visible and active commitment. Areas where senior support was less visible or active, were less successful in gaining staff buy-in to the scheme. Where senior management were actively and visibly supporting the principles and objectives of the scheme, there was greater support amongst staff.

Align with planning frameworks

The Makinson report stated that bonuses should be aligned to a clear hierarchy of targets. Experience in the DWP has shown that, in order to ensure

that bonuses incentivise the right objectives for businesses, it is critical that the design of bonus schemes is aligned with business planning.

Need to look at the long term

Ensuring a successful scheme will require a long-term approach. The DWP has introduced a bonus scheme in a step-by-step way which has necessitated a “next step focus” and led to a strategy which has “evolved”. This has affected the confidence in the scheme in some areas of the organisation. Although the long term policy is now clear, in hindsight a clear and unchanging strategy from an early stage would have been much more helpful to gain organisational buy-in.

Focus on delivery

Successful team bonus schemes focus clearly on the critical deliverables of the organisation in question. Where this has occurred most strongly, there has been a more noticeable impact on the overall performance and attitude of staff within the organisation. Targets should therefore focus on delivery of outputs, not reinforcing processes.

Communication is vital

Staff cannot perform to meet targets if they do not know what is expected of them or if they are unaware of their current progress. It is vital that managers give clear and honest messages on targets and progress against these at the beginning, end and regularly throughout the duration of the scheme.

Need to manage expectations

Bonuses are a two-edged sword; there is a chance for them to be not paid. Therefore it is important that management is careful to balance communications. It is important that staff are encouraged to meet targets but equally important that staff are clear that bonuses are not guaranteed. If expectations of achievement are too high then this can have a negative effect on motivation when targets are not hit; staff can see this as money taken away from them.

Conclusion

The DWP has now broken the link with HM Treasury additional funding, and team bonuses have been incorporated within the broader pay and reward strategy. Team bonuses will be a management tool to assist performance management, but businesses will not be obliged to operate team bonuses. Funding for bonus payments will come from within the department, and businesses will need to demonstrate value for money in their proposals.

The Case of the Revenue Agency, Italy

Background, scope and coverage of PRP policy

The experience of the Italian Revenue Agency (*Agenzia delle Entrate*)¹ relates to the evolution of the performance evaluation system towards more defined criteria.

In accordance with Law n. 286/1999, and on the basis of a specific strategy on human resources management pursued by the Revenue Agency, a new evaluation system was introduced in 2002 (*SIRIO: Sistema Integrato Risultati Indicatori Obiettivi* – Goals, Indicators and Results Integrated System).

The system integrates two different objectives:

- performance appraisal (with reference to results);
- the evaluation of organisational competences.

SIRIO is based on the principles of management by objectives and is intended to be a useful tool for evaluation, management and development of human resources, in accordance with the criteria of transparency, objectivity and equity.

Implementation and assessment of impact of PRP policy

In 1995 the Revenue Department of the Ministry of Finance introduced, for the first time, a system for planning and control, called PPC, in order to define objectives, assign resources and verify results achieved. The PPC, then transformed to PeC, had the principal aim of applying the directive of the ministry to concrete programs and objectives for central and local directions and communicating the results achieved to the overall administration.

In 1998 an agreement between the public sector and trade unions determined a system for assigning remuneration referring to results achieved, evaluated on the basis of the outputs produced and the financial resources used, through quantitative data. But these data were not effectively adequate to evaluate the activities of directions and central offices.

In 1999 a system for the evaluation of managers, called SIVAD, was introduced in the Revenue Department with the aim of filling the gaps in the previous system and systematising the evaluation process. SIVAD focused on quantitative and qualitative objectives, defined in coherence with strategic

planning. In 1999, SIVAD allowed the identification of five levels of remuneration connected to performance. Notwithstanding, the system presented some difficulties.

The necessity to re-design the SIVAD system resulted in the introduction, in 2002, of the SIRIO System.

Design of PRP policy: performance appraisal, rating and payment systems

The system for performance appraisal is a continuing process that contributes to the professional growth of human resources and to the improvement of results. The system is characterised by three phases:

- Planning and assigning of objectives – Each year (1 January-31 December) institutional and local objectives are defined. Institutional objectives are identified with reference to both the Agreement between the Ministry of the Economy and Finance and the agency and responsibilities of managers; local objectives concern the specific activities of the offices. Local objectives are directly proposed by line managers, specifying the results to be achieved, and the parameters to be used to identify the level of their realization. A specific “weight” is defined for each objective (the sum total of the weights must be 100) and a value is specified for each indicator. Additionally, each manager is assigned a profile of competencies on the basis of which the evaluation will be conducted.
- Monitoring and managing activities – During the year, line managers can ask for review, with the evaluator, the objectives defined, and any difficulties or new events that were not considered during the planning phase. On this occasion, changes can be introduced with regard to objectives previously defined.
- Evaluating activities – The objective is to verify the individual degree of achievement of personal targets and an assessment of the growth in competencies. At the end of the process a final, synthetic result is produced and communicated to the manager, who wish to have a discussion with the evaluator focused on the overall process as well as, eventually, training exigencies and actions for the future.

Results appraisal

The purpose of results appraisal is to verify that objectives set for each manager during the planning phase are reached. A maximum of ten objectives are assigned to each manager: six are institutional objectives and four are local objectives. All objectives, quantitative and qualitative, are measured through quantitative data. For qualitative objectives, specific indicators must previously be agreed between the manager and the evaluator.

With regard to both institutional and local objectives, results are converted into ratings and scores on the basis of the percentage of the result achieved. The score is then multiplied by a “weight” which refers to the importance attributed to the objective. Finally, the products are summed up separately for local and institutional objectives. Local objectives are complementary to institutional ones, this being the reason why they determine the final result of the evaluation only if the summative value for institutional objectives is at least “adequate”. Similarly, if the manager has not proposed local objectives, the global evaluation considers only institutional ones. The sum of scores for institutional and local objectives gives the final result for the appraisal.

Evaluation of competencies

The principal aim of competencies evaluation is to analyse the behaviour adopted by managers in pursuing assigned objectives, with particular attention to organisational behaviour. Individual competences are specifically defined in a “competencies framework” that contains 12 leadership competencies to meet the condition of the public sector and the specific context of the agency. Competencies are set in five clusters: self-control, leadership, motivational dynamism, relational dynamism and cognitive dynamism.

