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Public Sector Compensation in Times of Austerity

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Foreword

As part of the work programme of the Public Employment and Management Network (PEMN) of the OECD Public Governance Committee, the OECD Secretariat – through its Public Governance and Territorial Development Directorate – has initiated an examination of the strategies adopted since the onset of the economic and financial crises to manage employee compensation cuts more effectively. Wage and salary programmes represent one of the largest controllable costs for government employers. Changes in the structure and administration of pay programmes are not merely isolated austerity measures but in fact part of broader initiatives to restructure government so as to reduce costs more generally. The crises have made rethinking public sector compensation models imperative, both to meet the immediate need for lower operational costs and to effectively plan for the long term.

This volume aims to assist member countries with that rethinking, offering a close-up look at compensation planning and management as a tool for tackling the budget crisis and achieving the goals of government in a cost-effective manner. The focus is primarily on wages and salaries, and to a lesser extent on cash incentives and allowances.

The report is based on information provided by member countries through the 2010 OECD Survey on Strategic Human Resource Management in Central/Federal Governments and the 2010 OECD Survey on the Compensation of Employees in Central/Federal Governments, both conducted by the OECD Public Governance Directorate. Discussions held during the experts' meeting on compensation 9 September 2011 were invaluable in helping refine arguments and conclusions.

Howard Risher (consultant) wrote Chapters 2 through 5. Oscar Huerta Melchor (OECD Secretariat) co-ordinated the project and revised the report. Input that greatly enriched its conclusions came from members of the Public Employment and Management Network: Georgia Valatsu (Greece); Bunzo Hirai and Yoko Numata (Japan); Robert Cloarec and Per Stengard (Sweden); Wojciech Zielinski (Poland); and David Livingstone (United Kingdom). Useful comments were provided

by Robert Ball, Stéphane Jacobzone, Zsuzsanna Lonti, Varinia Michalun and Elsa Pilichowski from the OECD Secretariat. Randall Holden edited the book. Karena Garnier (OECD Secretariat) provided administrative assistance. Janos Bértok (OECD Secretariat) oversaw the project under the direction of Rolf Alter (OECD Secretariat).

Table of contents

Preface	9
Executive summary	11
Chapter 1: Current trends in the compensation of public employees in OECD countries	17
Introduction	18
The fiscal consolidation imperative	18
Plans to reduce payroll and labour costs	22
Comparing compensation in selected public sector occupations	30
Compensation cuts may produce workforce management challenges	35
Conclusions	38
Notes	39
References	40
Chapter 2: Public sector compensation management in a changing world	41
Introduction	42
Government compensation programmes are at a crossroads	42
The purpose of compensation	45
Controlling payroll costs is key to managing the total compensation package	47
Developing accurate job descriptions to establish appropriate salary levels	50
Balancing internal and market considerations	52
The growth of knowledge jobs has led to greater individualised pay	58
Downsizing, restructuring and salary management	60
Best practices in compensation management	64
Conclusions	66
Notes	67
References	68

Chapter 3: Managing compensation in a post “New Public Management” era	69
Introduction	70
The need for change in compensation management	71
The use of pay bands to manage salaries	73
The highest hurdle – transitioning successfully to performance-related pay.....	80
The new importance of the market factor in retaining talent	96
Compensating public managers effectively	96
Pay and gender equity	102
Conclusions	105
Notes	106
References	107
Chapter 4: Policies and practices governing public sector compensation planning	109
Introduction	110
The compensation data available	110
Collective bargaining and salary planning.....	111
Considerations in using labour market surveys to inform salary planning	115
Concerns in using inflation data to adjust salaries.....	118
How to allocate amounts for salary adjustments	119
Planning and managing additional payments: allowances and bonuses	123
Setting the stage for total rewards management	126
Conclusions	127
References	128
Chapter 5: Key considerations in reforming the government compensation system	129
References	135
Annex A Extent of union involvement in HRM issues and sources of financial support, 2010	137
Annex B Salary negotiations and determination of pay, 2010.....	140

Tables

Table 2.1. Restructuring plans and leaving conditions (2010)	62
Table 3.1. Factors that determine base salary at different hierarchical levels	82
Table 3.2 Gender pay gap in the New Zealand public service	104

Figures

Figure 1.1. Announced consolidation plans vary	20
Figure 1.2. Expenditure-based versus revenue-based measures	21
Figure 1.3. Operational expenditure measures – frequency	22
Figure 1.4. General government compensation of employees as a percentage of GDP, 2000 and 2009	27
Figure 1.5. Employment in general government as a percentage of the labour force, 2000 and 2008	28
Figure 1.6. Production costs as a percentage of GDP, 2000 and 2009	29
Figure 1.7. Average annual compensation of economists and statisticians in central government (2009)	32
Figure 1.8. Average annual compensation of employees in secretarial positions, 2009	33
Figure 1.9. Teachers’ salaries in lower secondary education in public institutions, 2008	34
Figure 1.10. Compensation of salaried doctors and nurses, 2008	35
Figure 2.1. UK approach to “total reward”	49
Figure 3.1. Extent of delegation of human resource management practices to line ministries in central government (2010)	79
Figure 3.2. Extent of use of performance-related pay in central government (2010)	85
Figure 3.3. Average annual compensation of central government senior managers, 2009	98
Figure 3.4 Average annual compensation of middle managers in central government, 2009	101

Preface

Since the global financial crisis broke in 2008, most OECD member countries have introduced measures intended to restore public finances. Over three quarters of the OECD countries participating in the OECD Fiscal Consolidation Survey 2012 have marked operational expenditures for savings with wage cuts and staffing reductions included in the reform agenda. More than half are introducing wage cuts (e.g. wage freezes in the United Kingdom and the United States, and 5-10% wage cuts and salary freeze in Portugal and Spain) and a quarter are undertaking staff reductions (e.g. 10-12% reduction in staff in the Czech Republic, Ireland and Poland, and up to 10 000 staffing positions to be permanently abolished by 2014 in Germany). These are significant orders of magnitude as governments in OECD countries employ 15% of the labour force, and compensation costs account for 23% of government expenditures, representing 11% of GDP on average. However, the effects of salary cutbacks and freezes on staff motivation and the longer-term consequences on the ‘attractivity’ of the public sector as an employer are not clear yet.

The crisis has led public employers to rethink the way work is rewarded, organised and managed in order to ensure the quality of service delivery and policy advice. While actual experience is limited, some lessons to inform a new thinking towards a competitive, equitable, and culturally congruent compensation system do exist.

Countries may need to invest more in strategic workforce planning to assess future capacity and human capital requirements, and develop strategies and instruments to address future needs in terms of staffing levels and compensation costs. Indeed, although curbing public sector wages might go some way toward improving fiscal positions in the short term, it generates the risk that they might rebound at a later stage or that public sector pay might lose competitiveness relative to the private sector as in Mexico and Poland in the 2000s.

More flexible compensation systems can improve government’s ability to attract, recruit and retain employees with high-demand skills, as has been demonstrated in Australia and New Zealand. Compensation systems that

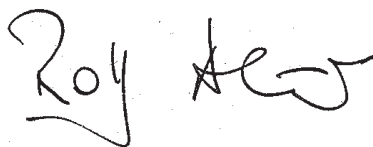
base salaries on post rather than on skills and increase all salaries at the same time may not be in a position to facilitate that flexibility.

Shifting to a new compensation system can allow government to focus on performance as a priority. Although a performance-related pay system may not achieve significant results by itself, it is a potentially useful complement to other elements of performance-oriented management, as has been the case in Denmark, Finland, Korea and the United Kingdom.

Addressing the gender pay gap remains one of the key priorities in the search for equality and fairness in compensation. Women's wages are on average 70-90% of men's. Closing this gap is not only an equity matter, but a way to achieve development of the workforce in a sustainable manner.

A new model for planning and managing pay programmes is likely to benefit from an inclusive process and open dialogue between employers and employees and from recognition of the role compensation plays in staffing and managing work. It should contribute to promote internal equity throughout the public sector; reflect the values of public organisations; and align compensation with government's core strategic objectives. The processes for rewarding public employees must be fair and transparent in order to attract and retain a talented public workforce.

Public Sector Compensation in Times of Austerity offers an evidence-based contribution to new thinking about human capital, government's most valuable asset and the one most difficult to replace.

A handwritten signature in black ink, appearing to read 'Rolf Alter', with a stylized flourish at the end.

Rolf Alter

Director

Public Governance and Territorial Development Directorate

Executive summary

The current economic and financial crises – sometimes referred to as the “Great Recession” – have made compellingly clear the need to reduce payroll costs and manage employee compensation more effectively. These imperatives are in fact part of broader initiatives to restructure government so as to reduce costs more generally. Some countries have proceeded to freeze or reduce salaries; others have yet to make that decision. Plans have also been announced to reduce employee benefits – primarily pensions – but the savings from these changes would only be realised over extended periods.

Compensation management in a changing world

The model for government compensation programmes that has been in place until now was developed in a very different era. Trends in government management began to prompt questions about continued reliance on traditional practices even prior to the crisis, but changes in pay programmes were slow to be implemented. Now the fiscal crisis has triggered a new urgency in the management of compensation. Budget cuts are forcing public employers to rethink the way work itself, as well as the reward for it, is organised and managed.

A major problem is that public employers have little experience to inform that rethinking, although there have been a few instances of government pay programmes that appear to be effective.

There is a frequently heard disclaimer that the intent “is not to run government like a business”. The fact is, however, that public employers have been moving toward the business model and adopting variations of practices developed in the private sector ever since the era of New Public Management (NPM) began in the early 1990s. Performance-related pay is one such practice; senior executive pay programmes are also loosely based on the common private sector model.

Downsizing and cuts in pay may be essential, but it is important to be cognisant of the impact on the commitment of employees and on the reputation of government as an employer. Pay is central to the psychological contract public employers have with each employee. Pay cuts are not

without a cost. Some of the issues that may arise are the loss of institutional knowledge if key contributors retire or resign; the time lost by managers and employees who have to deal with the issues related to vacancies and reorganisations; and lost productivity while people acquire new skills and learn new jobs. Possibly the largest cost is the falloff in performance among employees who become discouraged.

Programme administration may be an impediment to change if it delays the restructuring of work processes. Traditionally it starts with the documentation of duties in a job or position description, based on information collected in interviews with incumbents and managers. Everyone knows the information they provide will affect salary decisions, so they have reason to overstate the value or difficulty of their jobs. With sufficient concern for valid information, the process can require weeks or months, especially if a large number of jobs are redefined.

An important trend is the mushrooming importance of so-called “knowledge jobs”. The traditional programme model based salary administration on the internal “value” of each job, with employers relying on a job evaluation system to maintain “internal equity”. In the emerging model, the supply and demand for specific expertise in the labour market is recognised as a factor that governs salary increases and levels. This market factor cannot be ignored by employers seeking to attract well-qualified job candidates. Employers, both public and private, are searching for policies that enable them to balance internal and external considerations in planning and maintaining their salary programmes.

Government salary programmes started changing twenty years ago, after decades of little or no change. However, the programme model emerging now represents a significant change in thinking. Developments to date suggest a couple of common themes – but no single “best practice” model. Since pay is intended to have a positive impact on employee performance, it is important for employees to know what they can expect and to view the new pay programme as fair. Experience suggests that the best approach to planning the new programme is to involve managers and employees throughout.

Trends in the post “New Public Management” era

One of the important new trends in compensation management is delegation of that responsibility from a central office to agencies and ministries. In a few countries responsibility for managing salaries is delegated still further along to line managers and supervisors. The trend duly recognises the role compensation plays in staffing and work management, and is very much in line with the growing practice of holding executives and managers accountable for the performance of their units.

Individualised pay is another trend. The economics of supply and demand make education, experience and performance increasingly important determinants of pay. With knowledge jobs on the rise, employers are introducing pay policies that recognise the value of better-qualified workers with higher salaries. Occupations that are in high demand, such as those in technology and healthcare, command higher starting salaries. The challenge for government is to remain competitive and to modify their compensation programmes to meet the differentials in pay offered by the private sector.

The transition to performance-related pay continues despite the problems that have arisen and the fact that few countries claim to have fully made a success of the practice. In the business sector there is heightened interest in using what limited funds there are for salary increases to reward the best performers. With the current focus on government performance, there is likely to be continuing support for the public sector to follow suit.

A fourth politically sensitive issue is executive compensation. The public sector is known to have executive compensation levels below the levels in business, but the fact that pay levels are significantly higher than those for the average citizen makes it difficult to build political support for increases. Government executives have budget and operational responsibilities that are more than equal to those of many business executives. Performance-related pay plays a larger role at the executive level. The awards are smaller than those in the private sector but still appear large to the public.

Compensation planning decisions

As stated above, the model for new government pay programmes began to emerge in the NPM era. It is still being refined, but its major leap in development was triggered by the urgency of addressing budget problems. That accelerated the replacement of traditional pay practices, leading to heightened uncertainty and apprehension among employees.

Compensation planning involves two basic decisions: how to determine and adjust base pay levels over time; and how to allocate the funds budgeted for increases among employees. Traditionally, public employers have relied on collective bargaining, but it appears the next few years will be a period of transition.

Whatever the method, all employers track and respond to increases in the labour market. Salary surveys are generally available in every country, although the quality or validity of the data is not always accurate. The market data are also commonly a point of discussion in collective

bargaining. Understanding of labour market practices is central to competing for talent.

While step or across-the-board pay increases remain the most prevalent practice in OECD countries, individualised pay has gained acceptance. The linkage of pay increases to performance planning is defined by policy.

The recession has heightened interest in “total rewards management”: the concept that salaries and benefits are not the only rewards of work. Where pay levels may not be fully competitive, it is particularly important that government employers adopt recognition and reward practices that take advantage of the range of non-cash rewards.

Lessons from past experience

Changes in compensation and its management could affect employee lifestyles and careers, which means they can trigger anxiety and political resistance. Since the economic downturn was unexpected, countries did not have the time to prepare for needed changes, which are still not fully planned or executed in every country. The fact that this is sensitive territory makes the requisite organizational change all the more extraordinarily complex.

OECD analyses of prior initiatives to introduce new or modified pay programmes have highlighted the considerations that should be addressed in planning: the readiness of managers to accept the responsibility for managing pay; the extent of the changes needed in work systems and jobs; and the impact of the changes on employee behaviour and performance. The goal is to prepare the organisation for the programme changes.

To avoid or minimise possible problems and build support for change when replacing a salary programme, it is recommended that governments: i) create, under the leadership of the civil service authorities, a taskforce composed of representatives from the more prominent stakeholder groups (union representatives, members of the legislative body, members from academia and think tanks, and the more prominent HR heads across government); ii) develop a communications strategy to keep employees and stakeholders informed of plans and progress; iii) study best practices in other countries; iv) complete an analysis of the factors that led to the decision to replace the programme, which should include a survey or preferably focus groups to secure input from managers and employees.

Experience suggests that developing a new pay programme requires agreement on the philosophy of, goals of and responsibility for administration of the programme. The first job for the task force is to develop consensus on the nature of the programme that will best meet the near-term needs of government. Several basic issues need to be discussed:

i) the role and responsibilities of the central human resource management body in programme administration, ii) the roles of managers and other individuals involved in programme administration, iii) the decisions on compensation delegated to line managers, iv) the relative importance of performance, and v) the planned alignment with market pay rates. There must be agreement on the procedure and criteria for assessing the programme.

Moreover, the salary schedule or structure needs to be defined to encompass the lowest- and highest-paid jobs. The number of grades (or bands), their format, and the size of steps (if any) need to be decided. It is recommended that a decision process for assigning jobs to grades be developed and tested. As a rule, the most prevalent jobs are used in the development and testing. Agreement needs to be reached on the number of grades or bands, their format and size of steps. Policies, regulations and administrative procedures need to be drafted and credible market data developed. The cost of full implementation needs to be estimated and final approval secured. In addition, training materials for managers and employees need to be developed.

Public and private sector experience in introducing new pay programmes suggests that the first step should be a review of job descriptions. Employees should have an opportunity to confirm the accuracy of these descriptions. Jobs need to be assigned to salary grades or bands using government's preferred methodology. All grade assignments should be reviewed by committees. Each employee's salary will need to be positioned in new grades based on his or her time in position. If performance-related pay is adopted for the first time, managers and supervisors will require training and the performance management process should be reviewed. It is recommended that the programme be evaluated at the end of the first and possibly succeeding years. Employees should be made aware that problems are being addressed.

Chapter 1

Current trends in the compensation of public employees in OECD countries

Compensation of public employees – which is key to attracting, motivating and retaining qualified workers – will likely be affected by the budget crisis, through cuts/freezes in pay/benefits or possible reductions in staffing levels. Fiscal consolidation through budget cuts can be a double-edged sword if staff reduction (for short-term needs) is severe, or “rightsizing” initiatives result in a loss of capacity to deliver needed services or a demoralised workforce. Review of measures implemented in OECD countries suggests that it is more the style and practices of management and/or the composition of the public workforce – not its size or the level of operational expenditure – that stand out as causes of budget imbalances in the first place. Involving public employees in decision making regarding salary and workforce reduction measures can be a useful means for ascertaining how far they are willing to go to avoid job losses and accept salary reductions or freezes.

Introduction

Compensation of public employees plays an important role in attracting qualified workers to government jobs, as well as motivating and retaining them. It also represents a significant but varying portion of government expenditures, as compensation costs depend on the number and remuneration of staff that government employs. As governments respond to the budget crisis with austerity measures, compensation of public employees will likely be affected, either through cuts or freezes in pay or benefits – or both. Measures that have been adopted by a number of countries may have secondary effects that hinder economic recovery, such as decreasing the purchasing power of a large number of consumers, or reducing the morale of public employees. To manage these effects, governments require strategies for distributing the pain of the efforts required to boost economic growth and balance the budget across the public service. As a result, new thinking on compensation programmes for the public sector is necessary. This chapter presents an overview of the macroeconomic context in OECD countries, with particular emphasis on the fiscal consolidation plans adopted to overcome budget deficits. It also presents some lessons regarding compensation derived from past experiences.

The fiscal consolidation imperative

The global financial and economic crises threaten to keep several countries in the spiral of low growth, high unemployment, and lower necessary output. While governments pursue policies to create jobs, grow their economies, improve fairness, reduce inequalities and rebuild trust, many also need to introduce reforms to address rising debt levels resulting from the crisis. The heavy restraint put on public finances undermines political credibility and stability; and neither the state of the world economy nor prospects for public finances across OECD countries show definite signs of improvement. Some political leaders, policy makers and investors expect a second downturn. There is a growing consensus that the restoration of public finances is a prerequisite for sustainable economic growth. Restoration, however, requires credible medium-term fiscal consolidation plans.

Fiscal consolidation has become the cornerstone of the current budget policy debate across the OECD area. Rising debt levels have called into question the sustainability of the status quo, and the prevailing wisdom is that governments must consolidate finances in order to ensure future growth. Policy makers across the OECD area are currently discussing and debating fiscal consolidation, and many governments have already announced and put into action plans to restore budget balance. The average deficit across the

OECD was 5.6% in 2010, compared to 1.3% in 2007. These deficits, combined with low economic growth, have resulted in high debt levels in many countries: on average, debt stands at 74.2% of GDP across the OECD area in 2010, up from 55.6% in 2007 (OECD, 2011a).

Fiscal consolidation, however, is not in itself a policy. Rather, it is a key tool for addressing underlying issues and imbalances in individual sectors, such as welfare, pensions, healthcare and education.

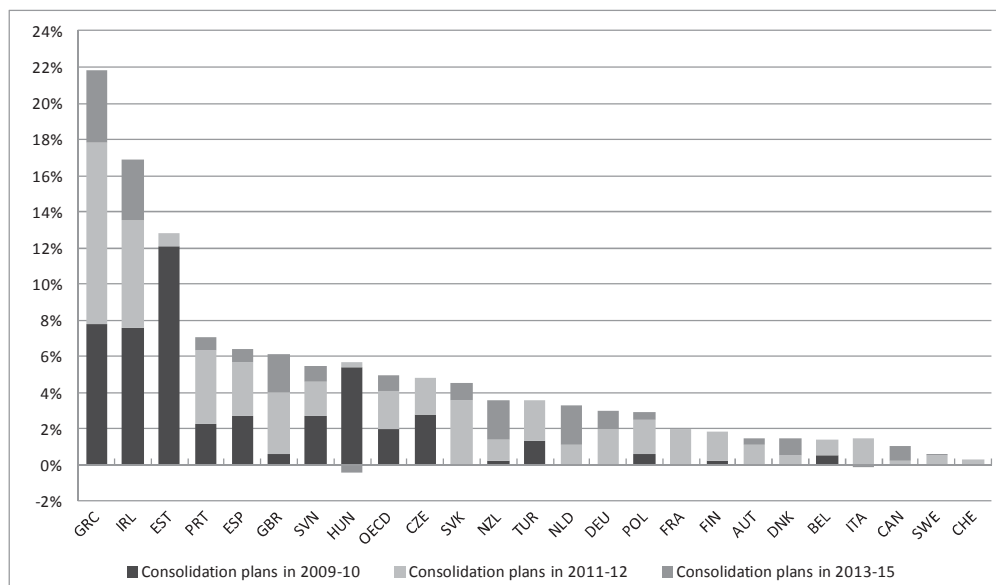
The “Great Recession”, as it is being called, has had a disparate impact on OECD countries. When the global economy took a sharp downturn in September 2008, it quickly caused political instability. Protests and riots occurred in 2009 in a number of countries. Several, including Greece, Ireland, Italy, Portugal, and Spain, have experienced what has been described as a fiscal crisis. Those countries have announced a combination of tax increases and severe budget cuts to reduce their deficits. Several countries received bailouts from the International Monetary Fund, and there are ongoing discussions to determine if lenders are willing to increase the rescue funds.

At the same time, a few countries were able to avoid the budget problems. OECD member countries such as Norway, Estonia and Switzerland maintained positive fiscal balances through 2010. Moreover, nine other countries – Australia, Canada, Denmark, Finland, Ireland, Korea, Luxembourg, New Zealand and Sweden – had positive fiscal balances from 2000 to 2008. Only four countries had a deficit larger than 5% of GDP in this period.

Almost all OECD member countries have announced fiscal deficit reduction targets to at least 2013, and to a lesser extent consolidation plans that need to be implemented for the deficit targets to be achieved. But while almost all these targets are over the medium term, two-thirds of the countries involved announced consolidation plans covering the 2010-13 period (Figure 1.1). Where consolidation plans are in place, the size of the plan varies significantly depending on the country’s fiscal position and the current status and time frame.

Figure 1.1. **Announced consolidation plans vary**

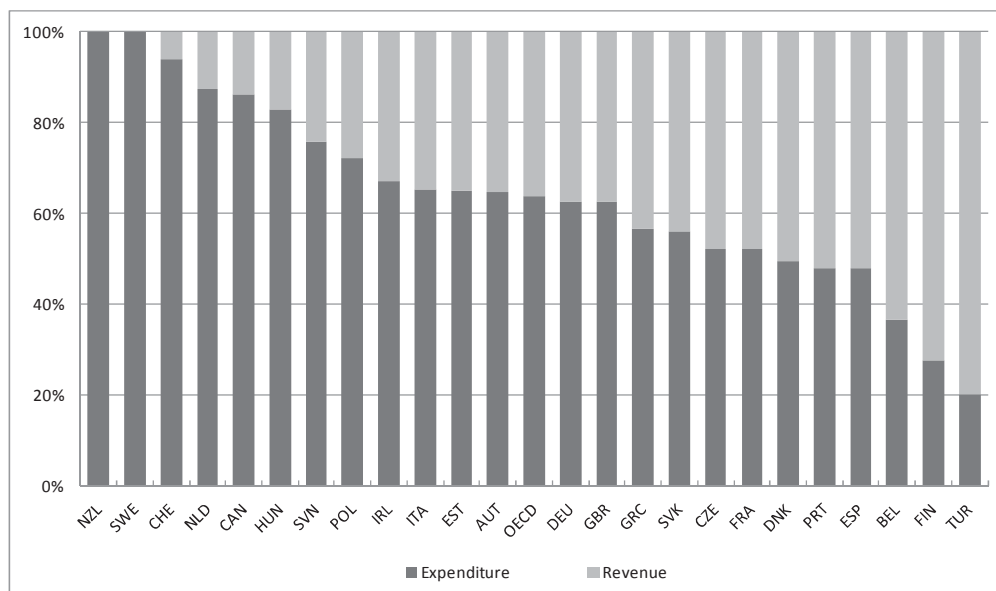
Percentage of GDP



Note: The figures are the sum of annual incremental consolidation for 2009-15 as reported by the national authorities and/or calculated by the OECD Secretariat. The figures include Estonia's and Ireland's 2009 consolidation. Hungary's 2007-08 consolidation is not included. Canada and the Netherlands report consolidation until 2015.