Each cluster is defined operationally into a set of competencies which can be observed empirically in managerial behaviour and are defined one by one:

- Self-control: Moral integrity and consistency, self-confidence, balance.
- Leadership: Team leadership, empowerment and development of collaborators, assertiveness.
- Motivational Dynamism: Initiative, results-orientation.
- Relational Dynamism: Persuasiveness, openness to others, flexibility.
- Cognitive Dynamism: creative thought, development and sharing of expertise.

Every year, in the planning phase, competencies from these clusters are attributed to each manager, in accordance with his or her profile and activity. Each cluster is characterised by a coefficient. During the evaluation phase, the intensity of each competence is identified. This intensity is expressed on a five-point scale. Consequently, the scores attributed to competencies are totaled for each cluster. In order to obtain an average score for every cluster, the sum obtained is divided by the number of competencies identified in each cluster. The average score is then multiplied by the coefficient assigned. The final result of the competencies assessment is the sum of all global scores for the five clusters.

At the end of the process, a global result is produced, in order to attribute the performance remuneration. The global result is obtained by multiplying

the two final scores obtained, one for results and one for competences, by a coefficient previously determined in accordance with managerial profile and the assigned objectives. The products are calculated and converted into an evaluation.

Difficulties of PRP policy, lessons learnt and prospects

In defining the SIRIO system principal difficulties and problems connected with the previous system SIVAD were considered, in particular: a complex organisational structure, an insufficient involvement of evaluators in the process, the centralisation of the system and, above all, insufficient attention to the qualitative aspect of performances.

The purpose of SIRIO is to better harmonise the management control system with that of management development, in order to evaluate quantitative and qualitative aspects connected to managers performance. Quantitative objectives (generally linked to management control) and organisational behavior adopted to reach objectives must be observed in order to achieve an efficient performance evaluation system, able to ensure the development of human resources. The introduction of local objectives and organisational competencies responds to this demand.

Note

1. The Revenue Agency is a section of the Ministry of the Economy and Finance created in 2001 as a transformation of the Revenue Department of the Ministry of Finance. The principal objectives of the Agency are: simplify relations with taxpayers; assure access to assistance and information for taxpayers; boost action against tax evasion; and improve administrative performance through innovative organisational models.

ANNEX A

Performance-related Pay Policies Across 12 OECD Countries: Brief Overview*

* The descriptions in this analysis are derived from the OECD country reports referred to in the Foreword. The material for Canada is derived from information provided by the Privy Council Office and the material for New Zealand is derived from material provided by the State Services Commission.

Denmark

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>PRP established for the first time in 1997. PRP policy revised in 1997. In 2002, most of the unions entered the new pay system.</p> <p>PRP applies to all staff in Denmark. For some personnel groups, it is voluntary to transfer from the old to the new pay system; for others it is mandatory.</p> <p>PRP is not defined in any laws. All rules related to PRP have been adopted in the collective agreement with the central employees' organisations.</p>	<p>In the new pay system, the pay runs are generally shortened and pay setting is to a wide extent decentralised. However, overall pay determination is still decided in a centralised manner.</p> <p>The Danish performance-related pay system is decentralised.</p> <p>This decentralisation is counterbalanced by the comprehensive control of each institution/agency using the new pay system. In order to monitor the wage level trends, the State Employer's Authority has developed a special on-line statistical tool – accessible from the internet – called ISOLA.</p> <p>This database has been important for enabling the State Employer's Authority to run, monitor and control the highly decentralised pay system.</p>	<p>There is no common PRP model across government organisations. However, most PRP schemes are based on the same three elements:</p> <ul style="list-style-type: none"> • Basic pay to be agreed upon centrally between the Ministry of Finance and the organisation negotiating on behalf of the employees. • A superstructure which is agreed centrally/locally on the basis of any special functions which are attached to the job and on the employee's personal qualifications and performance. • A PRP element which is agreed at the organisational level and reflects the fact that the employee has met a number of pre-defined qualitative or quantitative targets. <p>The ultimate goal of the new pay system is that up to 20% of the total salary payment in the Danish state should consist of allowances and (directly) performance-related pay.</p>	<p>All allowances are decided on the basis of individual appraisals, based on a dialogue between the employee and the line manager. This salary discussion is integrated into the yearly performance interview. The agreements are agreed and signed by the manager and the union representative/liaison. In some institutions a balanced scorecard is used for this appraisal, but normally the rating is much more informal and the salary discussions are only based on the local salary policy.</p>
Performance payment	Overall impact	Specific problems	Lessons learnt
<p>In the new Danish pay system there are no centrally-determined levels of pay reward. This question is to be decided at the local level by institutions/agencies. All control elements imposed on the new pay system are less restrictive, because the pay-pool system is in principle replaced by individual grants to institutions.</p> <p>Institutions controlling their own wage bills may make their own wage decisions within the wage-bill grant.</p> <p>The new pay system entails additional budget responsibility. Consequently, it presents an additional challenge to management.</p>	<ul style="list-style-type: none"> • Sign of success since 1997: the number of employees under the new pay system has increased. Since the last collective agreement, the Ministry of Finance has made about 20 new collective agreements with the respective unions/central organisations. • In 2001 the Ministry of Finance, the State Employer's Authority and the Danish Federation of State Employees' Organisations conducted an evaluation of the new pay system experiments in 111 government institutions. Some key results are: • A positive effect of PRP is "more focus on and acceptance of individual appraisal and payment." • PRP leads to better opportunities for recruitment. 	<p>Among the most significant negative effects mentioned by managers and employees' representatives:</p> <ul style="list-style-type: none"> • PRP represents too much administration; • it creates uncertainty among employees. <p>The main problems seen from the Ministry of Finance's point of view are:</p> <ul style="list-style-type: none"> • lack of delegation within the institutions; • lack of competencies/qualification of line managers to handle the new pay system; • not enough courage by line managers to treat the employees differently. <p>On the institutional level, the following difficulties are often seen:</p> <ul style="list-style-type: none"> • the salary policy is not clear enough; • no clear link between the goals of the institution, personnel policy and salary policy; • not enough information from management to the individual employee (creates uncertainty). <p>The introduction of PRP was a highly controversial issue with the members of the different unions (not enough money in the new pay system; too much focus on pay).</p> <p>The 2001 survey conducted on PRP indicated that only 39% of managers and 23% of union representatives think PRP leads to more focus on results.</p>	<p>To achieve the full effect of PRP, it is important that decentralisation continues within each institution/agency by empowerment of the immediate line manager.</p>