Source: OECD Fiscal consolidation Survey 2010. Published in OECD (2011), "Restoring Public Finances: Fiscal Consolidation in OECD Countries", Special feature of the *OECD Journal on Budgeting*, Vol. 2011/2, OECD, Paris, DOI: 10.1787/budget-v11-2-en.

Most countries are relying on expenditure cuts to achieve fiscal consolidation. Present consolidation plans envisage some mix of spending restraint and revenue-raising measures, with more weight placed on the former (Figure 1.2). There is significant variation in the composition of consolidation measures. The majority has based consolidation mostly on expenditure-based measures. These are typically countries with smaller consolidation needs. According to the OECD Economic Outlook (2011c), the OECD area-wide fiscal deficit is expected to fall by 0.75% of GDP in both 2012 and 2013, with the improvement more than accounted for by planned consolidation measures, partly offset by raising interest payments.

Figure 1.2. **Expenditure-based versus revenue-based measures**

Note: The figures are a contribution to consolidation from expenditure and revenue measures weighted by the incremental volume of consolidation across each year reported.

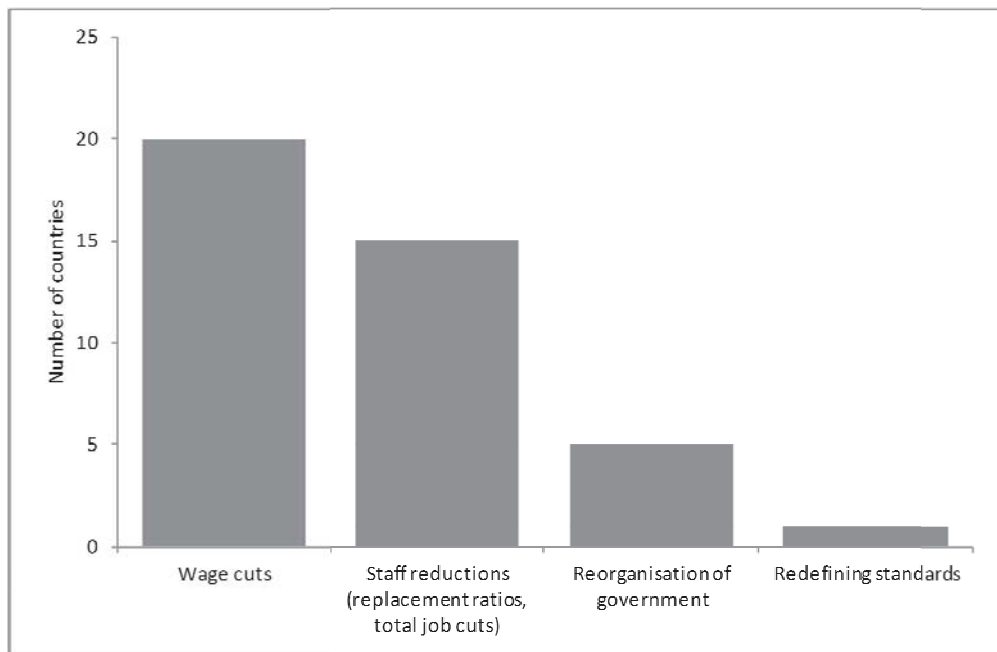
Source: OECD Fiscal Consolidation Survey 2010. Published in OECD (2011), “Restoring Public Finances: Fiscal Consolidation in OECD Countries”, Special feature of the *OECD Journal on Budgeting*, Vol. 2011/2, OECD, Paris, DOI: 10.1787/budget-v11-2-en.

In OECD member countries, fiscal consolidation plans emphasise cutting expenditures rather than taking steps to raise revenues. Indeed, almost all OECD countries have designated operational expenditures for reduction (Figure 1.3). This is broadly believed to have the most lasting impact in terms of stabilising finances and achieving deficit goals. Budget cuts can, however, be a double-edged sword if the staff reduction is severe and results in a loss of capacity to deliver needed services. From a different perspective, reduced spending is contrary to the Keynesian argument for stimulating the economy.

Nonetheless, a number of countries have announced budget cuts. France, for example, announced that operating expenditures are to be cut by 10% in the central government. Cutbacks announced in the Netherlands and the United Kingdom are substantial indeed. In the Netherlands, across-the-board savings on operational expenditures will be implemented at all levels of government, amounting to EUR 6 billion by 2015. Operating budgets in the

United Kingdom will be reduced by between 33% and 42% by 2014. In Greece, savings of 0.8% of GDP are targeted in 2011 alone.

Figure 1.3. Operational expenditure measures – frequency



Source: OECD National Account Statistics, October 2010. Published in OECD (2011), “Restoring Public Finances: Fiscal Consolidation in OECD Countries”, Special feature of the *OECD Journal on Budgeting*, Vol. 2011/2, OECD, Paris, DOI: 10.1787/budget-v11-2-en.

Plans to reduce payroll and labour costs

The results of the 2010 OECD Survey on Strategic Human Resource Management in Central/Federal Governments show that over 80% of OECD countries intend to implement or are implementing plans to restructure and “right size” the workforce. The goal is to balance the need to reduce costs while maintaining public service delivery. The initiatives are sensitive because the changes alter the psychological contract with current employees – which could affect their commitment to public service – and also adversely affect the image or “brand” of government as an employer. Both of those effects could impact the performance of ministries or other government institutions/bodies beyond the current crisis.

Across OECD countries operational cuts focus largely on reducing compensation costs. A large number of governments across OECD have announced workforce reduction measures and/or cuts in salaries and benefits (Box 1.1).

As to the latter course, least 20 OECD member countries have announced plans to freeze and/or cut public sector wages. The range of wage cuts is wide and crosses countries, from the two-year wage freeze in the United Kingdom to a 10% wage cut in the Czech Republic and an approximately 14% wage reduction in Ireland. The total quantified wage reduction is between 0.6% of GDP and over 0.8% of GDP in Hungary, Ireland and Portugal. As the public wage bill accounts for a large share of public expenditures and public employment is substantial in several countries, most member countries have announced operational savings in their respective consolidation plans, though these plans vary in aggressiveness and the level of detail. The measures were unprecedented for some countries; in Japan, for instance, salaries had not been cut since World War II. In previous times of austerity, countries like Japan and Spain (in the 1980s) had to freeze wage increases only, but now the severity of the situation has led to a wage reduction followed by a freeze. In Australia, wage reductions or freezes have not been utilised since the 1930s as a response to the Great Depression; even so, the pace of increases slowed as government introduced caps on wage growth.

A number of trends can be distinguished from the different initiatives to reduce and/or freeze salaries and benefits described in Box 1.1. As Box 1.1 describes, measures to respond to the crisis have involved salary cutbacks and/or freezes; suspension of automatic increases of individual pay and performance bonuses; reduction in the salaries of political officials, senior managers, and in some cases even members of the legislative and judiciary; and in some cases reductions in staffing levels that follow salary reductions. Three trends for the future of managing public servants' compensation can also be distinguished from Box 1.1: i) increases in wages and salaries will be closely linked to efficiency gains, productivity improvements, and collective and individual performance; that will demand investment in better management practices; ii) benefits will have to be in line with the market to avoid excessive costs; and iii) the bargaining model is being reviewed in the hopes of finding more developed or mature methods to engage with unions to face current and emerging challenges.

Box 1.1 Public sector salaries and benefits are being cut across OECD countries

In tandem with reducing civil service staff, **Portugal** has frozen pay rises, promotions, and the granting of performance bonuses and mobility salary changes, while implementing salary reductions of 5% on average (between 3.5% and 10% for salaries above EUR 1 500 per month from 2011). There have also been reductions in per diem allowance, overtime pay, and benefits such as pensions. The salary cutbacks are foreseen to be in effect until 2013. The aim is to ensure that the weight of staff expenses in the GDP decreases.

In 2010 **Spain** introduced a progressive pay reduction for all public employees from central state, autonomous community and local governments. The reduction, ranging from 3% to between 6% and 8% depending on level of function, was introduced through the exceptional recourse of a Royal Law-Decree procedure, used only in urgent situations. This was followed by a freezing of wages for all public employees. Government positions such as the Prime Minister, the Vice-Prime Minister and the ministers had a reduction of 15% of their salaries; officials of the general administration such as the Secretary of State, the Undersecretary, and the Director General had reductions of 10%, 9% and 8%, respectively. New measures to reduce the budget deficit introduced in 2011 establish alternatives to reducing wages.

Italy closed all open wage agreements for 2006-07 and 2008-09 in order to avoid excessive growth in salaries; suspended “complementary wage items” for civil servants; reduced additional local bargaining funds (funding these mostly through savings from cuts in consultancies and in contracts to civil servants); and reformed the bargaining model to link wage increases more clearly to collective and individual performance. In 2010 Italy suspended national wage bargaining procedures for the years 2010-12; prevented increases from the 2010 level of remuneration until 2013; and reduced managers’ pay by between 5% and 10%.

Greece cut allowances by 20% in 2010, and abolished the 13th- and 14th-month bonuses for monthly earnings above EUR 3 000 (= 14%). Greece has 500 000 public employees (in central and decentralised administration, local government authorities, education, health and public sector enterprises) that cost EUR 12.5 billion. The Memorandum of Obligation of the financial rescue package obliges Greek authorities to reduce operation costs by up to EUR 500 million until 2014.

The **United Kingdom** announced pay freezes for the fiscal years 2011/12 and 2012/13. The freeze applies to the Home Civil Service (government departments and ministries, executive agencies, and most non-departmental public bodies), which covers 40 permanent secretaries, 80 special advisors, 4 000 senior civil servants and 480 000 junior civil servants. The freeze also covers local governments, health workers, teachers, police and the judiciary. Ministers and members of Parliament saw their pay cut by 5%. The measures, applying to those earning non-contractual pay exceeding GBP 21 000, include no base pay increase; no upward salary repositioning; and bonus reductions for senior civil servants. Pension reforms are also being accelerated.

Box 1.1 Public sector salaries and benefits are being cut across OECD countries (*cont.*)

The **Netherlands** will also be implementing pay freezes in the next year or two and is also cutting redundancy benefits. In 2007 the government of **France** established a replacement ratio of one recruitment for two employees retiring, so as to stop the increase in payroll costs. In addition, the French government froze basic wages for the entire public sector for the period 2011-12.

In 2009 **Australia** adopted the *Australian Public Service Bargaining Framework*, which requires that all increases in remuneration be offset by genuine, quantifiable productivity improvements. The Framework also recommends what amounts to a 3% wage growth cap. Most state Governments have also introduced recommended caps in wage growth for the current round of public sector bargaining, ranging from 2% for Tasmania to 4.25% in Western Australia. The New South Wales Public Sector Wage Policy limits increases in remuneration and other conditions to 2.5% per annum; any higher increase needs to go through a parliamentary approval process and be funded by employee-related cost saving, which must be achieved before the improvement can be awarded.

In 2010 **Canada** announced a three-year freeze on departments' operating budgets. Salary increases will have to be funded through internal efficiency measures. Negotiations with unions on future actions are being undertaken; six agreements have already been reached that establish moderate wage increases and the elimination of costly benefits that are out of line with the market.

In 2010 **Slovenia** adopted a series of agreements negotiated with unions on public sector salaries. Measures included a reduction of 4% in basic salary for all civil servants and a 1% reduction in basic salary for directors, until real growth in GDP exceeds 2.5%. Base salaries for judicial functionaries were frozen until the end of 2012. Regular performance-related bonuses will not be paid and the amount of performance-related bonuses associated with an increase in workload will be reduced until at least the end of 2012. Promotion of civil servants to a higher pay class has been frozen until July 2012.

Iceland has cut the wages of higher pay grades, reduced overtime pay, offered flexible separation terms to employees who have gained the right to pensions, and reduced travel and vehicle expenses. The country announced salary cuts in order to avoid losing high numbers of personnel.

Since 2010, **Poland's** total pay budget for public administration (which includes the civil service) has been frozen and since 2009 there is no automatic increase of individual pay. However, since 2010 there have also been no limits on the numbers employed in the civil service: offices are free to increase or decrease employment with a given pay budget. As a result some offices may decide to reduce employment, but they could raise salaries as well.

Box 1.1 Public sector salaries and benefits are being cut across OECD countries (*cont.*)

In June 2011, **Japan's** government began negotiations with employee organisations to reduce the salaries of government employees. This was an effort to address the problems caused by the Great East Japanese Earthquake and the need for fiscal consolidation. On 1 March 2012 the Diet passed a new law that decreases the remuneration of national public servants by an average of 7.8% for two years.

The **United States** has imposed a two-year freeze on pay adjustments for approximately 2 million federal civilian employees. The freeze statute prohibits “statutory pay adjustments” for the period between 1 January 2011 and 31 December 2012. The measure also generally prohibits executive departments and agencies from providing any base salary increases of any size to senior executives or senior level employees, including performance-base increases. The measure is expected to produce savings of approximately USD 2 billion during 2010 and reduce the budgetary expenditures by USD 60 billion over the next ten years.

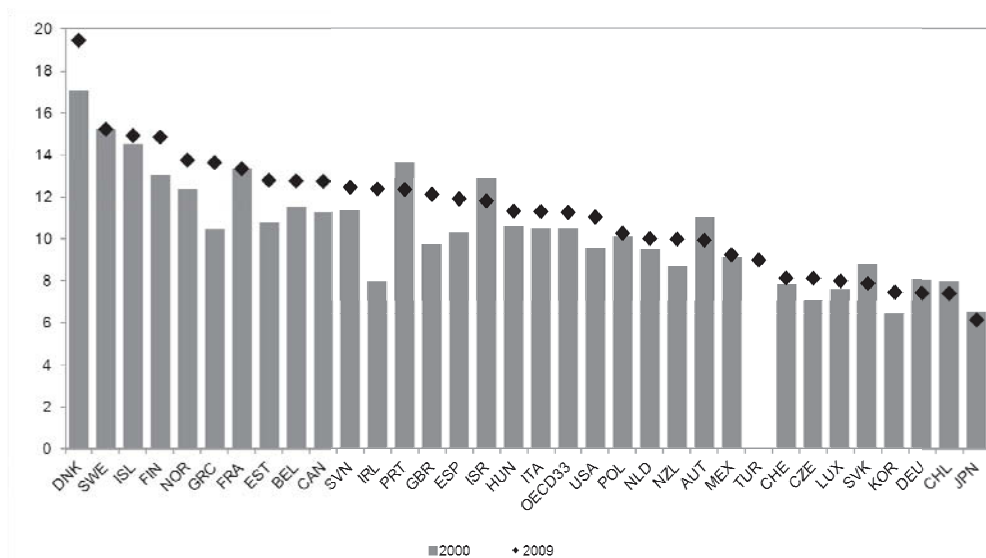
Source: Presentations given at the Public Employment and Management Working Party meeting, December 2010; and at the Experts Meeting on Compensation of Public Employees, 9 September 2011. Additional information was provided by delegates from Australia, Japan, Portugal, Slovenia, Spain and the United States.

Plans to reduce the size of the workforce have been announced by several countries (see OECD, 2011b for further details). Fifteen respondent countries to the OECD Fiscal Consolidation Survey 2010 have established replacement ratios to fill the gaps arising from staff leaving through retirement. In Austria, France and Portugal, the target replacement rate is set at 50%, meaning that these countries will hire one worker for every two who leave. In other countries the ratio is much lower: in Italy and Greece for instance, the aim is to replace one in five public servants who are leaving, while Spain plans to replace one in ten. However, in some countries certain sectors are protected from workforce reductions. In Spain for example, the sectors of health, education and security forces in particular have higher replacement ratios.

While general government compensation increased in most countries from 2000 to 2009 (Figure 1.4), the public employment share of the labour remained fairly constant for the same period (Figure 1.5). On average, governments in OECD countries employ 15% of the labour force. Across OECD countries the wage bill varies from a comparatively low level in Japan of around 7% of GDP to around 15% of GDP on average in Nordic

countries in 2009. A similar pattern is found in the share of public employment in the total labour force.

Figure 1.4. **General government compensation of employees as a percentage of GDP, 2000 and 2009**



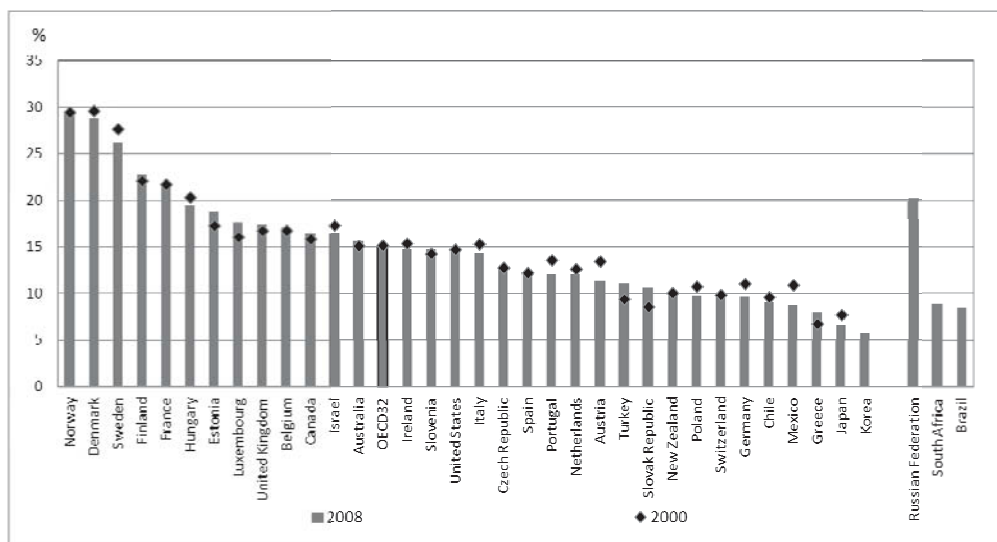
Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law. Data are missing for Australia. 2000 data for Turkey are missing. OECD33 does not include Turkey. Chile, Japan, Korea or New Zealand: 2008 instead of 2009. Mexico: 2003 instead of 2000. Russian Federation: 2008 instead of 2009, 2002 instead of 2000.

Source: OECD National Account Statistics.

Compensation costs account for 23% of government expenditures, which represents 11% of GDP on average. Apart from the various transfers to the economy, compensation costs represent half of the expenditures for producing goods and services (the other half being produced by the private sector but financed by government). The highest levels of compensation cost are found in countries such as Denmark (19.5%), Sweden (15.2%), Iceland and Finland (14.9%), and Norway (13.8%). With the exception of Iceland, these countries do not face the same budget and financial challenges as countries such as Greece (13.6%), Ireland (12.4%), Portugal (12.3), Spain

(11.9%) or Hungary and Italy (11.3%), which have some of the toughest measures regarding fiscal consolidation and compensation cutbacks.

Figure 1.5. **Employment in general government as a percentage of the labour force, 2000 and 2008**

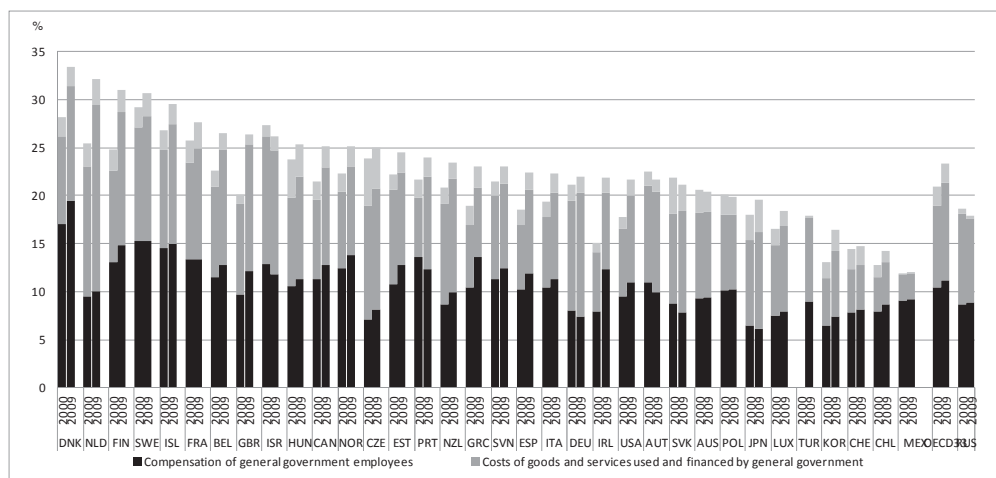


Note: Japan – Employment is not classified according to the System of National Accounts and is substituted by direct employment by central or sub-central governments. Data for Iceland are missing. Data for 2000 for Korea are missing, and this country is not included in the average (OECD32). Data for Australia, Chile and the United States refer to the public sector (general government and public corporations). Data for Austria, the Czech Republic, Italy, the Netherlands, New Zealand and Poland are expressed in full-time equivalents (FTEs). In New Zealand FTEs are included for education, health and community services and personal and other services. Finland, Israel, Mexico, Poland and Sweden: 2007 instead of 2008. France, Japan, New Zealand and Portugal: 2006 instead of 2008. Russian Federation: 2005 instead of 2008. Brazil and South Africa: 2003 instead of 2008. Ireland, Japan, Luxembourg, Slovenia and Switzerland: 2001 instead of 2000. 2000 data are missing for Brazil, the Russian Federation and South Africa. Data extracted on 18 March 2011. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: International Labour Organisation (ILO), LABORSTA Database. Data for Turkey are from the Ministry of Finance and the Turkish Statistical Institute. Data for Japan for employment are from the Establishment and Enterprise Census. Data for Korea were provided by government officials. Published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

Among OECD member countries, compensation of public employees on average accounts for 49% of the costs of producing goods and services, compared to 43% paid to non-governmental actors for intermediate goods and services or to deliver services directly to households. Consumption of fixed capital represents the remaining 9% of total production costs (OECD, 2011a). Total production costs as a share of GDP increased between 2000 and 2009 in all but four OECD countries (Australia, Austria, Israel, the Slovak Republic and Poland). This increase is primarily driven by increases in the costs of goods and services produced by corporations and non-profit providers (+1.5 percentage points) and to a lesser extent by increases in the compensation costs of government employees (+0.8 percentage points) (Figure 1.6).

Figure 1.6. **Production costs as a percentage of GDP, 2000 and 2009**



Notes: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law. 2000 data for Turkey are missing and this country is not included in the average (OECD33). Costs of goods and services financed by general government are missing for Chile in 2000. Australia, Japan, Korea and New Zealand: 2008 instead of 2009. Mexico: 2003 instead of 2000. Russian Federation: 2008 instead of 2009, 2002 instead of 2000. Data extracted on 28 February 2011 (Chile on 30 March 2011).

Source: OECD National Accounts Statistics. Data for Australia are based on a combination of Government Finance Statistics and National Accounts data provided by the Australian Bureau of Statistics. Published in OECD, (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

Comparing compensation in selected public sector occupations

Employee compensation plays an important role in making the public sector an attractive employer. It also constitutes, as shown above, a significant portion of government expenditures, as compensation costs depend on the number and remuneration of staff that government employs. As part of the fiscal consolidation measures implemented in many OECD countries, the level of public employee compensation is being called into question including in many cases salary cutbacks and/or freezes. OECD data on remuneration for key public sector positions show that wages and salaries represent on average 80% of total compensation. However, salaries are not a monolithic item across the government; they vary by position, performance, working hours and benefits. There is great variation across countries in the annual compensation paid to certain positions. Comparing total compensation levels across countries may help governments assess the competitiveness of their remuneration levels.

Data from the 2010 OECD Survey on the Compensation of Public Employees in Central/Federal Governments show that countries differ in the way they organise the structure for compensating government employees, through comparing employers' social contributions to the compensation package of wages and salaries, social benefits and future pension earnings. For example, Estonia, Hungary, Italy, Sweden and the United States have the highest share of employers' social contributions in total compensation, and Ireland, Korea and New Zealand have the lowest. Data comparisons also suggest, for example, that the annual compensation of senior managers varies significantly across countries. These variations can be the result of differences in national labour markets, in particular private sector remuneration for comparable positions. They can also indicate different organisational structures in countries (e.g. Sweden has a flat government with numerous top senior positions, D1s) and different levels of seniority in similar occupations.

Compensation of professional staff

Professionals are a key employee group in central government organisations. Two important subgroups are the economist/policy analysts and statisticians. Their research and analytical skills are key to improving government's ability to take decisions based on evidence. In the OECD countries that took part in the 2010 OECD Survey on the Compensation of Employees in Central/Federal Governments, the average annual compensation of the two professional groups amounts to approximately USD 90 000 PPP; that figure includes wages and salaries and employers' social contributions, and is adjusted for differences in actual working time

(both weekly hours and holidays). Their wages and salaries constitute two-thirds of that annual compensation and the remainder is made up relatively equally of employers' social contributions and the value of working time adjustment. Data also indicate that both positions are best compensated in the United States and Spain. Moreover, in the case of economists in Belgium and the Netherlands and statisticians in Ireland, the overall remuneration is significantly higher than the OECD average. It must be mentioned that in some countries it was not possible to make the distinction between the two professional groups because statistical work is performed by economists.

Compensation of secretarial and executive secretarial staff

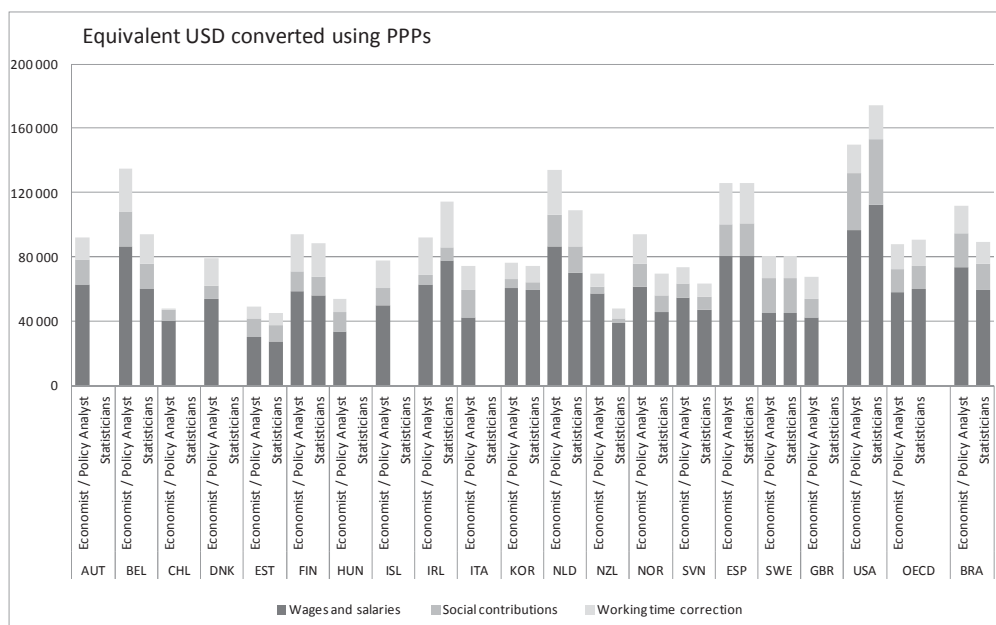
Executive assistants may supervise the work of secretaries and generally have more responsibility. Among the different central government occupations, the remuneration of staff in executive assistant and secretarial positions seems to vary the least across OECD member countries. Data from the OECD compensation survey show that on average, executive secretaries earn about USD 57 000 PPP per year and secretaries about USD 50 000 PPP. This also includes wages and salaries, employers' social contributions, and the monetary value working time adjustments (both weekly hours and holidays). However, the annual wages and salaries alone for these groups do not surpass USD 40 000 PPP. The Netherlands, the United States, and to a lesser extent Belgium, Norway and Finland pay their secretaries significantly above the OECD average.

Compensation of service delivery occupations

Among the public sector occupations, teachers, doctors and nurses provide especially critical services to the population. They belong to two key sectors for economic development, education and health. Teachers are the backbone of the education sector and their salaries represent the single largest cost item in education expenditures. In many OECD countries, salaries of teachers are set centrally, often through collective bargaining. Data presented in Figure 1.9 compare the starting, mid-career and maximum statutory salaries of lower secondary teachers in public institutions who have the minimum level of training. The annual statutory salaries of lower secondary teachers with 15 years of experience range from less than USD 16 000 PPP in Hungary and Estonia to over USD 54 000 PPP in Germany, Ireland, Korea and Switzerland, and more than USD 98 000 PPP in Luxembourg. In Korea and Portugal, top-of-the-scale salaries are more than 2.5 times greater than starting salaries, but it takes 37 and 31 years respectively to reach the top of the scale.

Figure 1.7. Average annual compensation of economists and statisticians in central government (2009)

Adjusted for differences in working hours and holidays

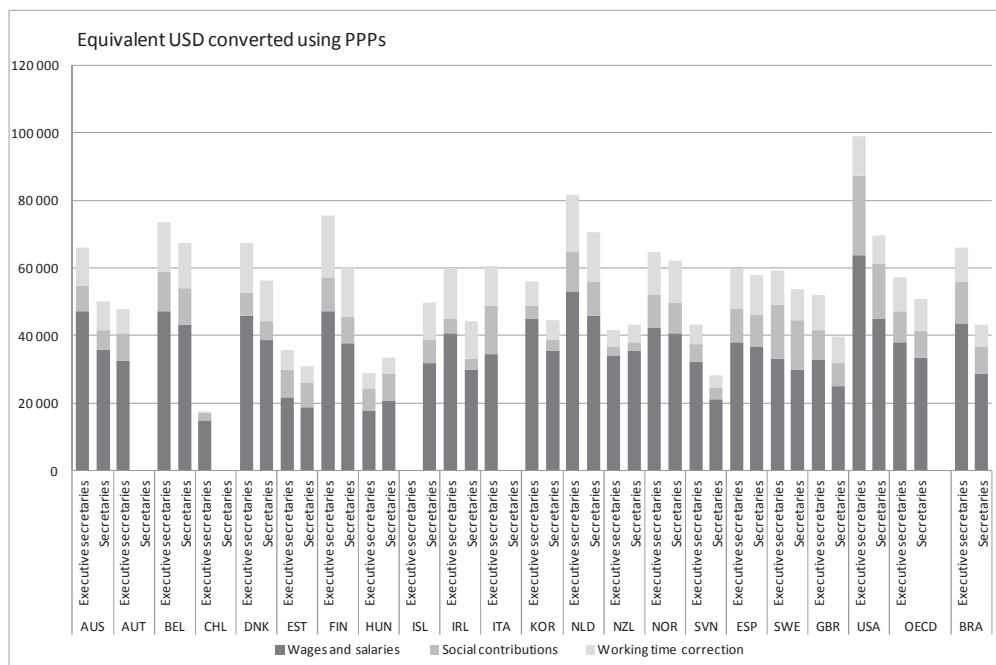


Note: Data for Australia, the Czech Republic, France, Germany, Greece, Israel, Japan, Luxembourg, Mexico, Poland, Portugal, the Slovak Republic, Switzerland and Turkey are missing. Canada withdrew its data. Compensation data for statisticians are missing or mixed with the economist/policy analyst positions for Austria, Chile, Denmark, Hungary, Iceland, Italy and the United Kingdom. Austria – Economists/policy analysts and statisticians have the same compensation. Brazil – Source of social contribution: IBGE; source of PPP: World Bank; data include career salary + 60% of *Direção e Assessoramento Superiores*. Chile – Data exclude bonuses for critical functions. This affects cross-country comparison by one to two percentage points depending on the occupational group, but may be much higher for top-ranking positions. Estonia – The information does not correspond exactly to the ISCO occupational groups. Economists/policy analysts cover all professionals that are involved in policy making or in basic units in ministries, and statisticians cover all professionals in support units. Ireland – Data take into account the decrease in salaries following the Financial Emergency Measures in the Public Interest Act 2009. Social contribution rates are for staff hired after 1995 and exclude unfunded pension schemes through the pay-as-you-go system. Korea – Civil servants are entitled to 3-21 days of annual leave per year depending on the length of service. New Zealand – Data do not include all social payments, including sick leave, or other unfunded leave payments made by the employers. Spain – Major reductions in compensation introduced in May 2010 are not reflected. The United Kingdom – Data exclude additional payments.

Source: 2010 OECD Survey on the Compensation of Employees in Central Federal Governments, OECD STAN Database. Published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

Figure 1.8. Average annual compensation of employees in secretarial positions, 2009

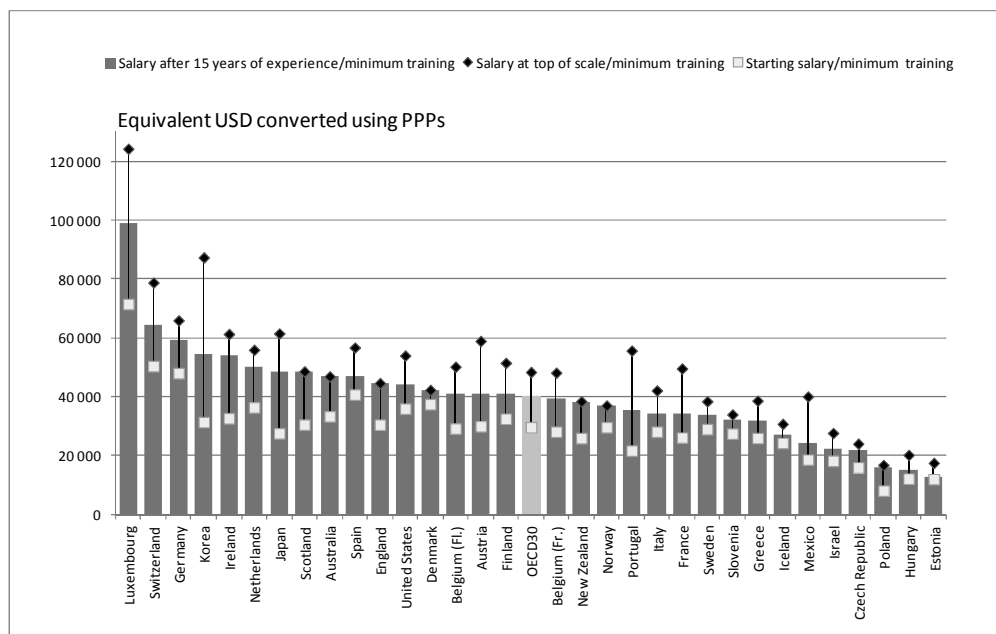
Adjusted for differences in working hours and holidays



Note: Data for the Czech Republic, France, Germany, Greece, Israel, Japan, Luxembourg, Mexico, Poland, Portugal, the Slovak Republic, Switzerland and Turkey are missing. Canada withdrew its data. Compensation data for secretaries are missing – or mixed with executive secretaries – for Austria, Chile and Italy. Compensation data for executive secretaries are missing – or mixed with secretaries – for Iceland. Austria – Value is median rather than average; executive secretaries and secretaries are not differentiated, therefore their compensation has been averaged. Brazil – Source of social contribution: IBGE; source of PPP: World Bank; data include career salary + 60% of *Direção e Assessoramento Superiores*. Chile – Data exclude bonuses for critical functions; this affects cross-country comparison by one to two percentage points depending on occupational group, but may be much higher for top ranking positions. Ireland – Data take into account the decrease in salaries following the Financial Emergency Measures in the Public Interest Act 2009; social contributions rates are for staff hired after 1995 and exclude unfunded pension schemes through the pay-as-you-go system. Korea – Civil servants are entitled to 3-21 days of annual leave per year depending on the length of service. New Zealand – Data do not include all social payments, including sick leave and other unfunded leave payments made by the employers. Spain – Major reductions in compensation introduced in May 2010 are not reflected. The United Kingdom – Data exclude additional payments.

Source: 2010 OECD Survey on the Compensation of Employees in Central Federal Governments, OECD STAN Database. Published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

Figure 1.9. Teachers' salaries in lower secondary education in public institutions, 2008



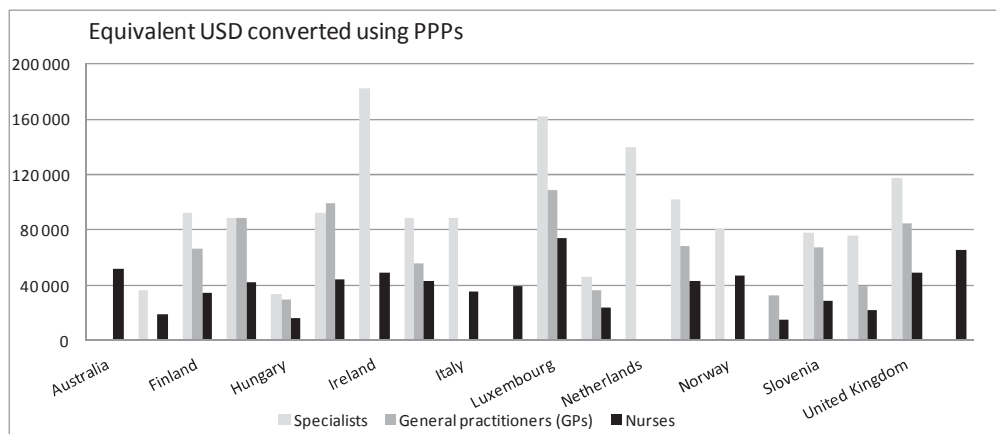
Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law. Data for Canada, Chile, the Slovak Republic and Turkey are missing. Belgium is presented as Belgium (Fr) and Belgium (Fl). The United Kingdom is presented as England and Scotland.

Source: OECD (2010) *Education at a Glance 2010: OECD Indicators*, OECD Publishing, Paris, DOI: 10.1787/eag-2010-en.

As with other occupations, compensation levels are among the factors affecting the attractiveness of different professions in the health sector, and the job satisfaction of incumbents. They also have a direct impact on healthcare costs, as wages represent one of the main spending items in health systems. Figure 1.10 shows compensation for general practitioners (GPs) and specialists who are salaried and for nurses who work in hospitals, as the focus is primarily on government workers. For all three occupational groups, there are indeed substantial differences across countries in the absolute level of compensation. The average salary of nurses and general practitioners is lowest in eastern European countries, Mexico and Turkey, and highest in Luxembourg. In 2008, the salary of medical specialists was highest in Ireland. The range of salaries across countries is highest for specialists: the difference between the highest- and lowest-paying countries

is around six fold. In all countries, specialists earn the most, followed by general practitioners and nurses. This partially reflects the varying skills sets of the three occupational groups as well as the time needed to be fully trained. The compensation gap is particularly large across the occupations in Luxembourg, Turkey, New Zealand, Finland, Israel and the United Kingdom.

Figure 1.10. **Compensation of salaried doctors and nurses, 2008**



Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law. Data for Austria, Belgium, Canada, Chile, Denmark, Estonia, France, Greece, Korea, Poland, Portugal, Spain, Sweden and Switzerland are missing. Australia: 2007. Germany: 2006. Netherlands: 2006. New Zealand and the United Kingdom (general practitioners): 2007. Luxembourg (general practitioners, specialists): 2006.

Source: OECD Health Data 2010. Published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

Compensation cuts may produce workforce management challenges

In many OECD countries, reducing compensation is a short-term measure aimed at reducing operational expenditure and balancing budgets. Although it is still early to assess whether expectations in terms of fiscal savings were met, it is possible to foresee some undesired workforce management challenges for the public sector.

Across-the-board reductions in wages and salaries and staffing cutbacks to balance the budget limit governments' ability to manage public employment effectively. They limit the ability to re-skill the workforce, and

have a negative impact on the morale of staff and managers. In Spain, for instance, vacant positions have been eliminated, limiting the ability to acquire skills and competencies; there has been a negative impact on mobility due to the lack of vacant positions, and on voluntary leave of absence for personal use, as the return to work is not guaranteed.

Freezing and/or cutting salaries and wages could affect the government's ability to attract and retain staff, with high performers leaving or forgoing the public sector to pursue higher-paid opportunities in the private sector. In Portugal, for example, approximately 20 000 public employees (3.2% of the public workforce) left the civil service in 2011 following adoption of the austerity measures.¹ In Slovenia, the revised budget for 2012 will cut public spending by at least 5%, possibly through salary cutbacks and reduction in the number of employees. Australia's past measures to tackle budget pressures have often resulted in staffing cuts (Box 1.2). In the absence of a strategic management of the workforce that promotes whole-of-government goals in terms of workforce planning, especially in terms of numbers, costs, competencies and diversity, staffing cuts and salary reductions/freezes may hinder governments' capability for service delivery in critical sectors. A large percentage of public employees at national, regional and local level provide vital services to their communities as teachers, doctors, nurses, fire-fighters, social workers, policemen, prison officials, etc.

Box 1.2. Australia's staffing reductions in the 1990s

Budget pressures in the 1990s resulted in reductions in staff numbers in Australia, mainly through natural attrition and voluntary redundancies. In 1996, the government implemented a fiscal consolidation programme that led to a significant reduction in the number of employees in the Australian Public Service (APS). During the period 1996-99, over 60% of the separations were linked to retrenchment. At the time of the programme's implementation, the APS employed 143 234 employees. This number reached its lowest point of approximately 113 500 employees in 2000 and has been steadily increasing since then. In June 2006, the number of employees had risen to 146 434, in line with 1996 employee numbers. The 2010-11 State of the Service reports that there are 166 495 employees in the APS.

Source: Information provided by the Australian Public Service Commission.

Public servants are also consumers. Cutting staffing and reducing salaries as a way to balance budgets may reduce public servants' purchasing power and slow economic recovery. Countries with the toughest fiscal measures, like Greece, Portugal and Spain, have reported this negative

impact on public employees' purchasing power. Reductions in the compensation of public employees has the potential to inflict greater damage on certain sectors of the economy – tourism is an example – as less income means less spending in leisure activities. Moreover, wage freezes may be reversed and reduce public sector efficiency by lowering salaries and compressing salary scale differentials. They may affect segments of the population unevenly, particularly women and children who benefit most from government programmes.

Because of the economic climate, public employees in countries such as Japan are seeing the salary reduction as necessary, but this is not the case everywhere. If salary reductions are imminent, governments need to find ways to reduce the pain and compensate public servants for their loss. For example, public employees can play a part in reducing the budgetary deficits of government and strengthening the economic recovery through the collective bargaining process. The chances of achieving sustainable reforms would be enhanced by a stable, mature method of engaging with the unions. Experience of past years provides a basis for further positive engagement between government and public service unions in negotiating reforms, in particular staffing and salary levels. Indeed, the collective bargaining process enables negotiations on relatively equal terms between employee and employer. In good times, collective bargaining can be used to divide up the gains, but in times of crisis it can be used to share the pain. Collective bargaining establishes rules that define and restrict the traditional authority exercised by employers. It develops a sense of self-respect and responsibility among employees; increases the morale and motivation of public employees; restricts arbitrary action on the part of the employer; and acts as a channel of communication between employer and employees. Moreover, collective bargaining provides a flexible manner of adjusting wages and employment conditions to economic changes, reducing the risk of conflict (see Chapter 4 for a discussion on collective bargaining).

Past experience suggests that operating expenses can be adjusted in a sustainable fashion through sophisticated workforce planning, accompanied by good use of the departures due to ageing as they facilitate restructuring; automatic productivity cuts; long-term policy reviews; skills strategies; and redesign of work. Spending cuts to operational expenses may be more effective when managers are given the flexibility to decide how to apply them across the portfolio, because they may have a better idea where inefficiencies exist than decision-makers removed from daily operations.

The effects of salary cutbacks and freezes on staff motivation are not clear yet. In some countries like Portugal, the image of the public sector has reportedly deteriorated, whereas in countries like Slovenia and Spain it still attracts and retains qualified staff – admittedly in part due to the lack of

opportunities to find jobs elsewhere. A strategy to compensate employees for their loss in salary may be needed. For example, as a result of the 1995 financial crisis in Mexico, public employees' salary was reduced but they were given more participation in policy making.

Conclusion

The acute budget crisis has led several governments in OECD countries to adopt measures to reduce operational costs, such as salary cutbacks and freezes. Although these are short-term measures, their implications for the public service may be long-lasting. If salary cutbacks and freezes are not managed adequately, governments may be hit by a capability crisis provoked by a less-skilled, unplanned and demoralised public workforce. A review of the measures implemented in OECD countries suggests that:

- The OECD countries with the highest levels of general government employment (*e.g.* Norway, Denmark, Sweden and Finland) are not those facing the most severe fiscal pressures (*e.g.* Greece, Italy, Portugal and Spain). Moreover, Nordic countries have the highest level of government compensation of employees as a percentage of GDP (Figure 1.4). The implication is that it is more the style and practices of management and/or the composition of the public workforce, and not its size or the level of operational expenditure, that stand out as causes of the budget imbalances. This does not mean that Nordic countries have not undergone periods of financial crises. What is critical for OECD countries is to develop the capacity to make adjustments to policy in periods of crises and pressures from internal and external actors.
- Salary freezes and cutbacks are most of the time accompanied by workforce reduction measures. There is, however, no evidence that these measures are being adopted based on a long-term strategic basis. In fact they are more a reaction to short-term needs, and there is little evidence that future needs for public services related to demographic trends and climate concerns are being considered. If this is not corrected the public service may place itself in a worse position and be unprepared to face future challenges due to lack of adequate skills, competencies and numbers of staff. Some countries with slightly more room for manoeuvre prefer to reduce salaries to avoid force redundancies, but other schemes such as work-sharing programmes are not being explored.
- A trend that seems to be emerging is to link future salary increases to productivity improvements. To enable this, countries may need to invest in better management schemes, training, and – perhaps most importantly – workforce planning, to systematically identify

competency gaps and mission-critical occupations and competencies, and to define the size of the workforce needed to meet organisational goals. Other measures that are being adopted include caps in wage growth.

- In some countries public employees have been involved in decision making regarding salary and workforce reduction measures. These negotiations have proved a useful means for ascertaining how far public employees are willing to go to avoid job losses and accept salary reductions or freezes. However, salary cutback measures do not incorporate a strategy to compensate public servants for their loss in purchasing power. Salaries of politically appointed and publicly elected officials and senior managers have also been reduced. The number of these officials and the percentage of the budget they represent may be minimal, but the message is that the pain must be shared by all public employees regardless of their hierarchical position. This would show solidarity with those more affected by salary reductions.
- The current situation suggests that government will, as part of the New Economic Thinking, have to consider alternatives to build high-quality public employment as a counterbalance to pay freezes, pay cuts and the recalibration of pension benefits – all of which were conceived during and for a different economic and management era.

Note

- 1 The numbers are provisional.

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Chapter 2

Public sector compensation management in a changing world

Times have changed: faced with the urgency of the “Great Recession”, public employers are finally dropping long-standing compensation management methods and adopting alternative ways of setting salaries. Some of these have proved effective but employers generally have little experience with such rethinking, and there is no one textbook answer. Borrowing methods of the private sector, such as performance-related pay, is a strong trend and bound to continue. Other trends are the delegation of responsibility for managing pay from a central office to agencies and ministries, and individualised pay for knowledge jobs. How information is collected for job descriptions is key, since inaccuracies can lead to costly grade inflation. Any restructuring undertaken is now more practical thanks to technology, but each employer must decide on the appropriate balance between internal salary hierarchy (perception of fairness) and external differential increases in occupational pay due to supply and demand in the labour market.

Introduction

The “Great Recession” has presented governments with a number of formidable economic, governance and public administration challenges. These crises are disrupting existing governance patterns and pushing governments to respond quickly and decisively to problems at hand. Compensation of public employees is a key human resource management instrument. But decisions in compensation levels have directly affected a great number of people. Changes in compensation for these employees may change their lifestyles and careers, triggering anxiety and political resistance. This chapter reviews elements of compensation management and points to practices that could update compensation systems to make them more flexible, and that could allow better management of staff. The chapter sees the management of compensation as a tool for tackling the budget crisis and achieving the goals of government in a cost-effective manner.. The focus is primarily on wages and salaries, and to a lesser extent on cash incentives and allowances. These four elements are commonly associated with goal achievement, have the greatest potential for near-term savings, and are directly impacted by efforts to restructure organisations and work groups.

Government compensation programmes are at a crossroads

Until recently, employee compensation had seen practically no change over the previous five decades. The model for the traditional salary programme was introduced in the years following World War II, when the world of work was very different. That was an era when management thinking was dominated by efficiency experts advocating the principles of scientific management. Government workforces were described in that era as “an army of clerks”; employees with university degrees were few in number.

Back then senior executives then made all decisions and directed the staff through layers of supervision. Workers began their careers in entry-level jobs, and with increased job seniority they could expect to follow predictable paths to reach the highest rung in their career ladder. Work systems, jobs and work methods simply remained as they were. Employees were expected to do what they were told, “stay out of trouble”, and meet minimal performance expectations.

Changes in government work management practices began only recently and have been largely incremental. Technology now plays a major role but the mission, operating goals and structure of many agencies remain largely unchanged. More than a few offices operate in more or less the same manner

they did two or three decades ago. Offices devoted to processing claims, compiling and reporting data, or administering ongoing programmes are generally stable, involve routine tasks, and change only infrequently. Traditional pay programmes were planned for stable organisation.

Now, however, the fiscal crisis has triggered a new urgency in the way compensation – and indeed other aspects of work structures – are managed. Budget cuts can force public employers to rethink the way work is organised and managed. The term “rightsizing” was adopted early in the current recession to refer to initiatives intended to determine the optimal staffing configuration. Currently in some situations the downsizing goes beyond that; “slash and burn” is possibly a more accurate descriptor. Public agencies in some countries are being forced to restructure their organisation, often eliminating or redefining jobs as well as layers of management, and at the extreme reducing the level of service – all to reduce costs.