Finland

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>The State Employer's Salary and Wage Policy Programme (known more commonly as NPS, New Pay System) was launched in 1992 after several years' preparation.</p> <p>NPS is becoming mandatory for all organisations. This has meant a gradual increase of pressure for organisations and the collective bargaining parties to prepare, negotiate and realise NPS. This development is about to reach full implementation, as there are provisions about NPS in the central state collective agreement for 2003-04, as well as for the demise of the old pay systems.</p> <p>The scope of NPS is wide and encompasses all personnel up to middle managers. Managers above that level are excluded from NPS. Top managers cannot benefit from results-based rewards either.</p> <p>NPS is intended to be applied in all sectors/activities and at all levels of the administration.</p>	<p>Ministries/units prepare, agree and implement NPS within the general framework and guidelines set at the central level.</p> <p>Once implemented, ministries/units have the responsibility for their performance appraisal system, as well as for covering its cost.</p> <p>The new pay system has not been defined in law or regulation. The implementation of the NPS policy is to take place by collective bargaining.</p>	<p>The three main elements of salaries and wages are:</p> <ul style="list-style-type: none"> • pay according to the demands of the job; • pay according to individual performance (parts of a collective agreement); • results-based rewards (RBR), allocated at the team/unit level (RBR may exist independently of the other two elements, as RBR are not based on collective agreements). <p>Performance appraisal is based on job objectives.</p> <p>The main elements for determining the criteria by which to assess performance are: organisational targets (politically determined); the collective bargaining process.</p>	<ul style="list-style-type: none"> • The principles and elements of performance assessment are specified for each unit separately, within the general framework of NPS. • Every organisation has a set of criteria for assessing individual performance. Ordinarily 3-5 main criteria are agreed upon in the collective agreement and a network of sub-criteria as well as their weights are specified. A typical set of criteria would be a variation of "competence, effectiveness, and co-operation".
Performance payment	Overall impact	Specific problems	Lessons learnt
<ul style="list-style-type: none"> • Pay according to individual performance is a combination of bonus and merit increment based directly on performance ratings. This link is standardised in each collective agreement. The amount of this pay element is correlated with the individual performance as well as the position in the salary range. • The maximum pay (for exceptional performance) is between 25-50% of the basic salary. The average of individual performance pay in relation to individual total pay is currently about 15%. • RBR are bonuses. The average amount of RBR was 1.7% in relation to individual total pay in 2002. The range between the agencies was 1-8.3%. 	<p>Implementation of NPS had a mixed reception. Top management has generally accepted NPS and energetically striven for its implementation, even if sometimes the amount of necessary input was underestimated.</p> <p>The employee organisations have principally accepted NPS.</p> <p>Recent evaluation reports reveal that a minority of organisations which have implemented NPS have analysed its effects on staff.</p> <p>An indirect but still very indicative statistical fact is that salaries and wages in organisations that have implemented NPS prove to have been a bit better than in other organisations.</p> <p>The overall management process has been improved with NPS.</p> <p>The unanimous message from management has been that, when linked with pay incentives and sanctions, the impetus for maintaining good management processes grows, as well as the likelihood of efficient management and leadership. Employers in agencies feel that NPS, PRP and RBR are a very good incentive, for example as a tool for organisational development.</p> <p>The introduction of NPS has also resulted in improved staff development and training.</p> <p>Employers think that the RBR system has had a fairly beneficial effect on collaboration within teams.</p>	<ul style="list-style-type: none"> • Homogeneity in ratings; • slow progress. <p>Since the early 1990s, progress towards the realisation of NPS has proved slower and more difficult than expected at first.</p> <ul style="list-style-type: none"> • Financing RBR is a problem for agencies with no chargeable activity. RBR, which are self-financed by agencies, are often considered relatively modest. • RBR systems were often very complex at the beginning. 	<p>The implementation strategy of the new pay system has proved to be a long-term project. The full benefits of it are expected to become evident only during the next generation.</p> <p>The State Employer's office and the central State employee organisations have formulated principles to be applied to RBR systems in agencies:</p> <ul style="list-style-type: none"> • RBR needs to be allocated at the team/unit level. • RBR is a tool for managing, but the reward system should be constructed in consultation with the staff. • The improved result must be objectively demonstrated using specially constructed indicators. • Financing must be ensured. • The development and operation of the results-based pay model must be followed and evaluated. • It is useful to develop simple PRP models, including at least three but preferably not more than 5 or 6 indicators.

France

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>The focus in France has traditionally been on incentives such as promotion or advancement. No real system of PRP until now. Individual remuneration for civil servants is based on:</p> <ul style="list-style-type: none"> • Their position (corps, grade and step). • Specific characteristics of the job for senior civil service jobs (<i>Nouvelle Bonification Indiciaire</i>, about 10% of basic salary). • Bonuses can be granted for overtime work, according to the difficulty of the work, special qualifications, etc. <p>Bonuses are generally allocated collectively and their amount varies greatly according to ministry and grade.</p> <p>Only 10% of civil servants earn bonuses that are more than 30% of basic pay.</p> <p>High bonuses are concentrated in senior management groups.</p> <p>Groups not covered by bonus schemes include teachers.</p> <p>Senior civil servants have NBI: a variable part of pay linked to the post.</p> <p>Bonuses were not pensionable until 2003.</p> <p>In October 2003 the French Minister of Civil Service and State Reform announced a proposal to introduce performance pay for top civil servants. As from July 2004, France started experimenting PRP for the director's level in six pilot ministries (Ministries of Defence, Finance, Interior, Equipment, Agriculture, Civil Service).</p> <p>PRP is in the form of bonuses, up to a maximum of 20% of the base salary. If successful, PRP will be extended to all directors in the central civil service in 2006.</p>	<p>The system of bonuses is highly decentralised and differs greatly between ministries and corps.</p> <p>Annual budgets for bonuses are allocated by the Finance Ministry to departments/corps. The budget is based on an average rate for each occupational group multiplied by the number of staff in that category within a department. The budget is indexed according to the general wage increase.</p> <p>Individual departments decide how to allocate bonuses among their staff and can supply budgets from their own resources.</p> <p>Audits by financial controllers, the General Financial Inspectorate and Parliament.</p>	<p>Current system:</p> <p>This is not performance-related pay in the strict sense of the term.</p> <p>The government has a "budgetary package" to cover the average amount, multiplied by the number of civil servants eligible for the allowance. How those resources are then distributed among civil servants is left entirely to the discretion of each government department.</p> <p>Joint technical committees are consulted on "allocation criteria for performance bonuses".</p>	<p>Since 2002, the evaluation and rating of civil servants must be part of an integrated policy process. The performance review results in a report validated by the official concerned and his/her line managers.</p> <p>Criteria for assessing performance:</p> <ul style="list-style-type: none"> • Professionalism and technical skills. • Organisation and performance. • Personal qualities and interpersonal skills. <p>The employee's rating is taken into account for fast-track promotion to another step within a grade.</p>
Performance payment	Overall impact	Specific problems	Lessons learnt
<p>Performance bonuses are not included in basic salary and did not enter into pension calculations until the 2003 pension reform.</p> <p>Indemnities represent about 17% of the remuneration of civil servants, but vary amongst ministries, sectors and level of qualifications of staff. Senior civil servants receive higher bonuses than other categories of staff (about 40% of their remuneration depends on these bonuses).</p>	<p>For ministries which have introduced PRP: The most positive aspect is the decoupling of pay and length of service.</p> <p>In departments that have reviewed their bonus allocation criteria, the system now gives a young high performer a much higher level of allowances than a longer-serving civil servant in the same corps.</p>	<p>Overall, no real PRP system in France for the moment.</p> <p>The bonus system is complex and obscure for most civil servants.</p> <p>Problems raised by the existing system:</p> <ul style="list-style-type: none"> • There is a natural tendency of secondary remuneration schemes to converge and give every person in the same grade approximately the average. • Disparities between ministries and corps. • Lack of transparency. • The system of bonuses is highly complex. Bonuses are usually distributed according to other criteria than performance. Bonuses for employees are usually distributed on a collective basis. • The variable parts of pay – bonuses or NBI for senior civil servants – are not directly related to performance in most cases. 	<p>Two reports were published in April 2004 on performance management and PRP in France (Report from the committee of enquiry into the cost and efficiency of public services and a report from J.-L. Silicani from the <i>Conseil d'État</i>). These reports call for a gradual introduction of PRP in the public sector, for a clarification of the bonus and allowance systems and for the setting up of a clear evaluation process based on job objectives – notably for senior management.</p>

Germany

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>PRP introduced in 1997.</p> <p>The Act Governing the Structure of Remuneration in 2002 created new opportunities to award performance steps, bonuses and allowances in a flexible manner.</p> <p>The Civil Servants Remuneration Act governs the legal basis for performance steps, bonuses and allowances as follows:</p> <ul style="list-style-type: none"> • Performance steps (no more than 15% of employees) • Performance bonus/performance allowance (no more than 15% of employees) • Allowance for temporary assignment to special duties. <p>PRP is meant to apply to all categories of staff. It is allocated at the individual or team/unit level.</p> <p>The granting of performance-related elements of pay as a means of rewarding excellent performance is applied throughout the federal administration. In 2003, for instance, over 41 000 performance-related elements of pay were given to 550 000 staff members.</p> <p>Over € 50 million were spent on performance-related pay. However, this instrument of pay is not applied uniformly by the <i>Land</i> administrations; some make much use of it while others do not.</p>	<p>The general guidelines for PRP arrangements (performance steps, bonuses, etc.) are defined at the federal level. Each department is responsible for designing and implementing its own performance appraisal system.</p>	<p>Combination of:</p> <ul style="list-style-type: none"> • Performance steps. • Performance bonuses. • Allowances. <p>In order to prevent performance bonuses and allowances from becoming set elements of remuneration and to keep them from becoming routine, there are restrictions in the Civil Servants Remuneration Act (<i>Bundesbesoldungsgesetz, BBesG</i>) with regard to the beneficiaries, the amount and the modes of payment.</p>	<p>Aptitude and professional achievements of a civil servant must be evaluated at least every five years.</p> <p>Detailed process of performance appraisal decided at the department level.</p>
Performance payment	Overall impact	Specific problems	Lessons learnt
<p>Performance steps:</p> <p>The number of performance steps awarded by the employer within one calendar year shall not exceed 15% of the civil servants and military personnel employed by a particular employer under remuneration scheme A.</p> <p>Performance bonus/performance allowance:</p> <p>Performance bonuses shall not exceed the initial basic salary of the pay grade of the civil servant; performance allowances shall not exceed 7% of the initial basic salary.</p> <p>Performance bonuses and performance allowances shall be awarded only within the framework of special budgetary provisions.</p>		<p>During the last legislative term, the legal basis for performance-related elements of remuneration was amended by the Federal Act on Special Payments. This amendment was prompted by a scientific study on the effects of the performance-related remuneration system introduced by the Act to Amend the Public Service Law of 1997.</p> <p>This study raised the following points of criticism:</p> <ul style="list-style-type: none"> • Demotivation of a majority of staff members because of the quota of 20% of staff members per year who may be awarded performance-related pay. • Lack of binding performance criteria and of objective performance evaluation. • Lack of information on performance-related elements of remuneration. Lack of transparency in the awards procedure. • Lack of financial resources. Resources for performance-related elements were only allocated during the current year and only for that year. • Restrictions concerning performance-related pay for top performers because of eligibility criteria (for example for the performance step). 	<ul style="list-style-type: none"> • In the amendment to the provisions on performance-related pay of 2002 some of the problems identified were remedied (increase of the quota to 15%, discontinuing the rule that staff members remain at a particular salary step for at least half of the usual time before being eligible to advance to the next step, transfer clause, improved system to reward teams). • So far there is no information on current problems and difficulties with the implementation of the new rules. • Furthermore, the 2002 reform of professors' remuneration introduced a performance-oriented remuneration system (fixed basic salary/ variable performance-related pay). The experience of the <i>Länder</i> concerning the implementation of this measure must be taken into account before any problems and difficulties can be analysed. A thorough evaluation of the model for professors will be undertaken by 31 December 2007.