The cost of government has become an issue of (often acrimonious) political debate, and a primary reason behind organisational and/or political changes in government. Reducing those costs is now seen as essential in many countries. Reducing the payroll is a common goal. Within weeks of taking office in 2010, for example, the then new British government initiated a review of the UK Senior Civil Service, froze the salaries of the higher-paid employees, and commissioned a review of government-funded pensions (Box 2.1).

Change is usually resisted. Uncertain of how proposed changes will affect them, employees can assume the worst, seeing their lifestyle degraded by reduced pay – and in some situations, their working lives ended. That gives them strong motivation to look for political support to oppose the cuts. Unions of course play a prominent role in most OECD countries, serving as the counterforce to critics pushing for reduced pay and benefits. The political nature of this debate means the final answers are subject to all the twists and turns of legislative decision making.

Box 2.1 United Kingdom: government's principles for reform

The reform of the compensation of civil servants in the United Kingdom is based on these principles:

- Top performers should receive better cash rewards than average performers.
- There should be financial incentives for meeting key business objectives.
- Best performers should take on the most demanding assignments.
- Assessments should be relative to ensure continuous improvement.
- Consolidated pay increases should align with the market.
- Team bonuses and gain sharing should be introduced.

Source: Livingstone, D. (2011), "Pay Freeze in the UK Civil Service: An Overview of the Pay Freeze Policies in Place 2011/12 – 2012/13", Presentation given at the Experts Meeting on Compensation of Public Employees, OECD, Paris, 9 September 2011.

A very real problem is that public employers have little experience with rethinking the way pay is planned and managed. There are few proved examples of effective government pay programmes. A number of countries have recently implemented changes, but their experience is still unfolding. There have been failures. At this point no country, it seems, is the model for the future.

There is a frequently heard disclaimer that the intent "is not to run government like a business", but the fact is that public employers have been moving toward the business model and adopting variations of practices developed in the private sector. Among the more frequently encountered of these recently adopted practices is the use of Balanced Scorecards and performance measurement systems. Performance-related pay is another practice borrowed from the private sector, and senior executive pay programmes yet another. Recent developments in government compensation management suggest that the next generation of programmes will continue the transition to a version of the business model.¹

This is not to suggest that government should copy the private sector model. There are clear differences between the sectors. Moreover, private sector pay programmes have contributed to the fiscal crisis. The European Federation of Public Sector Unions (EPSU) made the point in its review of this report² that the crisis brought into sharp focus the nature of a system that “appeared to deliver ever-rising profits and generous rewards but with a long-term cost suffered generally by society and perhaps not sufficiently by those at the centre of the crash.”

The purpose of compensation

Critics of government along with the media tend to focus on easily available macro payroll numbers: the average salary, the number of government employees. But that overlooks an important issue – pay is central to the psychological contract public employers have with each employee. Compensation is a consideration in career choice, and influences decisions to accept job offers as well to remain with an employer. As OECD studies have shown, compensation affects the number and quality of job applicants.

When pay cuts and freezes appear necessary, it would be advantageous to assess the savings relative to the costs – the loss of institutional knowledge if key contributors retire or resign, the time lost by managers and employees who have to deal with the issues related to vacancies and reorganisations, and lost productivity while people acquire new skills and learn new jobs. Possibly the largest cost is the falloff in performance among employees who become discouraged or angry.

Actions currently taken to reduce the payroll are also going to affect the reputation or “brand” of government as an employer. The question for management is: how will this affect our ability to recruit and retain the number of employees with the capabilities we need?

One of the strong trends for two decades now is delegation of responsibility for managing pay from a central office to agencies and ministries. That practice recognises the role compensation plays in the staffing and management of work, and is consistent with the trend of holding executives and managers accountable for the performance of their units. Individualised pay is seen as a tool to encourage the work efforts of employees. Pay decisions are never neutral; they have either a positive or negative effect on an employee’s commitment to satisfying performance expectations (See Chapter 3 for a more detailed discussion).

The importance of compensation as a cost and a tool for managing employees makes it essential for all employers to assess periodically the

impact of their policies and practices. The public and (increasingly) the financial community want to see pay justified and managed effectively. Perhaps the best summary of the situation confronting government employers is from a report of the Chartered Institute of Personnel and Development (CIPD) in the United Kingdom, titled “Transforming Public Sector Pay and Pensions”. The report concludes that:

To achieve better value from pay and reward schemes – in any sector – employers have to constantly examine whether the way they reward and recognise their employees actually helps them achieve what they need to achieve. If it doesn’t, then changes have to be made to ensure the organisation operates effectively and employees are fully satisfied and engaged. (CIPD, 2010)

Realistically however, government leaders dealing with a fiscal crisis cannot always wait for an assessment of the pay programme. They need to respond to the financial community, to their constituencies and to the many stakeholders.

If organisational priorities in managing compensation are superseded by the downsizing, it could produce a long-term negative impact on delivery of services. That should be considered in evaluating steps to reduce employee costs.

An added and often unrecognised problem is the workload for human resource (HR) specialists that follows organizational restructuring. The time required under traditional policies and practices can impede or delay reorganisation.

Questions for governments now include – What changes in the policies and practices governing workforce management are needed to maintain service levels in the current climate of diminished resources? Do existing compensation programmes support or impede the functioning of government agencies in this era? Are current compensation levels justified within relevant labour markets?

A review of the salary programmes in OECD countries makes it clear there is no single “textbook” answer to the design and administration of government compensation programmes. The mix and balance of the elements of the total compensation package differs significantly from country to country. Moreover, the structure of each country’s programme is clearly rooted in a unique country-specific history. There are common issues, but the structures and administrative mechanisms can be quite different.

Controlling payroll costs is key to managing the total compensation package

Salaries are the foundation – and salary levels the largest, most visible and readily understood component – of compensation programmes. While a number of additional components are included in the total package and add to payroll costs, some of these components depend on salary levels. That makes control of salaries a key to controlling or reducing payroll costs.

While there is some variation in these components from country to country, traditional components of total compensation include:

- wages and salaries
- allowances
- bonuses and incentives
- retirement income benefits
- health/medical benefits
- disability benefits
- death benefits
- paid time off

Payroll costs are also affected by the length of the workweek (since that influences if not determines the number of hours worked) and by staffing levels. Of all the components, only the cost of health/medical benefits is not directly linked to salary levels. In many but not all countries employees are required to pay a portion of the cost of benefits. Moreover, in virtually every country, employer-provided benefits are designed to supplement benefits provided by governments to all citizens. The variations make it difficult to compare employer practices and costs across national borders.

Most if not all components are governed directly or indirectly by collective bargaining agreements. In some countries the benefits are mandated by statute as well as by deeply entrenched societal customs. That can make change, and especially reductions, extremely difficult.

An added complication is that the cost of future benefits is to a degree unpredictable. Actuaries can estimate the costs but their estimates depend on a number of assumptions and are recalculated each year. This uncertainty is the reason benefits are commonly insured or pre-funded based on actuarial estimates. Employers at times reduce annual funding to conserve cash outlays, but that does not reduce the eventual cost. The funds set aside for

benefits are normally invested with the expectation that capital appreciation will help to pay future costs, but this also incurs a risk; moreover, stock values have fallen in the current recession and that increases future costs that have to be paid by employers. Underfunded benefits are now a cause for serious concern in several countries. Normally these issues are addressed over a multi-year period.

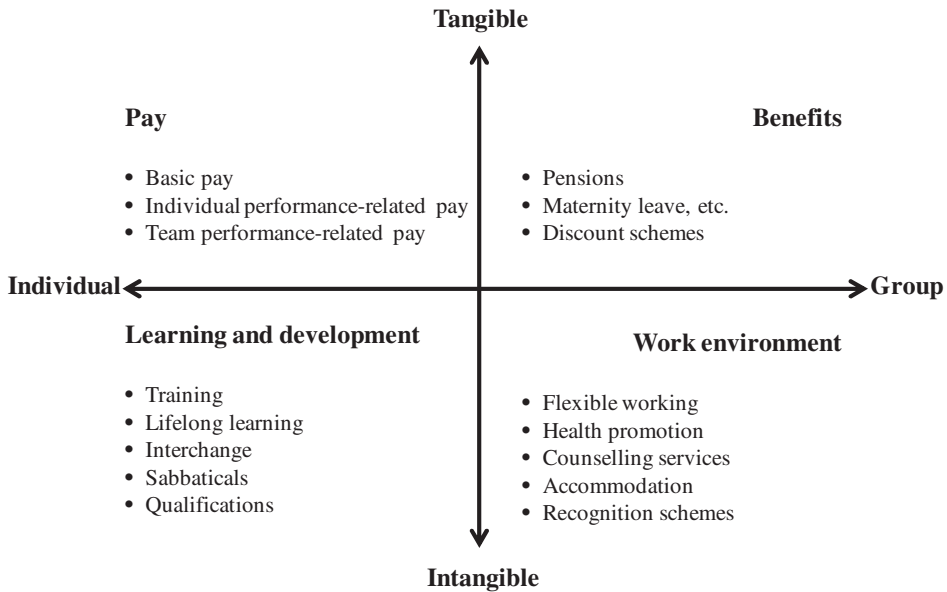
For the most part efforts to control non-salary costs have focused on retirement benefits. Those actions started several years ago although the actual savings are realised over extended periods. The OECD (2007) found benefits in member countries had been cut by 22%. More recently, the most severe benefit reductions were adopted by Greece. The United Kingdom plans to raise the retirement age as a way to cut costs, the most common change among countries. France adopted a similar strategy, requiring longer tenure to earn a full benefit.

The recession has prompted concern over how the levels of compensation components and employee contributions compare with those provided by other employers. Traditionally the salaries paid by government employers have been known to be lower, but that was offset by higher benefit levels and/or paid time off. Those differences were known but generally ignored for years. Now, concern with payroll costs has prompted the attention of critics in a number of countries.

Differences in the composition of the total compensation package prompted actuarial consulting firms to develop methodologies to estimate the value of the different components. Benefits, especially retirement benefits, are a tradeoff of funds that could have been added to base salaries. That makes narrowly focused comparisons of salaries or of the benefits alone misleading. Total compensation analyses, however, are extremely complex and involve time-consuming and costly data collection efforts.

The UK government, for instance, is looking to develop a more structured approach to and understanding of total reward. The reform looks at total reward through four aspects: pay, benefits, learning and development, and work environment (Figure 2.1). Although revision of the total reward scheme is ongoing, it is already expected that the reform will not cover all aspects of compensation. The revised compensation scheme is expected to be “less generous”.

Figure 2.1. UK approach to “total reward”



Source: Livingstone, D. (2011), “Pay Freeze in the UK Civil Service: An Overview of the Pay Freeze Policies in Place 2011/12 – 2012/13”, Presentation given at the Experts Meeting on Compensation of Public Employees, OECD, Paris, 9 September 2011.

Actually, comparisons should be limited to other employers competing for the same talent. For national governments that includes a wide assortment of other, typically large employers. However, since in many countries the overwhelming majority of employers are very small – having under 10 employees – and are usually in industry sectors such as retail, restaurants and personal services, where pay and benefits tend to be low and unrelated to government work practices, broad comparisons can be misleading and should be avoided.

This report focuses on “cash compensation” – primarily the planning and management of wages and salaries. The differences in the non-cash components from country to country make it very difficult to develop a coherent, comparative discussion of the issues. A number of countries are implementing the first steps to reduce the cost of benefits.

Developing accurate job descriptions to establish appropriate salary levels

Job documentation is the starting point for defining adequate salary levels. It is seldom discussed as an issue, but salary management is dependent on an accurate understanding of job duties. Textbooks commonly make the point that the job information has multiple uses, including staffing guidance, training needs analysis, performance management, etc. They also help applicants understand job opportunities. Although making this information available is a core HR function, job documentation has rarely been a subject of research.

Perhaps the most important use for job information, however, is as the basis for establishing just how much a job should pay. Accurate descriptions are central to both evaluating employees internally and matching jobs with market survey data.

The older textbooks all state that job analysts or classifiers are responsible for collecting the information and developing a written summary. These were common entry-level jobs for individuals planning a career in Human Resources in government. In the early factories, industrial engineers (IEs) were responsible for analysing and documenting jobs. For decades, the process involved an analyst observing and/or interviewing a job incumbent along with the supervisor. With multi-incumbent jobs it was often a group interview. The analyst then took the information back to his or her office and drafted a job description. The draft was sent back to the supervisor and incumbents for review. The editing often involved a couple of back-and-forth's, and then at some point the document was approved and filed. The same work process would be triggered each time a job was redefined. It is (or was) very time-consuming and costly.

In large government organisations it was common years ago to see a central group of Human Resource specialists who were responsible for the classification system. The US system is one of the oldest, tracing its origins back to the 19th century; the last time it was modified by legislation was in 1949. At one time the system recognised over 400 “job series” or occupational specialties, and a classification standard was drafted for each. The standards are documents that provide guidance for “Classifiers” – that was their job title – to classify or assign jobs to salary grades. This was a massive system that required shelf space measured in feet, as everything was in paper copy. The process began to change some years ago, now it is very difficult to find anyone who has that job title.

The US government is not a unique case. In every sector – and probably every country – job analysts are few in number. More broadly, HR staff in a

high percentage of organisations has been reduced. This is not a new phenomenon, although the recession and consequent staff reductions will undoubtedly eliminate more HR posts. This trend has not been publicised in part because these are not seen as mission-critical jobs.

In the private sector, companies find ways to work around the problem. Newer texts acknowledge the role of software in generating unclear pre-written job descriptions. Companies are also increasingly relying on descriptions written by incumbents and supervisors. Despite legal requirements, job descriptions are commonly out of date. Job evaluation methods have shifted to less rigorous methods such as whole job ranking. Companies have thus found ways to satisfy internal requirements without a staff of job analysts.

Job descriptions may in fact never have been as essential as the textbooks argued. When a job was redefined, there was a flurry of activity to develop the description – was used to assign the job to a salary grade, but then filed and rarely used again. When the job was again redefined the description was the starting point, but of course it had to be rewritten. HR specialists in staffing and training used descriptions in the same way, relying on them as the starting point but then meeting with incumbents and supervisors to develop an understanding of the jobs that satisfied specific information requirements.

Perhaps the most important problem with job descriptions is that it cannot be assumed they are completely accurate. However the information is collected, incumbents remain the primary source of job information, although they of course have an obvious reason to overstate their job's importance and it is very difficult for even experienced job analysts to disprove the claims they hear. With routine manual jobs, analysts can simply observe and capture the work activities.

With knowledge jobs, that is not practical. Work activities change in many situations daily; they move to new locations; and most importantly, the activity involved is mental and not physical.

When two or more analysts draft a description of the same job, they are very likely to produce somewhat different descriptions. Moreover, their use of language, particularly their choice of verbs and adverbs, can influence decisions – as can even the length of a job description. This contributes to what is sometimes referred to as grade inflation or grade “creep” – jobs that are graded higher than warranted by the duties involved, thus inflating payroll. Grades can be audited but the process is greatly time-consuming and involves the same job analysis issues that contributed to the problem.

A recent article in a US publication that focuses on federal issues highlights the grade inflation problem. “Since 1998, the percentage of employees in grades 12 to 15 – the highest four grades before reaching the executive ranks – increased from 48% to nearly 64%. Experts say inflated grades – and the higher salaries that come with them – unnecessarily cost the cash-strapped government at a time when it can least afford waste. Grade inflation has been going on for decades and the reasons behind it vary” (Losey, 2011).

Structured questionnaires have been used as an alternative means of collecting job information. They can generate more precise, comparative data but do not focus on actual job duties. The information is still provided by incumbents, of course. Moreover, the responses cannot be converted to a traditional job description.

These problems and the cost of maintaining job descriptions have sparked interest in the use of more generic job descriptions. That can dramatically reduce the time required, since they tend to be pre-written. Then again, generalised descriptions do not satisfy all job information requirements (e.g. staffing). They also fail to help job applicants understand exactly what they’re applying for.

For government employers that need to defend decisions based on job descriptions, there is no ideal solution. The accuracy of a job description is closely related to the time invested in the analysis and drafting. With the current budget crisis, it is unlikely that HR offices will again have the staff capacity for in-depth job analyses any time soon.

Balancing internal and market considerations

Salary management involves two dynamics that are often in conflict. First, employees are naturally concerned with how their salary compares with those of their co-workers and other employees. The concern with internal salary relationships is heightened in the public sector because salary information is widely available. A change in an employee’s salary level is not an isolated event; it creates a “ripple effect” that affects their relationships with other employees. The other dynamic is the labour market and the differential increases in occupational pay levels related to supply and demand. High-demand jobs command higher salary increases.

Traditionally, labour market considerations have been secondary to internal “equity” considerations. Job classification or evaluation systems have been used to ensure that jobs are assigned appropriate salary grades; thus these systems sustain salary relationships accepted as equitable.

References to internal equity can be found in literature stretching back to the early years of the 20th century.

Internal equity, as the phrase is used in compensation management, is a construct lacking a solid definition. It is widely understood and accepted but cannot be measured or verified. The notion is that assigned salary grades should reflect the relative worth or “value” of jobs within an organisation. Pay levels are always relative, so that aspect makes sense.

Job evaluation is best understood as a process to decide the internal hierarchy of jobs – or perhaps more accurately, to perpetuate the hierarchy. When a new evaluation system is designed, a common goal is to replicate the existing salary relationships – because job evaluation systems lock in the existing job hierarchy. In the United States the hierarchy was defined by statute in 1949 and has been static for six decades. And the evaluation system introduced to the business world by the Hay Group that same year is perhaps the most widely used today.

The Hay system is typical of many that are based on points assigned to a series of “compensable factors”. The factors are subjectively weighted according to someone’s sense of their relative importance, with the weights allocating points along ordinal measurement scales. Jobs are then “measured” against the scales via their compensable factors, and points assigned. The point totals are understood to be a measure of job value, but are really simply an index of where a job stands in the hierarchy of all jobs. The points are an ordinal scale measure since there is no true zero and the differences in point values do not have a constant meaning. A more rigorous interval measure would require differences that had a more certain interpretation.

Job evaluation practices did not receive much attention until the late 1970s and 1980s, when women voiced concern about what is now gender equity. At that time the existing evaluation systems reflected societal values that were decades old. Researchers and consultants worked to develop systems that were gender-neutral. The mid-1980s saw the introduction of systems based on automation and statistical models. The new systems were far more defensible but failed to gain widespread acceptance, in part because too few users truly understood the methodology. The statistical foundation also minimised the “flexibility” that was important to job evaluation committee deliberations.

The concerns with job evaluation methods were heightened by the 1990 recession. Over the years HR offices have been downsized, making it increasingly difficult to answer evaluation requests. Employers increasingly rely on job incumbents to draft their job description, or on software that

generates pre-written job descriptions. Both “solutions” diminish the validity of the job information.

It is clearly possible to develop and implement a job evaluation system that is accepted: Poland recently accomplished as much with a new system covering all civil service employees. The country has not been severely affected by the recession, but that in no way diminishes Poland’s success. The test for any new system is continued acceptance over time as government requirements change.

There has been a trend in the private sector to shift from quantitative job evaluation methods to simpler, more subjective approaches. This trend began with the 1990 recession and efforts to reduce administrative costs and develop more responsive practices. The focus on the internal hierarchy also results in some jobs being paid above market levels, and thus adds to payroll. Businesses have been switching to a decision process that combines the use of salary survey data with “job levelling” to assign jobs to grades. Job levelling is a less structured, more flexible approach that takes into account the career stage of incumbents. The goal is the same – to assign similar jobs to the same grade or band in all locations. The salary schedule or structure remains the same; the difference is the logic used to assign jobs to grades.

Practices that de-emphasise job value are more readily accepted by incumbents in knowledge jobs, where individual credentials are a factor in determining salaries. This approach is attractive to employees who understand the rationale and are comfortable because they feel their salary is a “fair” reflection of their abilities. The typical employee wants to be recognised for their abilities. However, their attitude can change quickly when he or she learns what other employees are paid.

All of this is decidedly more important in government, where pay programmes and pay relationships tend to be publicly available information. In the private sector such information is often confidential.

Market increase trends can change the hierarchy of jobs, as high-demand jobs progress faster. Consistent with economic theory, the relative balance of supply and demand for labour governs compensation increases (and employer-provided benefits). That phenomenon is no mere theory: pay levels are governed by the demand for specific knowledge, skills and abilities, and the availability of those capabilities locally or regionally.

Box 2.2. The new job evaluation system in the Polish civil service

Poland recently developed and implemented a new job evaluation system in its civil service as part of a new salary programme.

The Polish civil service has three distinguishing features. Each office enjoys a great deal of independence as regards human resource management and pay setting; there is a high level of discretion in individual pay setting; and pay budgets vary, which results in different pay levels for similar positions.

The mandate was to develop one job evaluation system that covers all civil service positions and satisfies the needs of the civil service. The project was limited to six months for pilot projects and a second six months for implementation. It was to be developed without incurring the cost of external advisers and consultants. It was also not to trigger major changes in the budgets of the offices. Further, it had to support continued delegation of salary administration to line ministries. The project started in 2007.

The new system is custom-made, based on points assigned to evaluation factors. The factors are a combination of traditional criteria (*e.g.* complexity of tasks, planning horizon, influence on decisions) and competencies (*e.g.* requisite education, interpersonal skills). All factors were described so as to be understandable to all civil servants. The responsibility for evaluating jobs was delegated, with each office creating a job evaluation committee.

A new law in 2008 restored higher managerial positions to the civil service. A separate but similar job evaluation system was developed to cover these positions. It focuses on job factors important to senior managers (*e.g.* external representation, scope of decisions, and responsibility for financial resources). The law is currently being implemented.

Source: Information provided by Wojciech Zieliński, Deputy Director, Civil Service Department, Chancellery of the Prime Minister, Poland.

Employers with market-based salary programmes track prevailing pay levels and assign jobs to grades in accordance with their staffing strategy. They also plan benefits and related practices so as to maintain a planned alignment with competitive practices. For these employers, the internal hierarchy of jobs is a secondary consideration.

Labour markets are dynamic, in that throughout the year employers are making hiring decisions, people are moving between employers or dropping out of the labour force, and young people are starting their careers. All of those changes affect the balance of supply and demand, and consequently occupational pay rates. Since an employer's salary schedule is fixed, normally at the beginning of a fiscal year, textbook practice calls for an annual review to determine how salaries compare with prevailing market pay levels, followed by adjustments to remain competitive.

Similar strategies have been adopted by OECD member countries needing to increase the supply of trained specialists. OECD studies have shown that increasing the relative pay levels of nurses and teachers contributes to an increase in individuals preparing for these occupations.

Box 2.3. Pay and career choice: The examples of nurses and teachers

The issue of employment, career choice and pay in the public sector is covered by other streams of OECD work as well, including the healthcare and education sectors.

An OECD study discusses the growing need for healthcare as the population ages and the problems associated with enlarging the supply of trained healthcare specialists – for example, nurses – multiply. These studies furnish evidence that increases in pay (relative to other occupations) are associated with an increase in the supply of “new” nurses – *i.e.* individuals entering nursing training programmes – in four countries: the Czech Republic, Finland, New Zealand and the United Kingdom.

Pay is, of course, not the only reason for individuals to enter or leave the nursing field. To quote from the OECD recent report: “To date, little is known about the cost-effectiveness of different policies to ensure an adequate supply of nurses. Both pay and conditions of service seem to influence flows ... Pay has been shown to influence entry into nursing schools, participation of qualified nurses in the workforce, nurse retention, and exits from the workforce, although more work is needed to quantify the impacts of pay on these stocks and flows.”

In education, a number of countries experiencing shortages of teachers have concentrated salary increases in the early stages of their careers. This was done in Australia, Denmark, Norway and the United Kingdom for example, and each of those countries has reported an increase in teacher education numbers. In Australia and England at least, there is some evidence of an increase in the academic quality of those studying teacher education. Mid-career teachers earned comparatively large pay rises in Japan, Portugal and Austria, while experienced teachers were granted relatively large salary increases in Greece, Hungary and New Zealand. The varying levels of increases for different types of teachers indicate a targeted and market-sensitive approach.

Source: Buchanan, J. and S. Black (2011), “The Impact of Pay Increases on Nurses Labour Market: A Review of Evidence from Four OECD Countries”, OECD Health Working Paper No. 57, DELSA/HEA/WD/HWP(2011)4, DOI: 10.1787/5kg6jwn16tjd-en

Wage and salary adjustments are also co-determined with unions at the collective bargaining table. Either or both sides typically rely on data showing pay adjustments in other sectors and/or increases in living costs. Multi-year labour agreements often base pay increases in the second and

later years on inflation rates. The employer's ability to pay has now become a consideration that often overrides the arguments for salary increases.

Each employer must decide on the appropriate balance between internal and market considerations. Secondary questions relate to the adequacy of the HR staff to administer a job evaluation system and the anticipated stability of the jobs and their organisation. The decision affects comparative payroll costs and also influences the employer's ability to compete for talent.

That is not to suggest all employers, public or private, are ready for this change in thinking. However, these considerations are consistent with the broader concerns of efficiency, flexibility and cost reduction. The perceived need to re-evaluate jobs and embark on organisation restructuring will delay the changes. Seeing job evaluation or classification in terms of a rigorous management process reflects the thinking of a very different era.

All employers have to respond to market trends on some basis. Largely because of fiscal management and budgeting practices, employers adjust their salary programmes at year-end for the next fiscal year (Risher, 2009). Until the current business downturn, annual pay increases were the norm. Employers rarely reduced or froze salaries for more than a year.

That state of things has clearly changed. Now for the first time since the 1930s and the Great Depression, public as well as private employers are, when necessary, taking drastic steps that would never have been contemplated in response to a more typical economic downturn. There is evidence, however, that private sector employers are returning to normal practices, and budgeting funds for salary increases. Public employers will feel the pressure to respond to local market developments.

Relative compensation levels differ from country to country and region to region within countries, and these differences influence the decisions of businesses to locate their operations. There has been a well-documented trend to move business operations to locations with relatively low prevailing labour costs. Over time that drives up pay levels in areas where business is expanding. Where jobs are lost, there is reduced pressure to increase pay. In a severe recession, with high unemployment and long lines of applicants, pay levels tend to stabilise or fall.

Differentials exist within countries as well. As a generalisation, compensation levels are highest in major metropolitan areas and lower in non-urban areas. Few employers have offices and other facilities in many locations (with the exception of hotel and restaurant chains).

The US government addressed the local differentials by adopting separate, locally adjusted, market-based salary schedules for 30 major

metropolitan areas in 1990. Companies commonly consider local prevailing pay levels in deciding where to locate their operations, but public employers do not typically have the same flexibility; they are uniquely required to maintain offices convenient to the public, which may mean locating in less desirable or high-cost areas. Local area schedules address that problem.

OECD countries like Canada, Japan New Zealand and the United States have policies to consider prevailing market pay levels in planning pay adjustments. In each country the goal in making annual adjustments is to balance the internal hierarchy of jobs with external market pay rates.

In the business sector, demand for talent tends to emphasise industry-specific knowledge and experience. Some industries and companies have continued to thrive and add employees during the current recession, while others have declined. Technology is one industry that is less affected because these products are constantly changing and important in virtually every industry. The healthcare sector and healthcare occupations have been less affected by business downturns because of the ageing population in many countries. Engineering is another broad occupational group that has benefited from relatively high demand. Meanwhile occupations such as telephone switchboard operator are no longer in demand. These trends affect occupational compensation levels.

Public employers compete in multiple labour markets for their diverse occupations. The business practice would be to base salary planning on relevant survey data, but realistically it is impossible to collect salary surveys covering all government occupations. Businesses can use questionable data sources because their analyses are not public. For public employers, however, the decisions are politically sensitive and subject to scrutiny from multiple stakeholders. That scrutiny makes it difficult to grant differentiated increases in response to occupational trends.

The growth of knowledge jobs has led to greater individualised pay

A century ago organisations were viewed as machines, with resources and supplies moving in one door and finished products shipped out through another door. Workers were treated as “cogs in the wheels of production”, and managed as a cost that needed to be minimised. Employment practices assumed workers were interchangeable and could be readily replaced. Job requirements focused on minimal physical abilities. In that environment, job tenure tends to be the primary criterion used to decide promotions.

That contrasts with what are now often referred to as knowledge organisations and knowledge jobs. Wage and salary levels for these jobs are governed by educational credentials and the individual’s demonstrated

capabilities in prior work roles. Economic theory again plays a role – the better-qualified employees are limited in number and command higher pay. This has contributed to a growing acceptance of individualised salary determination.

The emphasis on comparative knowledge and abilities represents a significant shift in the thinking behind human capital management. The focus here is on pay as it also influences recruiting, development, career management and performance management.

The graduates of the better universities can command higher salaries than those coming from lesser schools. Those with graduate degrees are paid more than individuals with only an undergraduate degree. Within an organisation, those employees who demonstrate the highest-level capabilities command higher salaries. And of course, with performance-related pay the high performers are granted higher increases. Companies pay a premium for the best-qualified workers. In combination, these practices serve to illustrate and explain individualised salary management.

The forgoing logic figures strongly in the planning for wage and salary programmes. A pay policy that provides for above-average pay levels to attract better-qualified workers increases labour costs, but employers believe the added cost is offset by the employee's potential contribution.

Generally speaking, knowledge workers are in high demand in every country and in every industry. There is already evidence from 2011 salary surveys conducted primarily by consulting firms showing that specialists in knowledge occupations can expect larger salary increases. While salary increases slowed with the onset of the recession, the competition for these workers is now pushing salary levels back up. That has been true for engineers and technology specialists for more than two decades. The salaries for knowledge jobs will continue to increase faster than the pay for work requiring more generic skills.

The notion of a knowledge worker dates from the early 1990s and the rapid acceptance of re-engineering to solve problems. Concerns with eliminating bureaucracy and increasing flexibility were issues, but businesses were also concerned with controlling labour costs. These concerns prompted companies to move away from traditional salary programme models. They now place more emphasis on market-sensitive alternatives, to ensure that salaries are justified. Since that period there has been a steady decline in the number of employers using traditional job evaluation systems.

An alternative is to develop a separate salary structure or schedule for the high-demand jobs. While public employers emphasize internal equity, it

has been common to find separate salary systems for certain occupational groups – examples include police, teachers, judges, physicians and the military. Possibly the explanation is simple: where separate salary programme exist, they were first adopted years ago before equity concerns became important.

Critics of job evaluation methods argue that the practice should be eliminated. Their key point is that when jobs are paid based on internal equity considerations, the relationship with market pay levels is observed only in general terms. The critics also contend that job evaluation methods are overly bureaucratic.

Downsizing, restructuring and salary management

When downsizing and restructuring are necessary, the majority of OECD countries provide for allowances as the quid pro quo for the loss of jobs (see OECD, 2011 for further details). A few countries focus on making voluntary resignations or retirements more attractive with generous allowances. Information gathered through the 2010 Survey on Strategic Human Resource Management in Central/Federal Governments of OECD Countries suggests that twelve responding OECD countries offer options for voluntary early departures on a regular basis (see Table 2.1). This can include early retirement programmes (Germany, Hungary, Ireland, Israel, Norway, Korea, Switzerland, the United Kingdom and the United States) and/or early leave programmes (Chile, France, Ireland, Israel, Mexico, Norway, the United Kingdom and the United States). Most OECD countries allow dismissal of employees with open-term contracts when a ministry/agency wants to restructure or decrease the number of its employees.

Restructuring can take many forms, but a common step is to reduce the number of layers of management: “delaying”. With fewer levels in the new structure, executives and managers commonly have a broader span of control, i.e. the number of individuals supervised. Employees in this environment have less direct supervision and broader responsibility, and are typically accountable for results – which is to say they are “empowered” (although that is a vague term).

Restructuring is now practical because of the technology that makes it feasible for a manager to monitor and direct the work activities of 20, 30, even 50 or more employees. With smart phones and performance measurement systems to track results, they can go for weeks or even months without face-to-face interaction with a subordinate. Technology makes that routine, and what makes telework a practical idea.

With restructuring, both managers and employees will need time to adapt to the change, learn new work styles and behaviours, and develop new working relationships. Studies have shown that employees, particularly young workers, enjoy the new freedom.

That is a far different operating environment than the room full of clerks that were common when the traditional government pay programme was conceived. At the extreme there are self-managed work teams that effectively handle everything, including staffing decisions. It may not be typical of government operations, but that kind of work environment exists in many companies. Most organisations are moving steadily away from close supervision and control.

The new work environment demands more flexible salary systems. For knowledge workers to be fully productive, they need to be trusted to apply their expertise to address problems. Their growth and accomplishments should not be held back by a rigid, seniority-based pay programme.

Job classification or evaluation was developed to assign routinely defined jobs to a salary grade. The typical career ladder has jobs at three, four or five grade levels, with higher-level job duties at each level. But the classification process was never intended for use in situations where the job changes are subtle, e.g. increased discretion with empowerment. An illustration is the supervisor who now assumes responsibility for additional staff; his time with any single subordinate is reduced. The former and current jobs may look the same on paper, but in practical terms they are not. New technology sometimes makes it possible for an employee to handle an increased workload. Those changes will not always show up on a position description, but they do alter jobs.

Table 2.1. **Restructuring plans and leaving conditions (2010)**

	Possibility of dismissing employees with open-term contracts when a ministry/agency seeks to restructure or decrease the number of its employees		Existence of regular plans to encourage voluntary departures in order to implement workforce allocation changes	
	Yes, and the employee receives an allowance	Yes, but government is required to propose reallocation possibilities beforehand	Yes, with attractive leave allowances	Yes, with attractive early retirement packages
Australia	●	○	○	○
Austria	●	●	○	○
Belgium	○	○	○	○
Canada	●	●	○	○
Chile	n.a	n.a	●	○
Czech Republic	●	●	○	○
Denmark	●	○	○	○
Estonia	●	●	○	○
Finland	●	●	○	○
France	○	●	●	○
Germany	○	○	○	●
Greece	○	●	○	○
Hungary	●	○	○	●
Iceland	●	●	○	○
Ireland	○	○	●	●
Israel	○	●	●	●
Italy	○	●	○	○
Japan	○	●	○	○
Mexico	●	○	●	○
Netherlands	○	●	○	○
New Zealand	●	○	○	○
Norway	●	●	●	●
Poland	●	○	○	○
Portugal	●	○	○	○
Korea	○	●	●	○
Slovak Republic	●	●	○	○
Slovenia	○	●	○	○
Spain	○	○	○	○
Sweden	●	○	n.a	n.a
Switzerland	●	●	○	●
Turkey	○	○	n.a	n.a
United Kingdom	●	●	●	●
United States	●	●	●	●

Table 2.1. **Restructuring plans and leaving conditions (2010)** (*cont.*)

	Possibility of dismissing employees with open-term contracts when a ministry/agency seeks to restructure or decrease the number of its employees		Existence of regular plans to encourage voluntary departures in order to implement workforce allocation changes	
	Yes, and the employee receives an allowance	Yes, but government is required to propose reallocation possibilities beforehand	Yes, with attractive leave allowances	Yes, with attractive early retirement packages
Brazil	○	●	○	●
Russian Federation	○	●	○	○
Ukraine	○	●	n.a	n.a
Total OECD33	20	18	9	8

● Yes

○ No

n.a. Not Available

Source: 2010 Survey of Strategic Human Resource Management in Central/Federal Governments of OECD Countries. Published in OECD (2011b), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

This is the essence of an argument that prompted a number of large corporations to abandon a traditional pay programme and replace it with one based on “broad” salary bands. As an example, when IBM experienced a fiscal crisis that brought the company close to bankruptcy in the early 1990s, a radical restructuring of the company and a new compensation programme were credited with changing what had been a highly bureaucratic culture. The old pay programme simply did not support the effective management of IBM’s knowledge workers (See Chapter 3 for a more detailed discussion).

It has been decades since public employers experienced a fiscal crisis comparable to the current reality. Where the recession has had minimal impact, there is little sense of urgency or pressure to rethink the pay programme. Germany is an example. Where there is pressure to change, the immediate focus is on reducing costs; the impact on the workforce and on organisational performance is decidedly secondary. The lack of prior experience with changes of this magnitude means no one truly understands how employees will react, or the best strategy for going forward.

Managers are in the best position to anticipate what the changes will mean to their local work efforts. The pressure for more flexible and responsive policies and practices reflects their concerns. A traditional centrally controlled pay programme is likely to be seen as an impediment by managers working to reorganise. In those situations, managers look for

policies that support their efforts. That is why public employers are delegating increased programme management flexibility.

Best practices in compensation management

There is a high level of interest in identifying and adopting better practices in virtually every area of management. This is certainly not new but through most of the 20th century, changes in organisation management were gradual and evolutionary. However, the reactions of large corporations to the 1990 recession marked a significant change in thinking.

The involvement of employees then represented a sharp change from centralised control by “experts” on a headquarters’ staff, the dominant practice from the earliest factories. That approach to planning and management originated with the early time-and-motion specialists who were followed by industrial engineers.

The advocacy of employee involvement originated with human resource specialists who referred to the idea as “participative management”. Interestingly, when it was an HR idea, it was largely ignored. It is now called “empowerment” and stands in direct contrast to the traditional close supervision. Prior to this, the job-related knowledge that employees always possessed was largely ignored. Now the contribution expected of “knowledge workers” is a priority and core strategic issue. Pay programmes obviously should not limit their potential contribution.

All of this is important to compensation management because a salary system should be planned to support the organisation’s human capital plans and its management philosophy. Furthermore, a new pay programme should be put in place to meet the organisation’s needs for years to come. That is particularly important in government, since there is often opposition to replacing a pay system. That can present a difficult communication challenge.

In the business world, when concerns surface, companies do not hesitate to modify their compensation programme. Generally, if the chief executive agrees change is needed, there is little opposition. Public employers, in contrast, have to build support for change, which often involves compromise policies. That can take time. It is essential to adopt plans that “fit” the organisation, its workforce plans, and its employer-employee relations climate. Also in contrast to the business world, the negotiations to gain legislative and union agreement mean new programmes are rarely the same from country to country.

From a different perspective, it is important to appreciate that there are millions of small employers around the world that are successful despite not

having a formal pay programme. Their success highlights the importance of the relationship between managers and employees, who together are able to resolve pay issues informally.

That raises two best practice issues that are unique to government. First, organisations that treat pay and performance ratings as confidential do not have to place the same emphasis on fairness. In the public sector, programme administration is far more visible and receives considerably more attention. With the oversight of stakeholders, fairness – actually, the perception of fairness – takes on critical importance. Public employers have to develop administrative procedures to maintain the perceived fairness of pay decisions. Second, an important consideration to strengthen the sense of fairness is transparency. Managers and employees need to know what to expect.

Public employers should also commit to periodic assessment of the programme and take steps to improve it. That is best handled in focus groups, where issues and their resolution can be discussed. Some changes can be handled at the bargaining table but many are occupation - or agency-specific. Reviews need to be undertaken regularly so employees know problems will be addressed.

The traditional salary system model developed in the post-World War II era reflected the common lack of trust between managers and employees in that period; the close, “over-the-shoulder” supervision that was then common; tight control of expenditures; and the narrow definition of jobs. That led to overly programmes that were bureaucratic and costly to administer. The widespread use of step increase policies reflected the close control and the failure to recognise the potential for employees to perform at higher levels.

The best programmes are those that enable an employer to attract and retain qualified employees, to provide attractive career opportunities, and to encourage employees to meet or exceed performance expectations. The thinking behind a best practice programme now recognises that the way employees perceive the programme and its management is central to its success or failure.

Over the past 20 years, there has been increasing recognition that employees are capable of performing at significantly higher levels. Much has changed in the past two decades – particularly the technology involved in virtually every job – so the potential today is different. However, the basic conclusion from the research was and is that employee performance depends on how they are managed. The difference in performance levels can be significant. A study some years ago concluded that increases in productivity of 30% to 40% or more are possible.

Global corporations are planning and managing compensation to support a high-performance work climate. Pay for performance has become increasingly important, and recognition and rewarding of the best performers is another priority. Delegating the responsibility for managing salaries to managers is a third priority (see Chapter 3 for a more detailed discussion). A fourth, for businesses, is knowing that salaries are aligned with planned market levels to assure payroll costs are justified.

Those are corporate priorities, however. Government employers often have somewhat different priorities. Defining the employer's goals should be the first step in planning a best-practice salary system. Effective compensation programmes start with consensus on the philosophy and programme goals. The steps to develop that consensus are likely to flow from discussions with political leaders and the many stakeholder groups focused on pay and performance practices. An early topic in the discussions should be management philosophy – the role of managers and supervisors in managing employee performance. They should also focus on the government's image or "brand" as an employer. Presumably any changes will need to support government's management of its workforce for years to come, so a long-term perspective is essential.

Conclusion

A flexible, fair and transparent compensation system is critical to attract the best and the brightest to positions in the public sector. The current economic and budget crises are forcing governments to rethink how work can be reorganised, managed and remunerated keeping in mind that the first priority is to reduce costs. Tackling compensation should be a first step for governments. Salaries are key to controlling or reducing payroll costs, as a number of components depend on salary levels (total compensation).

One of the key lessons from past experience in the public and private sectors is that when pay cuts and freezes are deemed necessary, it is suggested to assess the saving relative to the costs – such as the loss of institutional knowledge, the time that will need to be devoted to reorganisation, and the retraining of staff. Public employers, and in particular managers, need to develop the skills and competencies necessary to rethink the way pay is planned and managed.

Experience suggests that job documentation is the starting point for setting adequate salary levels. This is central to deciding how much a job should be paid. However, there is no ideal method for arriving at job descriptions. The accuracy of a description is closely related to the time invested in analysis and the drafting. It is unlikely that governments have the capacity for in-depth job analyses in the context of budget crisis.

Annual reviews of salary levels are a way to adapt pay rates to the dynamics of the labour market. In the current context, when private employers are slowly beginning to budget salary increases, public employers need to respond to this pressure by balancing internal hierarchy with external market pay rates. One alternative at the disposal of governments is to focus on knowledge and abilities. If governments are going to place more emphasis on knowledge, then seniority-based pay programmes will have to be transformed into more flexible salary systems.

Past experience indicates that planning a salary system necessarily begins with defining the employer's goals. But also, the way employees perceive the programme and how its management is conducted determines to a large extent success or failure. Public employers need to engage in social dialogue so as to ensure that the compensation programme is in line with the organisation goals and reinforces employer-employee relations.

Notes

- 1 Throughout this report references to the “private sector” focus on the policies and practices of larger business entities. Two prominent companies that replaced a traditional pay programme with a new model are IBM and General Electric. Both have a workforce composed largely of knowledge workers and manage salaries with broad salary bands and performance-related pay.
- 2 Comments provided in early versions on this report by the European Federation of Public Sector Unions.

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Chapter 3

Managing compensation in a post “New Public Management” era

Rather than simply downsize, governments now must determine appropriate salary levels and performance expectations for all jobs affected by their restructuring efforts – and that will require adequate HR staff capacity. Policies that base salary increases on seniority or job tenure send a clear message that downplays the importance of employee performance. Salary banding introduces a dramatically different way of managing employees, since their pay does not depend on their job description – and that can enhance recognition of their worth. There have been difficulties introducing performance-related pay, the success of which depends on managers’ commitment and a review process to ensure fairness. Executive salaries and bonuses are a hugely contentious issue, but it should be recognised that government executive jobs are simply not comparable to executive jobs in the private sector. There have been advances in gender equality in the world of work, but the gender pay gap persists.

Introduction

The current economic and financial crises have, as previous chapters have shown, unveiled financial, governance and public administration challenges. They represent a challenge to the way public sector bodies are organised and managed. Rethinking paradigms, managerial styles and approaches that until now seemed a solid and consolidated agenda is a priority for governments. Approaches such as the New Public Management (NPM) are now being challenged in a number of OECD countries (OECD, 2010). Some demands made of public servants over the past four years in state direction of the private economy have gone against NPM ideas like organising industrial bailouts and operating industrial policies of the kind scarcely seen since the 1970s (Lodge and Hood, 2012, pp. 79-101).

Box 3.1. New Public Management

The ideas of New Public Management (NPM) have been described in many reports and publications, with certain variations. NPM is a shorthand name for describing or referring to a set of broadly similar administrative reforms that have dominated the bureaucratic reform agenda in many OECD member and non-member countries since late 1970s. NPM intended to make the public sector less distinguishable as a unit from the private sector in personnel, reward, structure and methods of doing business; and reducing the extent to which discretionary power, particularly over staff, contracts and money, was limited by uniform and general rules of procedure (Dunleavy and Hood, 1994). NPM implied the development of an international agenda focused on general issues of public management, policy design, decision styles and international co-operation (Hood: 1991). NPM can be understood, according to Dunleavy and Hood (1994), as a shift that consists of:

- reworking budgets to be transparent in accounting terms, with costs attributed to outputs not inputs, and outputs measured by quantitative performance indicators
- viewing organisations as a chain of low-trust principal/agent relationships, a network of contracts linking incentives to performance
- disaggregating separable functions into quasi-contractual or quasi-market forms, particularly by introducing purchaser/provider distinctions and replacing previously unified functional planning and provision structures
- opening up the provider to competition between agencies – or between public agencies, firms and not-for-profit bodies

Box 3.1. New Public Management (*cont.*)

- deconcentrating provider roles to the minimum feasibly sized agency, allowing users more scope to exit from one provider to another

OECD (2010) reports have described the core of NPM as: i) the separation of execution from policy development; ii) more autonomy for line managers in operational management, in both policy development and policy execution; iii) steering and control of executive agencies on the basis of measured outputs; iv) budgeting on the basis of measured output (performance budgeting); and iv) outsourcing of intermediate production to the market.

Source: Dunleavy, P. and C. Hood (1994), “From Old Public Administration to New Public Management”, *Public Money and Management*, Routledge, Vol. 14, No. 3, July-September, pp. 3-19.

NPM was not without its critics, and its ideas are now being questioned by the current crisis. For example, some commentators (Doing and Wilson, 1998) argued that NPM affected how public managers perceive their roles, functions and future. Although offering high salaries to recruit and retain staff, particularly managers and professionals coming from the private sector, as well as the use of performance-related payments, has been known in the public sector, the adoption of private sector management practices increased the focus on reward for individual initiative and responsibility, without simultaneously integrating and monitoring the public interest perspective. Moreover, OECD (2010) found that in the era of New Public Management, the political desire for downsizing operations led to increased tensions with the civil service, which viewed the new approach as a shield against any political intrusion on its domain.

In the light of that background, this chapter discusses the need to change compensation management in order to adapt to a fast-moving context. It explores different instruments and practices for doing so, and stresses the importance of rewarding senior managers and bridging the gap in gender pay.

The need for change in compensation management

After two decades of changes associated with what is or was New Public Management, the fiscal crisis is forcing new, more rapid changes.

Corporations can manoeuvre more easily through waves of change because they have a single purpose – to survive and remain successful. In a corporate crisis everyone understands that purpose, and knows the worst-case alternative is bankruptcy. In contrast, government has numerous

stakeholders who often disagree. Moreover, shifts in the political climate often push agencies in a new direction.

The contentious 2011 debate in the US Congress over how to “solve” the debt crisis is an example – followed closely by world media – of how scenarios can change rapidly in a political environment. Now US federal employees are working in an environment of uncertainty, as the impact of the budget cuts is assessed and agency leaders decide how to function within the constraint of a reduced spending. An unknown number of employees will lose their jobs. Reporting relationships and job responsibilities will change. It has been reported that morale and performance have already begun to deteriorate.

The restructuring of government can take an endless array of forms – breakups of centralised agencies, shared services, downsizing, outsourcing, layering, centres of excellence, etc. Over the past 20 years the changes have come in waves (OECD, 2011a).

A common thread that runs through each restructuring initiative is the intent to reduce staff and payroll. A related thread, although often not acknowledged in the literature, is the need to determine appropriate salaries for all affected jobs in the new organisation structure. A third common thread following a reorganisation is the need to define performance expectations for each of the jobs. With a traditional government pay programme there needs to be a paper trail documenting the changes, along with any reclassification actions and pay adjustments. The experience of reform in the United Kingdom, for example (see Box 2.1 in Chapter 2), shows the importance of adhering to principles for reform. Those send on the message of what direction the reform is taking and government’s priorities on compensation policy.

The administrative work prompted by a restructuring can be substantial. With the downsizing of HR staffs and the possible increased workload on employees related to layoffs and retirements, it may be that HR staff capacity is already stretched for conducting reforms to the compensation system. An additional consideration is that the changes, as mentioned in the previous chapter, will be a source of anxiety and possibly trigger resistance that complicates the effort.

The restructuring of government began with the New Public Management (NPM) in the early 1990s. National governments followed the lead of the business world and began to reconsider the way they organised and managed work processes. It was also in this period that re-engineering gained popularity, along with the idea that front-line workers could often develop better answers to problems than the “experts”. NPM encompassed a patchwork of changes focused on efficiency, delegation, measurement and

results. NPM may be challenged but those concerns are more important today. The linkage of pay to results was another of the ideas that gained acceptance in this era.