Hungary

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>Hungary introduced its performance assessment system in 2001 when the Service Act was amended, creating the performance-based pay system. In practice this legal instrument was first introduced in 2002.</p> <p>The system embraces the majority of civil service personnel from interns to department heads.</p> <p>Rules pertaining to performance assessment shall not be applied to administrative state secretaries, deputy state secretaries, political lead consultants and political consultants.</p> <p>The performance assessment system provides for personal assessment exclusively without ensuring a separate budgetary allocation for it.</p>	<p>The basic features of the regulation are uniform. The Civil Service Act provides the regulatory framework. Performance assessment is obligatory for central and regional public administration organisations and local governments (municipalities).</p> <p>Beyond complying with the statutory requirements, it is for each public administration organisation to decide how to implement PRP, taking full responsibility for its actions.</p>	<p>The performance assessment system is based on three components:</p> <ul style="list-style-type: none"> • The definition of the key objectives of the public administration organisation. • The definition of personal performance assessment criteria. • The assessment of the civil servant's performance on the basis of the performance criteria by the person exercising the employer's rights by the end of the current year at the latest. <p>The head of the organisation exercising his/her transferable rights may alter the rank-based remuneration of the civil servant by a $\pm 20\%$ degree for the following year on the basis of the results. However, it is not obligatory to alter the basic remuneration of the civil servant.</p>	<p>The definition of the key objectives of the public administration organisation. The key objectives are annually set by ministers or the heads of public administration organisations. In local governments, key objectives are set by the body of representatives. The definition of personal criteria. It is the job description which ensures a link between the organisational/operational objectives and individual ones.</p> <p>The assessment of the civil servant's performance. The person exercising the employer's rights provides a written assessment of the performance of the civil servant.</p> <p>A legal dispute can be launched in order to eliminate false or incorrect statements of fact contained in the assessment.</p>
Performance payment	Overall impact	Specific problems	Lessons learnt
<ul style="list-style-type: none"> • Merit increments. • $\pm 20\%$ of salary. 	<p>An extensive training programme was launched and numerous national conferences held.</p> <p>The introduction of the performance assessment system was preceded by a published performance assessment guideline for civil service personnel and by professional conferences.</p> <p>It is too early to speak about substantial changes, but it is apparent even now that the system has induced positive changes in the civil service.</p> <p>A number of public administration organisations have developed their own internal procedures. This improves the objectivity and transparency of assessments, taking local conditions into consideration.</p>	<p>The greatest problem seems to be the lack of a separate financial allocation for public organisations to back up the possible $\pm 20\%$ fluctuation in remuneration, so the possible changes in salary must be financed by public organisations themselves from their own budgets.</p> <p>Short- and mid-term organisational objectives are hard to incorporate at individual level, making it difficult to harmonise organisational and individual objectives.</p>	<ul style="list-style-type: none"> • Increase the professional level of work; • promote change of the organisational culture.

Italy

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>Several initiatives were adopted to ensure a more transparent and accountable administration in the 1990s. Performance-related pay policy was implemented in this context in 1993. PRP is applied to the managerial level only.</p> <p>The current PRP system is based on evaluation of the individual performance of managers.</p> <p>The PRP for the second level of public managers ranges from a minimum of 5 to a maximum of 10%; for a top level public manager it ranges between 10% and 15%.</p>	<p>Governed by law and by collective agreements.</p> <p>All government bodies, local and central, are required to set up a performance appraisal system.</p> <p>Measures concerning the PRP system have been diffused through collective agreements since 1999.</p>	<p>Managers' remuneration is defined through collective contracts.</p> <p>The structure of additional pay for managerial staff in ministries is made up of the following:</p> <ul style="list-style-type: none"> • remuneration linked to the post; • performance-related pay. <p>The national collective contract regulates the overall pay with some flexibility left for the individual contracts.</p>	<p>The evaluation concerns the performance and organisational skills of each manager individually. The evaluation is carried out by the level immediately preceding the position to be evaluated, with the higher level (<i>i.e.</i> head of department) being evaluated by the relevant minister.</p>
Performance payment	Overall impact	Specific problems	Lessons learnt
<p>Bonuses do not represent an ongoing increment to the manager's remuneration.</p> <p>The annual performance-related pay cannot be inferior to 20% of the annual value of the salary for the particular post, within the limits of available resources.</p> <p>Again, the national collective contract regulates the overall pay with some flexibility left for the individual contracts.</p>	<p>The PRP system has not been fully implemented in Italy and it is therefore premature to indicate the overall impact of it. The system has achieved a first aim relating to a greater focus on results and has a great potential in improving performance by providing managers with a mechanism for the structured review of performance.</p>	<p>Often it is not easy to evaluate the achievement of objectives that cannot end in quantitative outputs, leading to a lack of objectivity during the process.</p> <p>Other difficulties noticed in the implementation of PRP: the insufficient development of planning and control systems; resources actually assigned are insufficient; trade unions tend to be sceptical in considering evaluation and remuneration systems as adequate in evaluating differences of productivity and professionalism; the part of pay linked to evaluation is not fixed nor, therefore, sufficient to be an incentive to managers (even though the last collective agreement changed this situation somewhat).</p> <p>Ministers do rather prefer alternative mechanisms in selecting and evaluating managers. They tend not to define measurable performance targets.</p>	<p>Some early lessons emerging from pilot experiences indicate that political leadership and a clear definition of measurable performance targets is paramount.</p> <p>According to the debates and experiences noted, the PRP system is applied more extensively at the local rather than the central level, because of the proximity with the citizens.</p>

Korea

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>The Korean Government introduced an annual merit increment programme and a performance bonus programme in 1999.</p> <p>The Korean civil servant's pay is composed of base salary, allowances and welfare expenses:</p> <ul style="list-style-type: none"> • Base salary is the regular pay by grade and step according to the degree of responsibility, difficulty of the position, and length of service. It accounts for approximately 50% of monthly pay, depending on the rank in the organisation. • The allowance is an additional remuneration paid separately according to the position and living conditions of individuals. Allowances are broadly classified into three categories: common, special, and extra work. There are five types of common allowances (seasonal, diligence, seniority, family support, and managerial allowances). Also, there are three categories of special allowance (hardship post, high risk, and special task allowances) and three types of extra work allowance (overtime, midnight work, and holiday work allowances). • The expenses paid for civil servant's welfare include meals, grade, household support, commuting, traditional holiday bonus, and non-vacation payments. <p>All categories of staff are covered by PRP schemes, with two different systems applying to top-level staff and mid-managers and below.</p>	<p>The system is designed and applied at the central level.</p>	<p>Annual Merit Increment Program (AMIP):</p> <ul style="list-style-type: none"> • Yearly stipend system. • Application: director general and above in each ministry. • Performance-related pay. • Increased variable proportion of pay is added to the fixed portion the following year. • Excellent performer (top 20%) = 7% of performance standard amount in each grade; outstanding performer (21-50%) = 5%; normal performer (51-90%) = 3%; unsatisfactory performer: 0%. <p>Performance Bonus Program (PBP):</p> <ul style="list-style-type: none"> • Application: division director and below. • Form of payment: lump sum bonus. • Bonus amount: excellent performer (top 20%): 100% of his/her standard salary; outstanding performer (21-50%): 70%; normal performer (51-90%): 40%; unsatisfactory performer (below 91%): 0%. 	<p>Two measures are used: MBO (management by objectives) for higher-level employees and performance appraisal rating for mid- and lower-level employees:</p> <ul style="list-style-type: none"> • The performance appraisal includes three major areas with different weights: performance (60%), ability (30%), and attitude (10%). • Management by objectives (MBO) is a planning and appraisal tool that has different variations across organisations. MBO is based on evaluation by the degree of goal accomplishment. Each goal is classified as follows: <ol style="list-style-type: none"> 1) the strategic goal assigned to the level of the director general; 2) the main goal assigned to the level of the division director; and 3) the basic goal assigned to the level of the assistant director. <p>In addition, 360-degree feedback is used for supplementing existing appraisals.</p>
Performance payment	Overall impact	Specific problems	Lessons learnt
<p>There are two forms of PRP schemes used in Korea: merit increments and bonuses.</p> <p>Merit increments are added to the annual salary of a higher level government employee and linked to his/her performance ratings.</p> <p>Bonuses are paid to government employees annually and designed for mid- and lower-level employees. Performance bonuses can be provided in various ways:</p> <ol style="list-style-type: none"> 1) on an individual basis, 2) on a departmental basis (<i>i.e.</i> collectively), and 3) combinations of both. <p>Performance bonus on an individual base is the most common form at present.</p>	<p>PRP is newly introduced in Korea and it will take time to succeed so it is necessary to make continuous improvements based on both domestic and international partnership.</p>	<p>Employees may receive merit increases even if performances do not warrant them, because supervisors want to avoid creating animosity among employees.</p> <p>Employees' job performances tend to be assessed subjectively, based on supervisors' judgments. Unfortunately, developing performance measures for every single job is not only difficult but also expensive.</p> <p>Because PRP programmes focus mostly on individuals, they do little to integrate workforce members. With limited budgets for merit increases, employees must compete for larger shares. Competition among employees is counter-productive if teamwork is essential for successful projects.</p>	<p>Link performance appraisals to business goals: The standards for judgement of employee performance should be linked to the competitive strategies and aims an agency has decided upon.</p> <p>Allowances are overdeveloped: base pay accounts for approximately half of the monthly pay, while allowances and other welfare expenses make up the remaining half. In these circumstances, government employees are likely to perceive PRP as an allowance. In order to avoid such a situation, allowances must be integrated with base pay as much as possible in the near future.</p> <p>Merit increases should consist of meaningful increments.</p>

New Zealand

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>Since 1988, every department has become an employer in its own right. Performance pay schemes were introduced as part of this general set of reforms. New Zealand was at the forefront of introducing performance-related pay to the public service.</p> <p>One reason for introducing PRP policies was to abolish the distinction between public and private sectors.</p> <p>PRP schemes potentially apply to all staff covered by voluntary agreements.</p> <p>PRP is implemented in almost all the public service in NZ.</p> <p>Chief Executives and the Senior Executive Service (about 150 positions) are covered by individual employment contracts.</p> <p>The health and education sectors overall are not covered by a national collective agreement (but groups within them are).</p>	<p>There is no standardised system of performance pay.</p> <p>Within broad provisions, departments are free to design their own systems and must fund them from their own budgets.</p> <p>There is no centralised oversight of the operation of departmental performance pay systems.</p> <p>Control is through the overall financial accountability of the Chief Executive Officer who must ensure there is adequate budgetary provision for approved performance payments.</p>	<p>Each manager is responsible for managing his own budget.</p> <p>Departments have to achieve certain "bargaining round parameters"¹ set by the government.</p> <p>Departments should work closely with the State Services Commission in planning for collective bargaining.</p> <p>Departments should set remuneration levels taking into account: 1) market demand for the relevant skills/capabilities, experience, and responsibilities; 2) recruitment and retention factors; 3) ability to pay within approved baselines; 4) comparisons with other groups within the department; 5) any future government policies aimed at achieving equitable outcomes for employees generally or for particular groups of employees; 6) other factors relevant to the particular department.</p> <p>The remuneration policy for Chief Executives and top managers is set by the State Services Commission and determined in agreement with the government.</p>	<p>Different in each department.</p> <p>Recognition of performance and/or acquisition of skills:</p> <p>In general terms:</p> <p><i>i)</i> performance which meets the normal expectations of the job should be recognised by salary rather than by lump sum;</p> <p><i>ii)</i> salary increases (rather than recurrent lump sum payments) should be given to employees who year after year exceed the normal expectations of the job;</p> <p><i>iii)</i> departments with existing contractual arrangements to make lump sum payments should have a strategy in place for negotiating/phasing out such arrangements as opportunities arise.</p> <p>There are some exceptions to this general approach.</p>
Performance payment	Overall impact	Specific problems	Lessons learnt
<ul style="list-style-type: none"> • Merit increments (decided by individual departments within the pay range set out in voluntary agreements) • Bonuses 	<p>The State Services Commission notes that experience of base remuneration based on performance or levels of competency (or a mix) has been very positive.</p>	<p>The one exception is Police – a career service – which is moving back to a more length of service basis for pay.</p>	<p>The schemes have led to clarification of job goals and greater accountability of staff.</p> <p>More successfully implemented in small departments where they can be more closely monitored.</p> <p>The schemes have not led to the expected reduction in wage drift.</p> <p>In the last five years there has been increasing emphasis on the competency basis and some agencies have moved away from the pure performance basis.</p>