The use of pay bands to manage salaries

A story from 1980 is perhaps more relevant to agencies struggling with downsizing and the need for significant restructuring. The US Navy decided to merge the staffs of two research laboratories near San Diego, California to form a larger facility now known as China Lake. The Commanding Officer (CO) was told by his Human Resource office that they would need up to two years to reclassify all the jobs. He told them that this was unacceptable, and that they had to develop a better answer. Fortunately this was shortly after the passage of a law allowing federal agencies to “experiment” with new approaches to compensation management.

The HR office proposed what was then a radical alternative, the idea that salaries could be managed within “broad bands” or “salary bands”. The concept is a variation on the widely used model for managing university faculty salaries (with “bands” for professors, assistant professors, etc.) A decade later the idea gained rapid acceptance in the business world when it was adopted by General Electric and IBM, and it is now an accepted alternative to the traditional model. As for the research labs, it gave them the flexibility to be more competitive for engineers and scientists in a tight labour market. Since it dramatically changes the traditional approach to job classification, it eliminates delays such as those that triggered the CO’s resistance.

Traditional pay programmes were planned for highly centralised organisations; regulations governed virtually every situation. Every employee knew what to expect, often years into the future. Managers had little ability to control or influence pay decisions, unless of course they “gamed” the system. That possibility was always a concern.

Clearly then, a traditional pay programme can be an impediment to change. The regulatory requirements tend to be restrictive and controlling. The opportunities for innovative answers to new problems are severely constrained. And each administrative action can take weeks or months and require everyone involved to invest hours working to secure the satisfactory resolution of a problem. For a massive restructuring the time spent is difficult to justify.

The environment in which agencies operate is also changing, prompting shifting priorities and fresh problems. The public is becoming more demanding. The media are exposing government operations to more

intensive scrutiny. Efficiency is a continuously heard mantra. Perhaps most importantly, the response time expected when new problems emerge is dramatically reduced. The (obvious) fact is that increased attention is being paid to the functioning of government.

Box 3.2. An alternative programme model: Salary banding

The new programme model, originally referred to as “broad banding”, is in many respects a radical alternative to the traditional salary structure or schedule, composed of overlapping grades and ranges. The idea was first adopted for a research laboratory, where a high percentage of the employees had graduate degrees and were thus familiar with the management of university faculty salaries. (At universities, each “rank” – Instructor, Assistant Professor, Associate Professor and Professor – has a separate “salary band” with associated benefits and employment rights.)

Banded salary programmes tend to be designed uniquely for each employer. For management jobs there is typically a separate band for each management level (*e.g.* all directors are in the same band). For lower-level employees the bands are generally defined around the stages or levels in career ladders. Research has shown that the typical career ladder has three levels – entry or trainee, developmental, and full performance. In some situations professional occupations have a fourth – expert.

The primary advantage of banding is that it dramatically reduces the time and resources necessary for classifying jobs to grade levels. All time spent by managers and employees on a reclassification request can now be used productively.

Banding is also different in that the focus is on the employee and his or her progress in developing important job skills: that is the basis for moving to higher bands. Notably, it introduces a dramatically different way of managing employees since their pay does not depend on their job description. They can be asked to tackle new problems and otherwise empowered to make better use of their capabilities. Employees generally like the change, because the philosophy supports their development.

A further advantage is that the transition from a conventional salary structure, with multiple grades, is less disruptive since the assignment to bands is normally straightforward.

Ultimately, performance-related pay has to be the basis for salary progression. It would make no sense to rely on step increases – the number of steps would be too high. In the private sector the high and low salaries are often not communicated as a maximum or minimum, since that suggests employees can expect to reach the highest salary. Experience suggests that managers and employees need to be heavily involved in developing the policies governing salary adjustments.

Box 3.2. An alternative programme model: Salary banding (cont.)

Employers have experienced problems when salaries are allowed to rise too far above market levels; managing salaries requires a disciplined approach. Problems can also arise if employees become dissatisfied by the small number of band-to-band promotions. For that reason some employers recognise changes within a job band as “small” promotions, with reduced pay adjustments, and changes from one band to another as “large” promotions. One of the key issues in the use of salary banding to ensure its adequate functioning is a commitment to revisit the programme annually and address any problems that surface.

Source: Risher, H. (2007), “Second-Generation Banded Salary Systems”, *WorldatWork Journal*. Vol.16, No. 1, pp. 20-28 Delegating the responsibility for compensation management.

With a classic government or corporate compensation programme, control of all decisions related to funding is centralised. Salary increases are negotiated in a single agreement in 19 OECD countries. In four other member countries increases are based on the recommendation of the president/prime minister. National decision making remains the dominant practice.

In three OECD countries – Greece, Iceland and Japan – advisory bodies, usually independently of the government, make annual recommendations on necessary adjustments to base salary (see Annex 2 for more information). The United Kingdom and the United States employ variations of this approach. In the United States the increases under the General Schedule (GS) pay system are centrally determined for employees working in 35 of the larger metropolitan areas.

An alternative and certainly more controversial approach is delegation of responsibility for compensation management from the central office to agencies. In ten countries, negotiations at the central office determine the budget for increases but allow adjustments by department/sector. Decentralised bargaining of some kind is allowed in 13 other countries. The logic is that agency leaders are in the best position to decide what pay adjustments are warranted and what the agency can afford.

Delegation of responsibility for programme management is one of the ideas that gained acceptance in the NPM era. As it relates to compensation management, it can encompass a range of policies and practices. Delegated responsibility can be extended to local offices, which is the common approach of private sector employers. Under a typical company policy, each manager is allocated a pro rata percentage of the payroll under his or her control, and is responsible for determining individual increases within the budget. The common control mechanism is an annually reviewed salary

increase policy that specifies the percentage increase permitted at each performance rating level. Managers are required to determine increases within the budget that are consistent with policy.

As a rule, in a delegated environment there are policies that dictate how salaries are to be managed. Performance is the dominant factor, but the need for separate salary policies for selected occupations where performance, although important, is not the determining factor for pay increases – such as police and teachers – is another possibility. In the 1990s, as another example, the high demand for technology specialists prompted employers to grant increases two or more times in a year as well as to establish separate salary programmes.

A number of countries have moved in this direction, part of a broader strategy to make managers accountable for their work group. It follows that they cannot be held accountable if they are denied the control of day-to-day decisions. The degree of delegation varies from country to country and no doubt varies significantly within countries, since it can only happen if permitted by senior agency officials.

There are a number of employee-related decisions that are best delegated to front-line supervisors. In any case, delegation of pay decisions needs to be considered within a framework of controls intended to limit “mistakes”.

At the extreme, employees are “empowered” and expected to function autonomously. The phrase “autonomous work teams”, now self-managed teams, surfaced almost 40 years ago in Sweden. Employees rarely work autonomously, but in many situations supervisors see their staff only occasionally. Close supervision is often impossible. Managers “supervise” by monitoring results data generated by performance measurement systems. In these situations customers and clients are in the best position to provide feedback on the employee’s performance.

Figure 3.1 shows that many OECD member countries have delegated managerial discretion on certain issues to ministries and agencies, allowing them more flexibility regarding staffing levels, recruitment, and some working conditions. Performance-related pay and performance appraisal systems have also been delegated to ministries and agencies in several countries, although overall responsibility for determining salary increase budgets remains centralised in a majority of countries. The imperative of cost control and the institutional structure of collective bargaining in member countries may partly explain these trends.

Box 3.3. The delegation of human resource management responsibilities

Why delegate?

Public managers are expected to improve the performance of their organisations and the outcome of their activities, and have to work with their staff to encourage, enable and support them in a continuous quest for quality, efficiency, productivity and propriety.

The traditional models for managing human resources in public administrations are the products of societies and dominant management paradigms that are more than a century old. They were designed for the exercise of public administrations in societies emerging from pre-democratic stages, and used centrally determined structures and procedures as a way to ensure a correct and equitable application of laws and regulations. They were also heavily influenced by hierarchical command-and-control models.

During the past decades, governments of OECD member countries wanting to strengthen the performance orientation of their public administration have found that these models hamper their efforts and make the development of new models for the provision of public services difficult. They have also come to realise that good management is essential for both improved performance and efficiency and for improved services to the citizen.

What can be delegated?

The key motive for delegation is the need to empower public managers and enable them to adapt their human resource systems to the business needs of their organisations. Both the speed and extent of the reforms vary across countries due to differences in political, cultural and historical context. It is however possible to identify a number of functions that have been delegated in several OECD countries such as: arrangements for recruitment, certain pay decisions, and the handling of special performance-related pay elements.

All organisations must be able to motivate their employees. That includes an ability to reward them for good performances and behaviour, and to sanction misconduct and unsatisfactory behaviour. This can be done in many different ways, but some degree of delegated control over monetary rewards is probably indispensable.

What are the challenges?

Delegation of authority is almost never uncontroversial or uncomplicated. The exact nature of the challenges depends (once again) however on the cultural, political and historical context. There are nonetheless a number of recurring challenges for which governments have to be prepared.

Box 3.3. The delegation of human resource management responsibilities (*cont.*)

One of these challenges is simply change itself. Many stakeholders – senior management, employees, trade unions – have adapted to the existing structure and may resist change. Some countries, including Ireland and the Scandinavian countries, have therefore opted for gradual changes supported by an appropriate social dialogue. Other countries, for instance Australia and New Zealand, have instead opted for cohesive reforms where the stakeholders can assess the outcome of the entire process.

Delegation entails a major cultural change. Stakeholders need to be convinced that modernisation of human resource management is both necessary and beneficial. Equally important, they need to be convinced that propriety and the public service ethos can be maintained even after the delegation of human resource management.

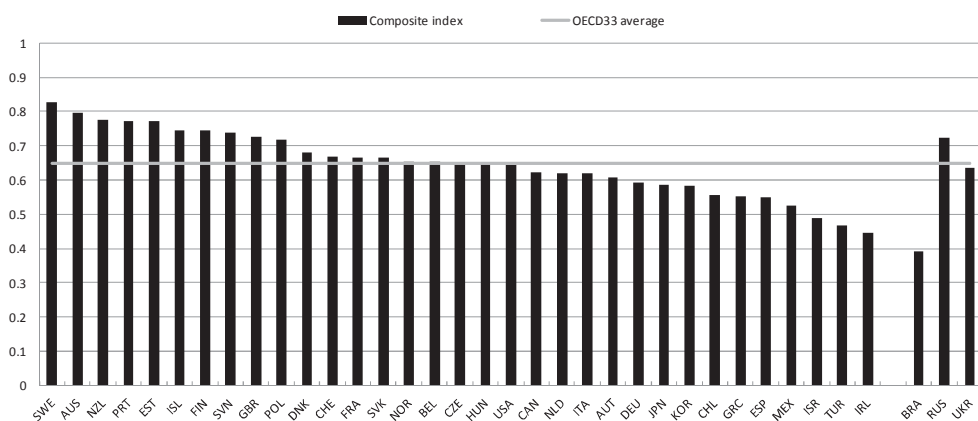
Another challenge is the need to develop and maintain sufficient managerial capacity and competence in the organisations that are authorised to handle their own human resources. The existing public managers normally lack training and experience in HR management, and the sub-central organisations normally lack professional human resource management units.

Source: OECD (2008), *The State of the Public Service*, OECD Publishing, Paris, DOI: 10.1787/9789264047990-en.

A common problem is that high-level leaders are reluctant to “let go”. Delegated authority and responsibility represents a redefinition of the traditional role of front-line managers and necessitates a different management style. Training is essential but more importantly, managers need to be motivated to change their behaviour. The desired behaviours need to be reflected in the evaluation of their performance, and the best performer in this new role rewarded. They need to understand that their success as managers rides on their effectiveness in managing staff.

Management of compensation programmes involves two periodic decisions: i) the structure or schedule adjustments deemed necessary, and ii) individual employee decisions governing salary levels. The levels are initially specified when an employee is hired or promoted, and then adjusted annually. Managers can play a role in all employee decisions.

Figure 3.1. **Extent of delegation of human resource management practices to line ministries in central government (2010)**



Note: Data for Luxembourg are not available. The index is composed of the following variables: the existence of a central HRM body; the role of line ministries in determining the number and types of posts within organisations; the allocation of the budget envelope between payroll and other expenses; staff compensation levels; position classification, recruitment and dismissals; and conditions of employment.

Source: 2010 OECD Survey on Strategic Human Resource Management in Central /Federal Governments. Published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

Private sector employers delegate the responsibility for making those decisions, but limit a manager’s discretion. The budget for increases is one control; another is the salary increase policy, which specifies the allowable increase at each performance rating level. That is to say, for example, that all employees rated as a “4” might receive the same percentage increase. Salaries are also controlled relative to prevailing market levels. In addition, many companies routinely monitor salaries for evidence of bias.

Government managers will initially require a basic education in salary management. They need “tools” to master this new role, such as easily accessible “just-in-time” e-learning modules to help address situations that arise (e.g. handling a poor performer). Employers are also now using technology to provide managers with information on market trends as well as pay levels for related jobs within the organisation. Technology also makes it possible for the HR staff to monitor salary adjustments for consistency with policy, and evidence of discrimination.

A basic concern is continued adherence to stated policies across government operations. For example, a core issue in the policy of virtually every country is that employees with similar if not identical jobs should be paid the same. That carries over to the relative importance of individual credentials (e.g. education and experience) as well as performance. In a delegated environment it can be very difficult to maintain consistency.

A new practice to minimise the problems related to inconsistency is the use of “calibration committees”, composed of peer-level managers. These groups review performance plans at the beginning of the year as well as year-end ratings and recommended salary increases. Their purpose is to identify inflated or unjustified ratings, and possible cases of discrimination. If they have questions, they ask the rating manager to meet with them and justify the rating and/or proposed increase. The process increases the level of honesty and consistency, and provides assurance to employees that they will be treated fairly.

Another practice is the creation of small teams of high performers selected from the major job families, who are asked to identify the performance measures and competencies associated with successful job performance. The phrase “subject matter experts” (or SMEs) is often used to refer to individuals who are asked to address occupational issues. Use of SMEs reinforces the use of consistent measures and competencies for employees in the same occupations. It also focuses on contemporary issues that facilitate discussions between managers and their staff.

Those practices cannot prevent all problems, however. Public employers should consider the full range of controls and monitoring practices developed by the private sector. It is essential in delegating programme management responsibility that employees have reason to believe they will be treated fairly. An important step is the commitment to review the experience each year. That should include meetings with managers and employees, followed by well-publicised actions to address problems. Most important, however, is the commitment to move ineffective managers back to non-supervisory roles.

The highest hurdle – transitioning successfully to performance-related pay

If there is one trend that dominates the literature on the management of pay in public organisations, it is performance-related pay.

The OECD (2005) notes that, “Two-thirds of OECD member countries have implemented PRP [performance-related pay] 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” (OECD, 2005). The practice ranges from a centralised approach in Luxembourg to policies delegating its management to “departments, agencies or work units” in Australia, New Zealand, Sweden and the United Kingdom. More recent reports show performance is an important factor in determining salaries in Chile, Finland, Germany, Norway, Portugal, Slovenia and Ukraine.

OECD reports show that the delegation of human resources and budgetary management is related to the introduction of performance-related pay. The 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.”

Performance assessment and the linkage to staff rewards remains a challenging issue in many OECD countries. Performance incentives include career opportunities (such as promotions) and pay. Performance-related pay (PRP) in the form of bonuses or merit increases to basic pay has been used more frequently in recent years. PRP can vary in terms of the range of staff positions to which it applies; whether the targets and the incentives apply to individuals or to groups; the extent to which rankings are used; and the size of awards. There is relatively small variance among countries reporting the use of performance-related pay, with the United Kingdom, Switzerland and the Czech Republic applying PRP more extensively than other countries and New Zealand, Austria and the Netherlands applying it the least (Figure 3.2). Six OECD countries (Belgium, Greece, Iceland, Mexico, Poland and Turkey) report not using performance-related pay at all.

Table 3.1. Factors that determine base salary at different hierarchical levels

	Top management					Middle management					Professionals					Secretarial level					Technical support							
	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Relevant experience	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Relevant experience	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Relevant experience	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Relevant experience
Australia	○	●	○	○	○	○	○	●	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Austria	○	●	○	○	○	○	○	●	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Belgium	○	●	○	○	○	○	○	●	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Canada	○	●	○	○	○	○	○	●	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Czech Republic	●	●	●	●	○	●	●	●	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Denmark	●	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Estonia	●	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Finland	○	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
France	●	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Germany	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Hungary	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○

● Of key importance

○ Somewhat important

○ Not at all important

Table 3.1. Factors that determine base salary at different hierarchical levels (*cont.*)

	Top management					Middle management					Professionals					Secretarial level					Technical support							
	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Relevant experience	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Relevant experience	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Relevant experience	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Relevant experience
Iceland		●		○	○		●	●	●			○			●	●	○	○	○		○		○					○
Ireland	●	●				○	●		○	○			○	○	●	●	○	○			○		○		○			○
Israel	●	○	○			○		●	○			○			●	●	○	○			○		○		○			○
Italy	●		○			○	○	●	●	○			○	○	○	○	○	○			○		○		○			○
Korea	○	○	○			○	○	○	○	○			○	○	○	○	○	○			○		○		○			○
Mexico	●	●				○	●	●	●	○			○	○	●	●	○	○			○		○		○			○
Netherlands	○	○	○			○	○	○	○	○			○	○	○	○	○	○			○		○		○			○
New Zealand		○				○	○	○	○	○			○	○	○	○	○	○			○		○		○			○
Norway		●	●	●	○			●	●			○			●	●					○		○					○
Poland	●	●	●				○	○	○	○			○	○	○	○	○	○			○		○		○			○
Portugal	●	●	○	○	○	○		●	●	○			○	○	●	●	○	○			○		○		○			○
Slovak Republic		○	○	○	○			●	●	○			○	○	●	●	○	○			○		○		○			○

● Of key importance
○ Somewhat important
○ Not at all important

Table 3.1. Factors that determine base salary at different hierarchical levels (*cont.*)

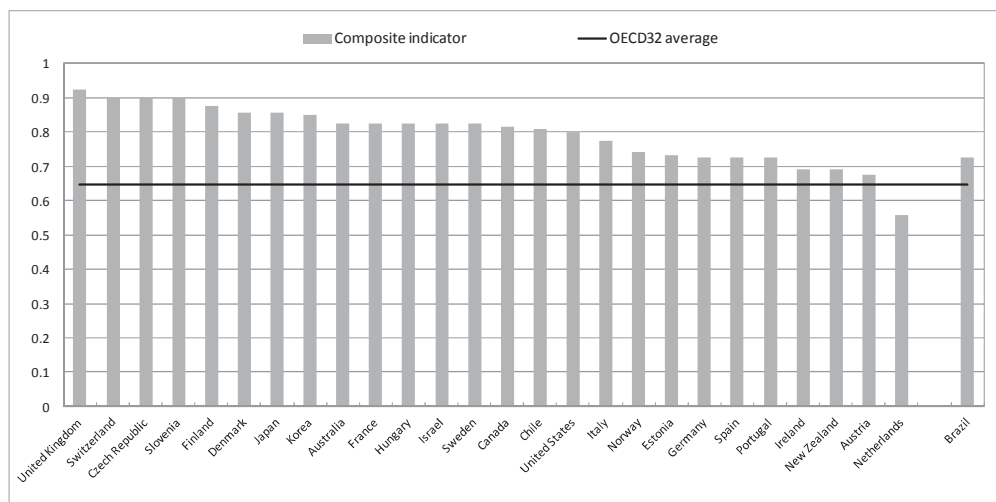
	Top management					Middle management					Professionals					Secretarial level					Technical support					
	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Educational qualification	Job content	Ministry	Performance	Age	Seniority in the position	Relevant experience	
Slovenia	○	○	○	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Spain	●	○	○	○	○	○	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Sweden	○	○	○	○	○	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Switzerland	○	●	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Turkey																										
United Kingdom	●	●	○			○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
United states	○	●				○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Russian Federation	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○
Ukraine	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○	○

● Of key importance ○ Somewhat important ○ Not at all important

Notes: No information available for Brazil, Chile, Greece or Japan.

Source: 2010 Survey on Strategic Human Resources Management in Central/Federal Governments of OECD Countries.

Figure 3.2. Extent of use of performance-related pay in central government (2010)



Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law. Data for Luxembourg and the Slovak Republic are not available. The average for OECD countries includes the six countries that have reported not having a PRP system: Belgium, Greece, Iceland, Mexico, Poland and Turkey. In addition, Ukraine reported that it does not use PRP and is therefore not included in the index.

Source: 2010 OECD Survey on Strategic Human Resource Management in Central/Federal Governments, published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

It was reported that performance-related pay is seen “as a way of increasing flexibility in working practices and managerial discretion over pay and individual accountability. Other reasons ... include increasing staff motivation, attracting more dynamic employees and facilitating managerial changes.” A widely used phrase among consultants is that performance-related pay motivates employees “to work smarter, not harder” – but that assumes the increases are linked to the achievement of goals (OECD, 2005).

OECD reports also make the point that member countries “focus on incentives to promote good performance rather than on sanctions for bad performance”. That is consistent with the typical philosophy in the private sector: it promotes a positive view of the policy. In contrast, past efforts to reduce pay levels and the argument voiced by government critics that performance-related pay should be adopted to deny increases to poor

performers often feeds a negative, sceptical view of any change in the pay programme.

Although not discussed in other OECD reports, there is evidence that the adoption of performance pay by government is related to the importance of the policy in the private sector. In some regions it is virtually a universal business practice. Few if any employers in the private sector would choose a pay policy that guarantees annual increases. They also would not choose policies that link pay increases to indices, such as inflation rates, that are unrelated to their business goals. They may accept those policies as part of a labour agreement but their business preference would be a system that has the flexibility to recognise and reward those employees who are the most valuable to the company.

There are no surveys on the preference of government leaders, but scattered evidence suggests most would agree with the philosophy behind performance-related pay. No one in a leadership position, it seems, contends that rigid salary systems based on step increases are the best answer. Progress has been slow but as OECD reports document, there has been an ongoing transition at all levels of government over the past 20 years to performance pay policies in many OECD countries.

Setbacks have slowed the transition. Most notable among these recently was the 2010 termination by the US government of the National Security Personnel System (NSPS) authorised for the Department of Defense in 2004. A review of NSPS was completed at the request of the US Congress, and the conclusion was that the system and the performance pay policy should be modified but continued. Nonetheless, a decision was made by the political party then in control to terminate it. That system covered 226 000 workers and was in its 5th year of implementation.

The NSPS experience highlights several of the reasons performance pay policies can fail. The most obvious is that the policy needs vocal advocacy from top management; it cannot be seen as “another HR project”. Second, it is impractical to mandate the use of the same performance systems and performance criteria over a diverse workforce. Third, employees need to know what to expect. NSPS relied on committees to decide increases in closed meetings. Training for managers is of course important, but far more important is their commitment to making the policy a success.

The NSPS experience also suggests that the prospects for success are higher when managers and employees play an active role in the planning and implementation. In this situation the Department of Defense held “town hall” meetings where employees heard presentations and could ask questions, but the new system and associated regulations were developed

“behind closed doors”. It was never publicly acknowledged but the unions believed the goal in planning NSPS was to reduce their influence.

Despite setbacks, the pressure continues to make the transition. In the United States for example, despite the NSPS termination, there have been repeated recommendations to end the now-60-year-old General Schedule (GS) salary system covering most white collar employees, and replace it with a market-sensitive, pay for performance system. The failure of NSPS did not deter those recommendations.

The OECD concluded in 2005 that:

- “The adoption of performance-related pay in the public sector reflects the influence of the private sector culture...”
- “Civil services have increasingly sought to manage service production tasks on similar lines to those in the private sector.”
- “Many studies have concluded that the impact of PRP on performance is limited, and can in fact be negative.”
- “It seems that, in the right managerial framework, 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.”

The wider management and organisational changes include: a revision of the appraisal and goal-setting processes, clarification of tasks, acquisition of skills, creation of improved employee-manager dialogue, more teamwork, and increased flexibility in work performance.

The point related to private sector culture is central and important to understand as background for planning the transition. Business leaders generally have a strong focus on building a successful company. Performance data are widely communicated and there is pressure to perform better than the prior month, year, etc. Performance measurement systems monitor, and the information they generate impacts, every aspect of the business. Often at the executive level, over half of the total compensation package depends on company financial results. Career success at all levels rides on performance. Every employee understands the need for continued profitability. Companies also benefit from the competition in their product/service markets. The desire to be successful is no doubt a core human desire.

In the typical company, day-to-day management of employee performance and the annual appraisal rating are part of a panoply of practices used to communicate performance results. Moreover, PRP makes identification and management of the “star” performers a priority. They are

commonly recipients of incentive awards and, in some companies, stock ownership opportunities that dwarf the annual salary increase.