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

Spain

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>The productivity bonus remunerates specific performance or working behaviour.</p> <p>The productivity bonus can be used in all public administrations – central, autonomous and local – although it is generally used in the central administration.</p> <p>The productivity modality for remunerating achievement of objectives is applied in specific sectors, for example: social security, state traffic office, police, university professors.</p> <p>The productivity bonus is applied to a high percentage of civil servants in groups A and B. The percentage of groups C and D is much lower and, in general, the productivity bonus is not based on performance assessment but on longer working hours. There are two important exceptions: Social Security and the Police, which have their own systems, based on performance measured by achievement of objectives and are linked to collective performance assessment at the team/unit level. All categories of staff are included in these schemes.</p>	<p>At the beginning of each fiscal year, the Ministry of Finance issues a resolution fixing the productivity level for each ministerial department or autonomous administration.</p> <p>During the year, the productivity level can be adapted to the number of staff. The Ministry of Finance determines the amount of the global credits intended for the productivity bonus, adapting it to the number of staff and the degree to which the objectives fixed for each programme have been achieved.</p> <p>Inside this total salary allocation the different departments and organisations are free to design and develop their own systems of performance and productivity related pay. Each department determines the criteria for awarding the individual amounts of the productivity bonus.</p>	<p>The different departments and organisations design and develop their own productivity and performance remuneration systems independently. There are models based either on assessing individual performance or for team/units.</p> <p>Team/unit PRP is the majority system when productivity is used for remunerating special performance.</p> <p>The main characteristics required by law for calculating the productivity bonus are the following:</p> <ul style="list-style-type: none"> • It remunerates any special performance, extra activity and interest or initiative used in doing the job. • The global amount cannot exceed a certain percentage of total personnel costs in each programme and each organisation. • The amount of PRP awarded has to be known by the other civil servants in each department or organisation concerned, as well as by trade unions' representatives. 	<p>There is no standardised performance appraisal system. Each department/agency has the responsibility for developing its own system. Once the global amount or salary allocation for the productivity bonus has been fixed, each department enjoys wide independence in establishing individual criteria for each civil servant.</p>
Performance payment	Overall impact	Specific problems	Lessons learnt
Productivity bonus.	No evaluation of the results at the central level.	The application of the productivity bonus for special performance is limited as it only affects specific sectors. In most cases the productivity bonus has been linked to the extra activity (longer working hours) and it is almost always a fixed amount related to this criteria. At the same time, there are different sizes of productivity bonuses according to working hours in the different ministerial departments for equivalent positions.	

Sweden

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>Until the late 1980s, pay agreements were very centralised and negotiated increases were applied to the entire civil service.</p> <p>From 1980-89 a new budget system was introduced, replacing detailed annual appropriations by performance control and framework budgets.</p> <p>In 1989, the salary grade system was abolished and replaced by individual salaries. In 1994, full autonomy in employer policy matters was granted to heads of agencies.</p> <p>The centrally negotiated and Individual and differentiated pay system was implemented around 1990 and is today well-established throughout the civil service.</p> <p>There is no uniform system of PRP. Nearly all agencies use some kind of performance appraisal/evaluation dialogues once a year.</p> <p>Most employees of the Swedish Government are under individual pay systems set by collective bargaining, except senior government officials – including university professors, Directors-General, Under Secretaries of State – who were taken out of the collective bargaining system.</p> <p>Their salaries are now set on an individual basis either by a review board or directly by the government.</p> <p>Workers at all levels may be covered by bonus systems as part of their local collective agreements. There are however some exceptions among the police, armed services, and judges.</p> <p>In practice, agencies are reluctant to award them and bonuses are therefore more used in businesslike activities than in traditional central administration.</p>	<p>The remuneration system is highly decentralised. Agencies are almost completely autonomous in employer policy.</p> <p>Legislation concerning labour is largely discretionary – <i>i.e.</i> collective agreements may be substituted for legislation, provided that the labour market agrees.</p> <p>Most terms of employment are laid down in collective agreements.</p> <p>Since 1997, the government monitors agencies' employment policies by using a system with annual reporting of competence planning, salary level and development, gender distribution, age structure and staff turnover.</p>	<p>Every individual salary is negotiated at local level and is open to public scrutiny.</p> <p>Pay should be individually determined and differentiated.</p> <p>The system demands that management develop local pay policies that are generally transparent and understood by most staff. A typical local pay policy:</p> <ul style="list-style-type: none"> • focuses on the agency's activities and objectives; • supports the agency's ability to recruit and retain staff with adequate skills; • clarifies how pay determination can motivate the staff; • defines criteria for pay determination; • includes the means to prevent discrimination. 	<p>There is no uniform government staff evaluation system in Sweden.</p> <p>Nearly all agencies use some kind of performance appraisal/evaluation dialogue once a year to review performance and potential future tasks, results and training needs.</p> <p>Most agencies have evaluation and pay talks between a manager and each of their subordinates.</p> <p>Some agencies, such as the tax authority, have started to try to introduce 360-degree dialogue where the employee gives feedback to the manager and <i>vice versa</i>.</p> <p>Supervisors are required to inform their subordinates of their (the subordinate's) individual wage increase, explaining it in terms of job performance.</p>
Performance payment	Overall impact	Specific problems	Lessons learnt
<p>There are three types of agreement negotiated at the agency level within a few framework agreements covering the entire central administration. The basic agreement and the general agreement are negotiated at the central level between the Swedish Agency for Government Employers and the central unions. The basic agreement deals with the negotiation procedure and is valid over a period of time, and must be confirmed by the government. The general framework agreement deals with overall salary levels and other general conditions. Local agreements determine the individual pay and other local conditions of employment and are negotiated at the agency level between management and union representatives. There are no centrally determined pay scales or remuneration schemes.</p> <p>The agencies are fully responsible for the results and consequences of their collective agreements.</p> <p>Where applicable, bonus payments are more directly linked to efficiency measures and cost savings.</p>	<p>Individual pay determination is much appreciated among employees and employers alike.</p> <p>Directors-general are well aware of their role as employers. They carry their responsibility for employer policies very well.</p> <p>Recruitment and retention of good managers is believed to have improved under the individual salary setting scheme.</p>	<p>There is a risk that individualised pay awards are used to pay newly recruited staff competitively rather than to award good performance. That is, PRP is used to recruit and train core staff rather than motivate and reward the majority of staff.</p>	<p>The division of functions between the government and agencies facilitates a clear separation between:</p> <ul style="list-style-type: none"> • pay increase – and budget appropriations; • staffing policies – and labour market policy; • available resources – and new unplanned activities; • recruitment – and politics.