The work culture in public organisations can be very different. The pace is generally slower and it is not clear that employees have a similar commitment or understanding of the goals of their employer. There is less emphasis on identifying or rewarding high performers. The cultural focus on performance can be reinforced by adopting organisational performance management practices such as a Balanced Scorecard.

In both the public and private sectors the prospect of a salary increase is intended as an incentive, but it is impossible to isolate the impact of the policy from other practices influencing performance such as work/life balance, and training. It is not accurate to argue that the prospect's impact is limited; it is more accurate to state that its true impact cannot be confirmed. At the very least, the policy sends the message that management considers employee performance to be important.

Box 3.4. United Kingdom: Lessons learned from the experience with performance-related pay – Hutton Review

Today there is greater recognition of the subtleties of running performance pay in the public sector, allowing that the future could present a very different picture. It is noteworthy – though perhaps no coincidence – that opposition to performance pay has been softening, and that there is now a greater consensus on what works. For example:

- It is recognised that performance is better measured in terms of outcomes over time rather than against peers. For instance, the value added by a school is better gauged by tracking the performance of the same pupil over time rather than by “pitting” pupils against one another in comparisons. This acknowledges that each pupil has a different level of achievement and ability that reflects differences in parental investment, socioeconomic background and other personal characteristics – factors that are beyond the school’s control.
- The pitfalls of strictly quantifiable measures are also increasingly understood, not least where they are used to rank every individual and organisation in painstaking attention to detail. It is recognised that positions on such ranks may jump around chaotically in response to the choice of performance measures. However, objective measures can be a powerful way of starting a conversation in which staff have to account for their performance and undergo more finely tuned judgemental assessments, including 360-degree and stakeholder reviews. Where necessary, there should be a move away from specific targets to the use of more general success criteria, such as benchmarks, milestones and directions of travel– which are harder to manipulate.
- There is an understanding that the performance appraisal process is the backbone of the whole system, without which pay decisions become arbitrary. A high priority should be attached to consultation with employees as well as to simple and regular communication, so that different goals are recognised and objectives are transparent. One study found that perceptions of pay fairness were a 25-times stronger predictor of employee commitment than pay satisfaction. It also found that overall pay fairness is influenced most strongly by pay process fairness.

Box 3.4. United Kingdom: Lessons learned from the experience with performance-related pay – Hutton Review (cont.)

- Where feasible, performance indicators should be based on alternative, independent and manipulation-proof information sources such as general household surveys and ratings. The distribution of rewards should be controlled and co-ordinated by independent committees. These tasks have been made easier by advances in technology that allow for the rapid collection and processing of information.
- It is clearer that rating systems should avoid forced rankings – relative assessments can do more harm than good and create divisiveness among employees. If it is necessary to use ranking systems, they should be used more to check the distribution than as a rigid quota.
- Finally, objectives should be relatively stable over time and to the extent possible be protected from political interference. Performance assessments should involve defining medium-term measures of success and placing considerable weight on them. In part this can be done by requiring that the choice of short-term performance measures correlate empirically and theoretically with positive long-term outcomes.

Source: United Kingdom Government (2011), “Hutton Review of Fair Pay in the Public Sector”. HM Treasury, www.hm-treasury.gov.uk/d/hutton_fairpay_review.pdf.

At the same time, policies that base increases on seniority or job tenure send a clear message that downplays the importance of employee performance. Too often managers are inclined to ignore problem employees – it is a far easier strategy – and from everyone’s perspective that should not be the case.

The public is also a stakeholder and in most countries, citizens are now expressing their concern about government, the quality of public service, and the accountability of leaders. Performance pay sends an important message to the public as well.

It is perhaps unreasonable, however, to expect the added compensation to be a powerful incentive. The difference in the annual increase, even with an aggressive performance pay policy, is not large. Prior to the recession a typical salary increase budget provided for average increases of 3-4% and possibly 6-8% for the best performers. With required withholding for taxes

and benefit contributions, and the net take-home increase spread over a year, the difference is not going to change the employee’s lifestyle in any important way.

However, performance-related pay is more than an annual increase. Consistently higher performers of course see, with compounding, faster growth in their salary level. Perhaps equally important, PRP is also a form of recognition; the ratings are or can be linked to other organisational rewards. This is consistent with widely understood psychological theories employed throughout all societies (that includes success in school, parenting, product marketing – the applications are many).

In an organisation there are many other ways to recognise and reward employee contributions. No other formal practice, however, is applicable to all employees. Informal reward practices are too often not used consistently across an organisation.

Cash bonuses and incentives are considered to be a more effective reward when well managed. The amounts are generally larger, the ties to results more explicit, and the potential differential between good and bad performance greater. The practice has never gained acceptance in government but is widely used in industry. Perhaps when performance metrics are more fully developed, cash awards will be accepted in the public sector, especially for executives.

Box 3.5. The potential value of group or team incentives

Discussions of bonuses in previous OECD reports have focused on two key points: i) there is recognition that these plans can be more effective than the typical salary increase policy, but ii) they have rarely been adopted.

There is scattered evidence that group or team incentives have become increasingly important in the business world over the past two decades. The literature and the surveys tend to focus on larger companies, so the actual extent of use is unclear.

An element of the confusion is that the common executive and management incentive plan is in fact a group incentive. Those plans were first adopted with the economic expansion following World War II, as owner-managers were replaced by “professional managers”. The early plans were effectively profit-sharing arrangements by which all executives shared in the payouts, and that philosophy is still a core consideration.

Corporations with stock traded on an exchange generally have an added group incentive in the form of stock options (or similar arrangements). With these plans, all participants benefit when the stock price appreciates.

Box 3.5. The potential value of group or team incentives (*cont.*)

In combination, those plans -profit sharing & stock options- are generally far more powerful incentives than the prospect of a salary increase. In some corporations the plans have been extended down to senior professionals or below. The plans make it very clear: it is to everyone's benefit to make the company successful.

Profit-sharing arrangements in which *all* employees participate are also an alternative. These plans have declined in use in larger companies, as employers realise that relatively few employees can truly see how their work efforts contribute to company profitability. They are of course not feasible in government organisations.

The alternative, which clearly can be adopted by government employers, is now referred to as “goal-sharing plans”. The message to participants is simple: “When we achieve our performance goals, everyone can expect a cash payout.” There is no standard model for these plans, but they all reflect the same basic philosophy.

The predecessor concept was a “gain-sharing plan”, conceived in the 1930s by a union leader, whereby payouts are based on improved performance over a base period. These plans are still mentioned in the literature, although it may be that the phrase is used but the plans have been changed. A problem is that the potential for improvement is limited and performance plateaus after a period, which means payouts decline.

Goal-sharing plans can be designed to fit any work group with measureable or verifiable group or team performance goals. The general recommendation is to focus on a few key indicators that in combination would be considered successful performance. In a hospital setting, for example, patient satisfaction is a frequently used measure.

Payouts typically start when performance reaches a threshold of 80% or 90% of the goal(s), and progressively increases to a planned payout for achieving the goal(s). With the typical plan the planned payout might be 5% of salary; at the threshold the payout might be 2.5% of base salary. Most of these plans reward participants for exceeding the goal, with maximum payouts of possibly 7.5% of salary. The argument is that the potential swing in the payout – in the illustration it can swing from 2.5% to 7.5% – provides the incentive (Risher, 2002).

The payouts are controlled by defined performance scales. The threshold performance notion is found in most corporate incentives, and reflects the reality that planned performance is never precise. Too often in government, payouts are strictly linked to actually achieving a goal or goals. There is no payout if the goal is not reached. And there is often no benefit in exceeding the goal. In a business, payouts typically continue to increase for performance above the threshold. That reflects the profit-sharing philosophy. The message is straightforward – “The better the team performs, the more everyone can expect to earn.”

Box 3.5. The potential value of group or team incentives (cont.)

All participants typically share equally in the payout, usually as a percentage of salary. The percentage is often referred to as a “target” or “guideline” award and is the amount paid for meeting the goals.

There is an argument that employees could refrain from a full effort and essentially be “free riders”, but they will usually feel the brunt of group pressure to perform. Experience suggests that employees like the sense that they are working as a team and do not want to “let the team down.” That may be a more powerful incentive than the prospective cash payout.

Three problems need to be avoided. First, the group can be too large and too removed from the goals to feel a sense of commitment. Second, the performance goals can be too soft and subjective. When awards are subjective, it sometimes becomes difficult to deny payouts and that leads to a sense of entitlement. Perhaps most importantly, when all employees are not logically a member of a group and do not participate in a plan, it means their compensation is lower.

Source: Risher, H. (2002), “Improving Agency Performance Through Incentive Payouts” *The Public Manager*, Vol. 31, No. 4. Pp.23-27.

For government, performance-related pay requires a commitment to effective performance management along with a review process to provide the assurance that employees will be treated fairly and the policy managed consistently. There are solid success stories. In most cultures the best performers want to be recognised so the philosophy gains acceptance. Perhaps the most imposing barrier is that it represents a significant organisational change, and the implementation needs to be planned and managed as a change initiative.

One of the issues with delegation is the relevance of inter-agency comparisons of salaries for jobs at the same organisation level. The policy question relates to the fairness of disparate salaries for similar work. It can be argued that the same job, in terms of its content, might have a different “value” in different agencies. It also may be that the staffing strategy calls for highly qualified specialists and salaries are commensurate. However, explanations to justify the differentials may not be convincing.

Too often the Human Resource office is solely responsible for planning and implementing new pay policies. This fails to recognize that HR specialists have little involvement in the day-to-day management of employee performance – that of course is the responsibility of managers. For individualised pay to be truly accepted, it is important to have the “buy-in” of managers. It is correctly seen as a tool to help managers achieve performance goals.

The importance of buy-in cannot be overstated. The transition to performance-related pay is perhaps the most complex organisational change any employer can undertake. The following list of questions is intended to provide guidance and highlight key considerations. The list, however, is not intended as a roadmap, since each situation involves different dynamics. There is a proverbial train leaving the station and the goal is get everyone on board.

Box 3.6. Issues to consider in moving to performance-related pay

- How is the existing salary programme perceived by managers and supervisors? Employees? Elected officials? Union leaders? Other stakeholders? The public? Were their concerns documented?
- Have senior leaders made it clear that making the new system a success is an organisational priority? Have they agreed to act as “champions” of the new system?
- Is there a communications campaign to keep managers and employees aware of the plans for a new programme? Do employees know what to expect?
- Did the planning and implementation reflect adequate concern for transparency?
- Was there an effort to understand the “best practices” in other countries?
- Was the new programme negotiated? Were all labour organisations involved? Consulted?
- Were other stakeholders asked to provide feedback? Professional associations? Prominent critics of government?
- Were market data assembled and made available to negotiators (or the programme planners)?
- Were specific workforce concerns addressed in planning salary levels? Locality pay differentials? Occupational differentials? Mission-critical skills differentials?

Box 3.6. Issues to consider in moving to performance-related pay
(*cont.*)

- Do managers and employees understand what factors will determine their salary? Internal job value? Career stage? Education? Experience? Performance? Competence?
- Are the logic and process for assigning jobs to grades (or bands) accepted?
- Were managers involved in planning the new programme? Would they agree it reflects their concerns?
- Are managers “ready” for their role in managing staff salaries? Has their training been adequate? Is refresher training included in the plan? Are managers rewarded for performance? Are employees asked to comment on their supervisor’s skills?
- Were employees trained in the performance management process as well as in performance planning and measurement?
- Is the performance management system reliable? Are ratings viewed as “fair”? If rating inflation is seen as a problem, is there a strategy to bring ratings down to more credible levels?
- Has “Meets Expectations” (or satisfactory) performance been defined in terms understood by managers and employees? Do employees understand what they need to demonstrate to be rated as “Outstanding”? Has “Unacceptable” performance been defined using credible performance criteria?
- Is there a process to review ratings (beyond a “one-up”) manager? Is the grievance process available to employees who are convinced their rating and/or salary increase is unfair?
- Does the plan create or continue a methodology to identify possible cases of discrimination?
- Does the plan provide for a regular review of programme effectiveness and agree to modify it as necessary to address recognised problems?

The new importance of the market factor in retaining talent

Conceptually, individualised pay reflects an employee’s performance along with the market expression of his or her value. The best-qualified and best performers can normally command a higher salary if they test the market. This is both an internal salary management issue as well as a market and salary survey issue.

Many private sector employers are now deciding to adopt policies to attract and retain better-qualified employees as part of their compensation strategy. That translates into paying above-average salaries. The typical policy identifies those occupations and jobs that are seen as keys to success, and selectively assigns the jobs to higher grades. Few employers can afford to pay all or most of their employees above market salaries.

A common assumption in interpreting market survey data is that worker qualifications and experience are reflected in the distribution of pay around the average. It is assumed that the better-qualified workers are paid higher in the distribution. Based on that assumption employers might, for example, decide to pay engineers at the 75th percentile level. That salary level is then the basis for assigning these jobs to a grade.

This logic can be adopted and used informally to manage individual salaries. Organisations that find they have a truly outstanding performer or someone who is believed to have that potential can simply pay them more. In current workforce planning jargon, these employees are referred to as “A Players”. The concern of course is the need in a government organisation to be able to justify the decisions. An element of the justification is that the best-qualified are most likely to have job opportunities in the private sector.

Compensating public managers effectively

One of the earliest of the executive pay programmes in government was the creation by the US Congress of the Senior Executive Service in 1978. The SES provides for performance-related salary increases along with bonus awards for the roughly 7 000 members of the SES. It is important to note that every few years there are proposals to revamp the programme; the most recent was in August 2011. This is to a large extent due to fact that 95% of employees covered by the SES are rated at the highest two levels. It is clearly not functioning as expected, although the problems have not been publicly stated.

The United Kingdom is experiencing similar concerns with its Senior Civil Service (SCS) system. Dating from 1994, it is not as old and the cadre of SCS executives is naturally smaller. Its handling of performance ratings is

based on a forced distribution policy, with a limit of 25% in the highest rating and 5%-10% in the lowest of three rating levels.

But it also is not seen as effective. Soon after the new administration took office in May 2010, the government commissioned a study on SCS pay and pensions. The report, titled the “Hutton Review of Fair Pay in the Public Sector” (United Kingdom Government, 2011, and see Box 3.4), gives renewed emphasis to performance-related pay and concludes that public employers should be much better, in keeping with the importance of transparency, at communicating to the public the explanations for executive compensation practices.

It seems executive compensation is always contentious. Government executives earn far less than their counterparts in large companies, but their income is considerably higher than the average citizen. A common focus of critics is the use of bonuses to reward performance. The awards are smaller than those common in industry, but still appear large to the public.

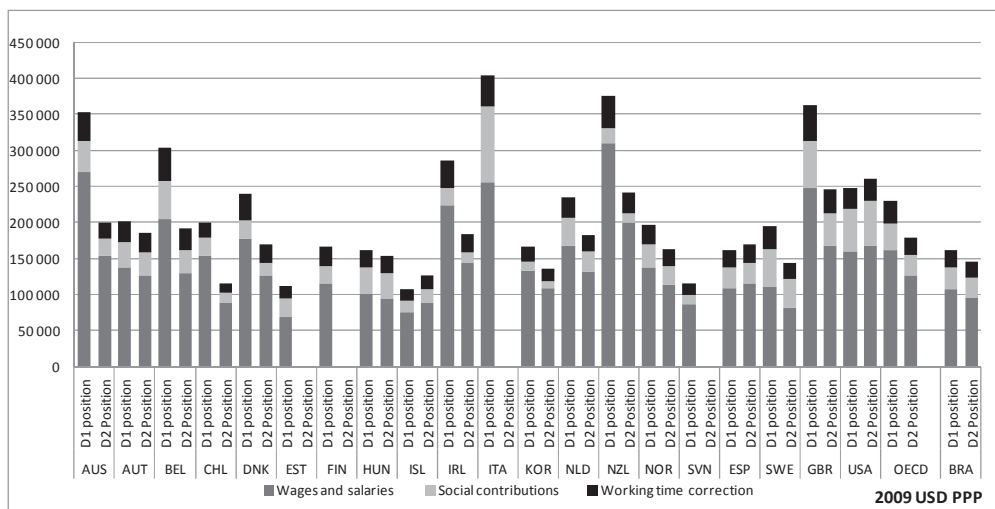
Figure 3.3 suggests that the yearly compensation of senior managers (excluding political levels) varies significantly across countries and between D1 (top public servants below the minister or secretary of state) and D2 (usually just below D1) levels. On average, in countries responding to the OECD 2010 Compensation of Employees in Central/Federal Governments Survey, D1-level senior managers’ total compensation amounts to just under USD 235 000 PPP (fully adjusted for employers’ social contribution and holidays), and to about USD 165 000 PPP in wages and salaries. D2-level managers’ total compensation nearly reaches USD 185 000 PPP (fully adjusted for social contributions and holidays), and to USD 130 000 PPP in wages and salaries in the same year.

Due to their smaller numbers, the total compensation costs of senior management are relatively small in the context of total government spending. Their levels of compensation are nevertheless considered crucial for attracting and keeping talent for positions involving high levels of responsibility in government. Compensation for these positions has important symbolic value, as they are usually at the top salary scales and involve staff whose appointment tends to be more discretionary.

A basic problem is that the customary analyses based on so-called benchmark jobs and surveys of current pay levels are not feasible. Government executive jobs are simply not comparable to those in industry. Different strategies have been tried and rejected. The Hutton Review sets forth a new idea, tying executive pay by fixed ratios to the pay of non-executive civil servants.

Figure 3.3. Average annual compensation of central government senior managers, 2009

Adjusted for differences in holidays



Note: Data for the Czech Republic, France, Germany, Greece, Israel, Japan, Luxembourg, Mexico, Poland, Portugal, the Slovak Republic, Switzerland and Turkey are missing. Canada withdrew its data. Compensation data for D2 positions are missing or mixed with D1 positions in Estonia, Finland, Italy and Slovenia. Austria: Value is median rather than average. Brazil: Source of social contribution: IBGE; source of PPP: World Bank. Data include career salary + 60% of *Direção e Assessoramento Superiores* (a sort of senior civil service) Chile: Data exclude bonus for critical functions. This affects across-country comparison by one to two percentage points depending on occupational group, but may be much higher for top-ranking positions. Ireland: Data take into account the decrease in salaries following the Financial Emergency Measures in the Public Interest Act 2009. Social contribution rates are for staff hired after 1995 and exclude unfunded pension schemes through the pay-as-you-go system. Italy: Public managers' compensation is comprehensive in that it rewards "all functions, tasks, and assignments performed in relation to their office" and also includes social contributions paid by the manager (11% of gross salary). Government introduced cuts in 2011 to the wages of all public managers with a total gross remuneration above EUR 90 000. Reductions amount to 5% for the share of gross remuneration between EUR 90 000 and EUR 150 000, and 10% to the part exceeding EUR 150 000. Korea: Civil servants are entitled to 3-21 days of annual leave per year depending on the length of service. New Zealand: Data do not include all social payments, including sick leave and other unfunded leave payments, made by the employers. The D1 and D2 managers' compensation of the particular organisations surveyed are among the highest of all the New Zealand public service departments. Spain: Major reductions in compensation introduced in May 2010 are not reflected. United Kingdom: Data exclude additional payments. Compensation levels are calculated by averaging the compensation of staff in place (it is not the middle point between the minimum and maximum salary).

Source: 2010 OECD Survey on Compensation of Employees in Central/Federal Governments, OECD STAN Database. Published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

However defined, executive pay levels involve political decisions and inevitably it seems general pay levels are restricted. That leads to pay compression, which is defined by reduced differences in pay between management levels. Severe compression cascades down and can limit the pay of several levels in the hierarchy.

Korea reports that overall compensation levels for senior officials are low relative to levels in neighbouring countries such as Japan, Hong Kong and Singapore. In response to OECD survey questions, the Korean respondent reported that the situation generates general discontent among civil service employees. Although not stated, the level of compensation for public officials is often an indicator of their stature in society. The respondent also reported that “human resource management for high-level positions... is not...well developed”, which is possibly an indication that these positions are not a priority.

The use of bonus payments is another controversial practice. In many countries, large payments to government officials are frequently highlighted in media reports. A number of countries state that they make bonus awards to executives and in some cases to middle managers. The descriptions suggest that the awards are subjectively determined. (Several countries reported cancelling bonuses for a year or two in response to the recession.)

The common model for awarding bonuses or incentives in industry differs in several respects from the way awards are determined in government:

- In industry, awards under a “management incentive plan” are planned and budgeted. The awards at each level of management are defined as a percentage of salary. The amounts might start at 10% of salary at the lowest level and increase progressively to 50%, 60% or higher. The words “guideline” and “target” are used to refer to the percentages.
- All awards in part reflect organisation performance, which follows from the profit-sharing heritage. It means that all participants benefit when the company is successful. That also makes the typical award plan a team reward system. This is an important distinction.
- The awards are typically based on goals that are weighted for importance. That makes it possible to calculate the awards using a formula logic. There is virtually no subjectivity.
- Actual awards can go up or down around the target award level. If the company is successful and the individual exceeds their goals, they can earn more than the target. If the company performs poorly

or the individual fails to meet one or more goals, the individual might simply get no monetary award.

- Finally, all plan participants (except poor performers) can expect to earn an award. The target amounts are treated as an integral element of the “total compensation” package, not an extra year-end add-on. The total cash amount is planned based on survey data. Everyone has their payout depending on how well the organisation performs. This is an important philosophical difference from government.

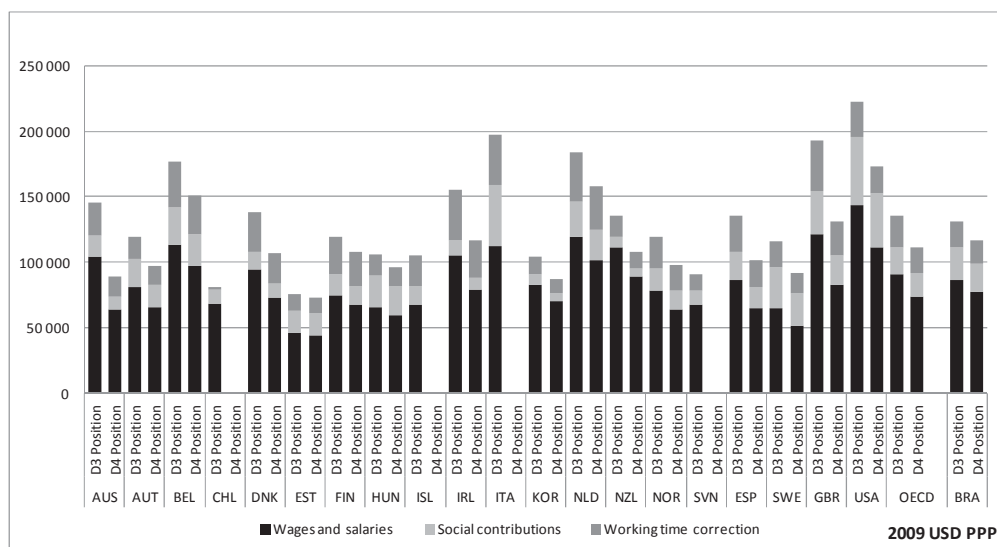
Those points define the distinction between a bonus, which is normally based on subjective factors decided *ex post facto*, and an incentive, which is based on largely quantitative measures and has a method for calculating awards that is spelled out early in the year. With incentives, participants can track their performance progress and estimate payout at any point in the year. Bonus awards are much more likely to create distress, since the rationale for awards is often vague or unstated.

Private sector employers also commonly include middle managers as participants in management compensation programmes, avoiding the artificial distinction between executives and managers. This is not always the case in the public sector, where there is a tendency in a number of OECD countries to further separate management of senior managers from that of senior experts. In a knowledge-based economy, senior experts may become more valuable to public organisations, and thus should be highly valued and rewarded.

Middle managers are located between senior management and professionals in the central government workforce hierarchy. D4 managers are directly below the D3 level. As Figure 3.4 shows, there are significant differences in the amount of compensation between the two levels of middle managers. In the OECD countries that responded to the 2010 Survey on the Compensation of Public Employees in Central/Federal Governments, the higher level of middle managers’ (D3) total compensation amounts to on average about USD 135 000 PPP annually, including wages and salaries, employers’ social contributions, and the value of all working time adjustments. In contrast, the average annual compensation of lower-level middle managers (D4) amounts to around USD 112 000 PPP. Compensation of middle managers is significantly lower than that of senior managers. For example, middle managers in D3 positions only earn 59% of what senior managers in D1 positions earn, and 76% of what managers in D2 positions earn (see Figures 3.3 and 3.4).