Switzerland

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

United Kingdom

PRP	Flexibility and control	Overall design of PRP	Performance appraisal
<p>The policies of previous administrations to decentralise civil service management by creating free-standing agencies, and to reward all staff according to their performance, distinguishes civil service pay practices from much of the wider public sector, such as local government and the National Health Service. The two distinctive features of civil service pay are:</p> <ul style="list-style-type: none"> the delegation of pay, grading and performance management arrangements to departments and agencies for staff below the Senior Civil Service; the near-universal application of individual performance pay. <p>Prior to such delegation, HM Treasury centrally determined the pay, grading, and terms and conditions of employment for all civil servants in negotiations with unions. Individual departments had no control over the terms and conditions of their staff. The delegation of pay and grading regimes to departments and agencies began in the early 1990s. At the same time, performance-related pay was introduced to achieve a closer link between performance and reward for individuals and groups of staff. Departments received full delegation to develop terms and conditions for their staff in 1996.</p> <p>PRP policy applies to all staff. Senior civil servants' pay is managed directly by the Cabinet Office. PRP policy can be applied both at the individual and collective (team/unit) level.</p>	<p>The system was originally centralised with a trend to increased decentralisation in the past 10 years.</p> <p>In 1994, the government announced its intention to extend its policy of delegation to all departments for staff below the senior civil service and to replace the existing national pay frameworks. The senior civil service pay and grading remained centralised and managed by the Cabinet Office.</p> <p>In developing their own systems, departments are required to have regard to the four key principles set out in the Civil Service Management Code (CSMC): better value for money from the pay bill; improved flexibility in the pay system; better budgetary control of pay costs; an effective link between pay and performance.</p> <p>The Cabinet Office is the custodian of the CSMC and all civil service organisations are bound by the Code.</p>	<p>Current practice varies greatly within the civil service, with departments and agencies encouraged to align their reward strategies with their own business objectives. Current pay systems typically involve:</p> <ul style="list-style-type: none"> Most departments and agencies set pay ranges by grades. Most departments are designing reward systems in support of business needs. Most departments and agencies provide progression to a target rate or a "rate for the job". Non-consolidated bonuses. <p>Other rewards – departments and agencies generally offer very good non-pay rewards, such as good annual leave, flexible working hours, work/life balance policies, varied work, etc. The benefits of these are not "sold" particularly well and can sometimes become stale if not refreshed or publicised.</p>	<p>Most departments and agencies set pay ranges by grades. These are set in order to relate to market pressures and/or recruitment and retention factors. Pay ranges are generally revalued on an annual basis to meet needs and keep in line with market pressures.</p> <p>Most departments design reward systems in support of business needs. Most departments and agencies provide progression to a target rate or a "rate for the job". Target rates are set in accordance with what is considered to be the market rate for the job and are generally positioned between 80% of the pay range and the maximum. Once at the target rate, it is generally the case that only the best performers can receive consolidated payments past this point. Departments may also vary starting pay to reflect particular skills or pay in previous posts. High performers will not necessarily be the best paid in their grade. Departments are working hard to develop progression arrangements that are robust against equal pay challenges.</p>
Performance payment	Overall impact	Specific problems	Lessons learnt
<p>Non-consolidated bonuses are now being used as one of the main vehicles for delivering performance-related pay to staff performing above a satisfactory level. Bonus levels vary in different organisations and can be substantial in some and much less substantial in others.</p>	<p>There are a number of important elements that make reward schemes work well, including:</p> <ul style="list-style-type: none"> transparency; employee involvement; sense of fairness; realistic and clear goals; proportionality of the reward to the effort required; high degree of employee control over the measured outputs; impartial and high quality people management. 	<ul style="list-style-type: none"> Management capability: A report to the Civil Service Management Board in 2003 recommended "more active organisational and personal performance management – including greater transparency in expectations and regular honest feedback, based on better evidence, more clarity on how we will reward people who perform, and a simplified appraisal process" as part of a wider programme of improving leadership capacity. Flexible funding: due to funding constraints, departments and agencies are not able to provide adequate financial incentives for staff to want to perform at the top level. Departments and agencies also have difficulty measuring the impact that a performance-related pay system has in the achievement of organisational objectives. 	<p>The government considers pay delegation an important tool to facilitate improvements in delivery and productivity. Permanent secretaries/chief executives can determine how best to recruit, retain and motivate their staff and they have the ability to control their pay bill.</p> <p>The design of the reward system should reflect the nature of how work is actually carried out and also the culture and direction of the organisation. Performance-related pay schemes are used to align employees' performance with organisational objectives, to create a clear line of sight between individual objectives and achievement of organisational goals.</p> <p>It is important to pay attention to the culture of the organisation. If an organisation has a team-based culture, individual rewards may not be suitable.</p> <p>It is important to keep schemes fresh. There is scope to expand the use of non-pay rewards in the civil and public services. The Cabinet Office, with the help of key stakeholders, is currently developing practical proposals to improve the workings of the delegated arrangements within which departments can operate.</p>

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