Figure 3.4. Average annual compensation of middle managers in central government, 2009

Adjusted for differences in working hours and holidays



Note: Data for the Czech Republic, France, Germany, Greece, Israel, Japan, Luxembourg, Mexico, Poland, Portugal, the Slovak Republic, Switzerland and Turkey are missing. Canada withdrew its data. Compensation data for D4 positions are missing or mixed with D3 positions in Chile, Iceland, Italy and Slovenia. Austria: Value is median rather than average. Brazil: Source of social contribution: IBGE; source of PPP: World Bank. Data include career salary + 60% of *Direção e Assessoramento Superiores*. Chile: Data exclude bonuses for critical functions. This affects across-country comparison by one to two percentage points depending on occupational group, but may be much higher for top-ranking positions. Estonia: Data for managers in policy-making/basic units of ministries have been presented under D3 and data for managers in support units of the ministries (budgeting, personnel, IT, etc.) have been presented under D4. Ireland: Data take into account the decrease in salaries following the Financial Emergency Measures in the Public Interest Act 2009. Social contributions rates are for staff hired after 1995 and exclude unfunded pension schemes through the pay-as-you-go system. Italy: Public managers' compensation is comprehensive in that it rewards "all functions, tasks, and assignments performed in relation to their office" and also includes social contributions paid by the manager (11% of gross salary). Government introduced cuts in 2011 to the wages of all public managers with a total gross remuneration above EUR 90 000. Reductions amount to 5% for the share of gross remuneration between EUR 90 000 and EUR 150 000, and 10% to the part exceeding EUR 150 000. Korea: Civil servants are entitled to 3-21 days of annual leave per year depending on the length of service. New Zealand: Data do not include all social payments, including sick leave and other unfunded leave payments, made by the employers. Spain: Major reductions in compensation introduced in May 2010 are not reflected. The United Kingdom: Data exclude additional payments.

Source: 2010 OECD Survey on Compensation of Public Employees in Central/Federal Governments, OECD STAN Database. Published in OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

The level of compensation of middle managers varies much less across OECD countries than that of senior managers. Figure 3.4 shows that middle managers in the United States earn the most relative to other OECD countries; their annual compensation exceeds just over USD 220 000 PPP for D3 levels and USD 170 000 for D4 levels. The division of total remuneration between wages and salaries and employers’ social contributions varies across countries. In Sweden, the United States, Italy, Hungary and Estonia, employers’ social contributions constitute a relatively large share of total remuneration of middle managers, while they tend to represent less in other countries. It should be considered that differences in the remuneration levels across countries can be the result of differences in national labour markets, particularly remuneration in the private sector for comparable positions.

Pay and gender equity

The phrases “comparable worth” and “pay equity” first surfaced in the late 1970s as a central issue of improving the relative pay of women in the labour market. Back then it was common to find women and men working in single-sex occupations and female-dominated jobs were commonly paid less. In many countries women were routinely denied opportunities to work in higher-paying occupations, and in school they were channelled into traditional female fields.

The occupational outlook for women has broadened dramatically since then. They now have successful careers in virtually every occupation, and leadership roles at the national level are frequently held by women.

In compensation management, demands for gender equity spawned an intense effort through the 1980s to develop non-discriminatory job evaluation systems. The system model that eventually gained acceptance was developed for Bausch & Lomb in 1980. It was based on data from structured scaled-response job analysis questionnaires; this data was used to develop multiple regression statistical models that predicted the salary based on job data. The model had the advantage that the incumbent’s gender was specifically excluded from the data. By the middle of the decade, similar systems were marketed by each of the major consulting firms.

Problems surfaced quickly, however. Perhaps the most important was that relatively few people understand multi-variate statistical analyses.² The new systems were viewed by managers and employees as “black boxes” that generated poorly understood results. Even the responsible compensation managers were often unable to explain the analyses.

Interest in systems based on statistical models, as well as in other formal job evaluation systems, fell off dramatically with the onset of the 1990 recession. Employers acted to eliminate all practices seen as overly bureaucratic and costly. The prevalence of formal systems has continued to decline over time.

Fortunately, women were steadily gaining a foothold in male-dominated occupations. The generation of women that entered the workforce in the 1980s and later had every expectation they would be successful in any field. Employment patterns changed significantly. Laws supporting gender equity have been passed in a number of countries.

For the most part, OECD countries do not provide preferential treatment for women. Only the Czech Republic and Germany reported to provide women preferential rights for promotions. Austria, Finland, France, Hungary, Japan and Switzerland have targets for promoting women. Belgium, Finland, France, Germany, Italy, Japan, Korea, Sweden and the United States provide coaching and information sessions to support women’s career advancement.

The earnings gap between men and women is still significant, however. Reliable data are not always available, but a gap is consistently evident. The primary cause is still choice of occupation and career patterns. Within at least the larger employers, women and men in similar jobs are now generally paid similar salaries, although individual discrimination is always possible. Many employers, public and private, routinely conduct analyses to identify and correct where necessary patterns of discrimination.

In Finland for instance, women are well represented in the civil service, but their average monthly earnings are 80% of those of men. One of the reasons is segregation in the labour market, as the majority of women work in the fields of social care, health, education and culture, while men are more likely to work in the higher-paying fields of technology, agriculture and security. New Zealand has a similar situation: the gender pay gap in public service has been steady over recent years despite a focus on gender equity.

Table 3.2. **Gender pay gap in the New Zealand public service**

	2003	2004	2005	2006	2007	2008	Labour force (2008)
Gender pay gap (%)	15.8	17.0	16.4	16.1	16.0	15.4	14.9

Source: New Zealand Government, Human Resource Capability Survey of Public Service Departments as at 30 June 2008, State Services Commission.

The International Labour Office – the permanent secretariat of the International Labour Organization – has noted that in spite of continuous positive advances in anti-discrimination legislation, the global economic and social crisis has led to a higher risk of discrimination against certain groups. One of the key findings of the ILO Global Report on “Equality at Work 2011” is that although significant progress has been made in recent decades in advancing gender equality in the world of work, the gender pay gap remains a challenge. Women’s wages are on average 70-90% of men’s.

The United Nations Population Fund has declared that women have a right to equality. “Gender equity” is one of the goals of the United Nations Millennium Project to end world poverty by 2015; the project claims, “Every single goal is directly related to women’s rights, and societies where women are not afforded equal rights ... can never achieve development in a sustainable manner.” A number of UN organisations have made similar pronouncements.

In 2010, the European Union opened the European Institute for Gender Equality (EIGE) to promote gender equality and to fight sex discrimination. The International Labour Organization has also made gender equity a goal.

The World Economic Forum first published its Global Gender Gap Report in 2005. The 2008 report covers 130 major and emerging economies. For the most part OECD countries rank high in the index used to quantify the status of women. The highest scores were earned by Iceland, Norway, Sweden and Finland. The lowest scores of OECD countries are still high relative to countries in Africa and the Middle East.

Gender equity is a priority in the HR offices of OECD countries. Gender-neutral job evaluation systems can be developed, and statistical analyses can be applied to identify situations involving possible discrimination. However, the problems related to the recession and the budget crises have largely superseded the issue in recent literature on government and business practices.

Clearly, discrimination still occurs. While systemic discrimination is less today than it was 30 years ago, the trend of delegating responsibility for compensation management provides increased opportunities to discriminate. It is incumbent on employers to monitor pay levels and pay adjustments to identify and assess suspicious patterns.

Conclusion

The fiscal crisis, together with the consolidation measures aimed at reducing operational expenditure, is forcing rapid changes in the public sector compensation management. As mentioned above, governments are restructuring in an effort to balance budgets – and restructuring generally involves reducing staffing and compensation levels. However, governments now need to determine appropriate salary levels and the performance expectations for all affected jobs in the new organisation structure. To perform this task, they require adequate HR staff capacity.

The environment in which governments operate is also changing, prompting shifting priorities and posing new challenges. Countries are now exploring new approaches to compensation management, such as salary bands. A number of countries have moved to delegating responsibility for compensation management in an effort to make managers accountable for their work group, but delegation is not without its problems. Leaders are generally reluctant to “let go”. Training in salary management for line managers is essential.

Moving towards performance-related pay (PRP) has been the hardest challenge for OECD countries. The reported lack of or limited success of PRP is due to: i) the absence of top management advocacy, as the system is seen as just another HR project; ii) the use of the same performance system (i.e. PRP) and performance criteria over a diverse workforce; and iii) employees’ general lack of awareness of what it is expected of them. Training managers in PRP is important, but experience shows that success depends on the managers’ commitment to make the policy a success. A possible way of overcoming this situation and reinforcing the performance focus is to adopt organisational performance management practices such as balance scorecards.

Apart from commitment, performance-related pay schemes are going to require a review process, to provide the assurance that employees will be treated fairly. PRP is more than a pay increase; it is a form of recognition. This cannot be seen as a task for the HR departments, as they have little involvement in the day-to-day management of the employees. It is the managers who have the largest responsibility.

Compensation of public managers is a contentious issue. Compensation programmes should look for ways of attracting and retaining management talent, but also ways of offering salaries that are socially acceptable – or even above, considering the current economic crisis. One way of approaching this issue is by improving transparency and communication and explaining the decisions regarding executive compensation practices. A starting point is to acknowledge that government executive jobs are simply not comparable to executive jobs in the private sector.

Notes

- 1 For further information visit: www.opm.gov/oca/l2tables/locdef.asp.
- 2 Multi-variate statistical analysis is a form of statistics encompassing the simultaneous observation and analysis of more than one statistical variable. It is used in studies that involve more than one dependent variable (also known as the outcome or phenomenon of interest), more than one independent variable (also known as a predictor), or both. This type of analysis is desirable because researchers often hypothesise that a given outcome of interest is affected by more than one thing.

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Chapter 4

Policies and practices governing public sector compensation planning

Compensation planning requires transparency, fairness, and a genuinely inclusive approach – especially during times of austerity. Informed decisions that can be justified to stakeholders require social dialogue. While union involvement would reduce resistance to proposed changes, labour negotiations are normally not the best setting for restructuring pay programmes. Information on labour market trends is central to remaining competitive, although data quality issues, differences in demand, and the frequent lack of counterpart jobs in the private sector must be taken into account. Transition to performance-related pay is perhaps the most difficult change initiative for a public employer, but policy formats such as a “merit matrix” can help facilitate the changeover. Employees need to know as much as possible about plans for the near future and what they can expect. Maximising the total rewards of the work experience can enhance the performance of personnel truly committed to the organisation and its success.

Introduction

The implementation of consolidation programmes to address budget deficits, mainly through cutting operational costs, has had a negative impact on public employees' trust in government. Building the dialogue between government as employer and public employees is fundamental to rebuilding the strained relations of trust and confidence, which after all legitimise decisive and effective action by government. This chapter aims to review alternatives for improving compensation planning with a more inclusive approach. It discusses the importance of social dialogue for salary planning, the relevance of labour market surveys to inform salary planning, and the need to use inflation data to adjust salaries. The issue of allowances and reward policies are also discussed, with an emphasis on the need for a total reward management strategy.

The compensation data available

A thread running through the national debates is the concern shared by a segment of the public that government salaries, allowances and/or benefits are too high relative to the compensation levels of other workers. The concern is somewhat different in each country; in some cases it is vague and not explicitly stated. In part it reflects a more general criticism of government, its cost and efficiency.

A reading of the media coverage suggests that public employers need to do a better job of justifying compensation levels. While businesses do not discuss or disclose compensation policies in a public arena (unless required to do so by law), they are typically more concerned with justifying salaries and benefits than are public employers. In fact, toward year-end and as needed throughout the year, HR specialists in industry routinely assess compensation levels. Private sector salary planning strategies could be considered by government.

Salary planning is likely to receive more attention as public employers deal with restructuring and questions about appropriate pay for redefined jobs. Elected officials, the media and the public will be looking for the justification. Government pay and benefits can indeed be a hotly debated political issue. Public employers should be ready to respond to the critics, because market data are now available on several websites to anyone with a computer. The availability of information on SalaryExpert.com is illustrative: the website claims to have market data for every country, allowing employees as well as the media or the public to decide if government salaries are too high or too low.

Published surveys are also available in many countries. Every year thousands of surveys are conducted throughout the world. Industry groups frequently sponsor surveys that are not readily available or relevant to government, but a number of other surveys report market data for generic jobs such as lawyers, accountants and HR professionals. Several OECD countries conduct surveys or compile published data for salary planning.

Market salary data should be available whenever salary levels are discussed. Knowing how salaries compare with market levels is relevant to everyone involved with staffing.

Labour unions of course also have reason to use the data. In all but one OECD country, labour unions are involved in salary planning discussions. Their involvement varies from required presence at the bargaining table to consultation. In several countries unions play a role in discussions of pay increases for individual performance. They should also be concerned with justifying the salaries paid under freshly negotiated labour agreements.

Collective bargaining and salary planning

Unions and collective bargaining play an important, longstanding role in virtually all OECD countries. Leaders in every country pay attention to stakeholders, and that clearly includes government employees. They and their representatives should be involved in any decision process that affects their futures. Unions are of course unable to control the supply and demand for labour, but they do have a role in deciding how employers respond to market developments. They also can play an essential role in preventing discrimination and unfair practices.

The information collected through the 2010 OECD Survey on Strategic Human Resource Management in Central/Federal Governments shows that unions are heavily involved in defining base salaries, social benefits and additional remunerations. For example, in 11 OECD countries agreement with unions on base salary and social benefits is mandatory; in 14 countries the law establishes that unions must be consulted; and in 6 countries consultation is voluntary. Only the United States stated that unions are “not at all involved in negotiating “base salary/social benefits”. In 10 countries agreements with unions regarding additional remuneration and performance pay is mandatory, whereas in 12 countries the law stipulates that unions must be consulted and in 4 countries consultation is voluntary. Six countries reported that unions are not normally involved in the process of additional remuneration and performance pay (See Annex A).

In the past, collective bargaining benefited union members because their pay increases and benefits were negotiated beyond the levels that would

have been granted voluntarily. For employers there was also the corollary advantage of avoiding work stoppages or other labour problems through the term of the contract. The latter is true in dealing with the current crisis, but for employees the focus is now on avoiding or minimising pay cuts or the loss of jobs. Ultimately however, only government leaders can decide how funds are to be allocated.

Box 4.1. Social dialogue in selected European Union countries

Finland: Civil servants have a legal right to conclude collective agreements. It is obligatory to initiate a collective bargaining process involving civil servants when a central-level party in the central government sector demands it.

France: Trade union organisations do not have a right to initiate negotiations to reach collective agreements. The government is not obliged to negotiate with trade union organisations except for wage increases, which is a legislative obligation. However, this fact has not prevented the development or enrichment of negotiation practices during the past ten years – for instance for working conditions, training and social action. Wage policy is set for three years. During that time government and unions meet at least once a year to discuss whether or not action should be taken to adjust wages, given the existing economic context.

Germany: Civil servants have no legal right to collective bargaining, although they are allowed to participate in the development of regulations dealing with the legal employment conditions of civil servants. Thus civil service laws contain provisions that oblige the government to consult with trade unions before adopting unilateral measures. Their pay and working conditions are adjusted to the results of the collective bargaining negotiations between employers and workers.

Hungary: The legal status of civil servants, public servants, officials of the armed forces and soldiers of the Hungarian Army determines the topics on which the employer's side is obliged to consult with trade union organisations.

Luxembourg: In theory, remuneration and working conditions are determined unilaterally by law, although in practice social dialogue plays an important role during decision-making processes in the public sector.

Poland: Central government administrations consult the trade unions regarding their opinion on proposals and drafts for legal acts. If there is political will to implement the results of the discussions with the trade unions, the government can elaborate a proposal for a new or modified regulation.

Spain: There is legal recognition of the right to collective bargaining. The negotiating rights of civil servants are laid down in a specific law. Thus the employer's side is obliged, by law, to negotiate all topics related to their working conditions.

Box 4.1. Social dialogue in selected European Union countries (cont.)

Netherlands: There is a “requirement of agreement”, which establishes an obligation to consult the trade unions on the conditions of employment. There is no obligation to consult trade unions on political or organisational matters.

Source: *Direction Générale de l'Administration et de la Fonction Publique* (2008), ‘Comparative Analysis of the Social Dialogue in Central Public Administrations of the European Union Member States’, *Etudes et Perspectives, Ministère du Budget, des Comptes Publics et de la Fonction Publique*, France.

Where restructuring is necessary, it would make sense (even if it not required) to involve unions and their members in order to take advantage of their work process knowledge. This should also reduce resistance to proposed changes.

Labour negotiations are normally not the best setting for restructuring pay programmes, for several reasons.

- It would be uncommon for negotiated pay increases to mirror the increases in market rates. As a rule in labour agreements, employees at all levels are treated the same. That may satisfy union members, but it makes it difficult to respond to the dynamics of labour market trends.
- Union leaders and the more active members tend to come from the ranks of senior workers. There is evidence that young, so-called “millennial workers” will not be satisfied with the same contract terms. That appears to be confirmed by media coverage in those countries where riots and public demonstrations occurred recently. Both government and union leaders should monitor the concerns of all groups of employees.
- Labour contracts tend to lock in the terms of employment and working relationships, making it difficult to respond to change. This is a time when flexibility and willingness to accept change is essential. Union leaders are likely to find it very difficult to convince members to accept layoffs and reduced compensation and benefits.
- Finally, unions tend to resist pay for performance and individual pay arrangements. If there is one overriding trend, it is the delegation of salary management and the transition to individualised salary management.

Another aspect of the current reality is that employees need to know as much as possible about plans for the near-term future and what they can expect. Studies show that future anticipated actions have more impact on

morale than recent events. When change is handled in union-management discussions, direct communication with employees sometimes does not receive adequate attention.

The influence of unions often extends beyond the scope of a labour agreement and affects decisions – for example, on the pattern of increases (or cuts) – relating to non-union employees as well. That can be a problem if talent competitors are offering larger increases or better benefits for jobs not covered by the agreement.

Each country's fiscal and political considerations are of course different and present different challenges for union-management relations. Unions will continue to play an important role in virtually all OECD member countries, but it appears the next few years will be toward a period of transition.

Government leaders will have to define the role of unions. Sweden has shown that unions can play a vigorous role in maintaining a responsive, flexible salary programme.

Box 4.2. Sweden's approach to pay planning

Sweden has a somewhat unique approach to working with national unions and to pay planning: a “constructive climate” that has moved relations “from debate to dialogue”, and “from confrontation to agreement”.

Agencies have a delegated responsibility for human resource policies, but with required co-operation and co-ordinated approaches to negotiation, and productive relations with unions and employees. Agencies receive an appropriation that is adjusted automatically based on price and labour cost increases.

They negotiate national agreements governing working conditions, pay policy, pensions, job security and co-operation, and also have local agreements governing the basis for individual pay decisions and local working conditions. Management and the unions agree that, “Local pay formation is the right way to go.” It is at the local level that individual contribution and local needs are understood. The senior negotiator for the Union for Professionals has stated, “Central solutions become too general and cluster the members of staff into a collective.”

The country ended the use of traditional pay scales in 1990 and now relies on individual pay setting based on the difficulties and responsibilities in the job; the market situation; and the performance of the employee. Pay setting depends on the dialogue between the manager and a subordinate. When they fail to agree, the issues move to local negotiation between the employer and the union. The system works well, is accepted in Sweden, and is supported by extensive statistics produced by employers and/or the trade unions.

Source: Information provided by Robert Cloarec, from the Swedish Agency of Government Employers.

Considerations in using labour market surveys to inform salary planning

Private sector employers commonly base their budgets for salary increases on analyses showing the increases necessary to remain competitive. Surveys are conducted each year in many countries that support market analyses.

An alternative is the use of data related to living costs or inflation rates. There are, however, problems or questions that have prompted private sector employers to downplay the use of inflation rates. Those are discussed later in this section.

All employers, including those that involve unions in decision making, should feel obligated to make informed decisions that can be justified to stakeholders. For government employers, that now clearly includes the public.

The need for information related to labour market trends is universal and central to the goal of remaining competitive. However, surveys vary significantly in quality. And quality is directly related to the time invested by participating organisations in compiling the information. That does not mean surveys are not useful, only that care is needed in their selection and use.

Surveys are open to several criticisms. All salary surveys are based on the matching of an employer's jobs with so-called "benchmark" or generic jobs found commonly in many organisations. This matching is always suspect and too often performed by lower-level human resource specialists who have no direct knowledge of the jobs. That is a data quality issue. A second problem for public employers is that they are competing with a broad spectrum of other employers, and the survey participants should really be a representative sample of the other public employers.

Actually, each occupation has a somewhat different labour market. For example, the employers competing for economists are not the same as those in the market for accountants. It would be virtually impossible for a single survey to cover all occupations and generate 'valid' survey data. The spectrum of government occupations is far broader than that relevant to the typical private corporation. That complicates the selection and use of surveys.

Box 4.3. Japan's plans for an autonomous labour-employer relationship

In response to the changing socioeconomic and political climate, in 2008 Japan's government enacted the Civil Service Reform Law, which reformed the compensation system for national public service employees. Under the current system, a third party organisation formulates a series of recommendations to the Cabinet and the Diet to establish salary levels equivalent to those in the private sector. Under the proposed new system, salary levels as well as other working conditions will be decided on the basis of autonomous labour-employer negotiations. The intention is to build a sense of ownership among employers and employees and to allow personnel to take part in the process of determining working conditions. The system is expected to foster the motivation and abilities of personnel, secure a skilled workforce, and provide efficient and high-quality government services.

The reform contains three major proposals. First, it would grant the right to conclude collective agreements to the majority of national public service employees; to that end the government drafted the Act on Labour Relations of National Public Service Employees. The act refers to procedures for, and matters to be handled by, collective bargaining; the validity of collective agreements and stipulation of the obligations incurred therein; procedures for conciliation, mediation and arbitration of labour disputes, to be conducted by the Central Labour Relations Commission; and prohibition and examination of unfair labour practices.

Secondly, the reform proposes an employer organisation to revise and improve the functioning of public structures and operations. To this end, the Japanese government drafted an act to establish a Civil Service Office. The Office will have responsibility for the overall personnel management and remuneration system, and undertake negotiations with labour unions as the employer.

Finally, it is proposed to abolish the third party organisation (National Personnel Authority) and at the same time establish a new third party committee (Personnel Fairness Committee) under the jurisdiction of the Prime Minister. This committee will be responsible for ensuring fairness in personnel administration; dealing with personnel complaints and restrictions on personnel regarding political or commercial activities; and providing relevant ministers with recommendations for improvements to personnel administration.

The National Public Service Employees Law is to be revised to accommodate measures relating to the autonomous labour-employer relations system.

Source: Presentation given by Bunzo Hirai and Yoko Numata, government of Japan, during the Public Employment and Management Network meeting, 7 November 2011.

There is a common political problem in using survey data. Government employers generally are in competition for talent with the larger companies, particularly positions in government contracting and outsourcing. For political reasons, however, there is often pressure to survey from a broader range of employers – and generally, the small “mom-and-pop” businesses that account for a high percentage of employers (possibly as high as 90% have fewer than 10 employees) are not relevant. Furthermore, in every country a high percentage of the workforce is employed in non-professional jobs not found in government (e.g. restaurants, hotels, retail establishments). Those businesses typically pay lower salaries and benefits. But of course, politicians often want those employers included in surveys.

Actually the differences in the labour markets relevant to government are a focal concern in salary planning, in terms of harmonising increases. On the one hand, government needs engineers and technology specialists along with other high-demand jobs and is competing with corporations that will pay whatever is necessary to hire the talent. At the same time, government agencies have many jobs that are found only in government, and that limits the demand. To illustrate the problem: differences in demand are pushing up the salaries in healthcare. If the average market increase for nurses is 6% and for clerical support jobs the increase is 3%, an average 4.5% increase is not competitive for the nurses but above market levels for the clerical support jobs. For employers concerned with payroll costs, the latter is an unjustified cost.

Dynamic labour markets and policies that focus on competitive practices compound the problems for government employers. First, there is the need to respond to labour market trends in order to remain competitive for the high-demand fields, even though (as pointed out above) there are a good number of jobs limited to the public sector for which there is generally less pressure on wage and salary levels.

Government employers can of course decide to grant pay increases for all employees that reflect trends in the private sector, knowing this will help in competing for talent but also knowing it will increase payroll costs. The alternative is to pay all employees at “government rates”. However, this could lead to lesser-qualified workers in high-demand fields, and also make it necessary to rely on contract workers in those fields if below-market salaries make recruiting difficult. Another alternative is to create separate salary structures for high-demand occupations. That might mean, for example, having a separate technology pay programme. There is a longstanding tradition of separate programmes for certain occupations (e.g. teachers and law enforcement).

A second labour market problem stems from the pay for government executives, middle managers and senior professionals. The compensation provided for elected officials and high-level appointments are commonly limited by political considerations and below-market levels. The typical point of comparison is the compensation “package” of business leaders and lawyers. This “ceiling” on government salaries contributes to what is referred to as “wage compression”, which is to say the differences in pay between tiers or levels in a government organisation is less than in comparably sized companies. The obvious result is that the compensation of government executives is below the levels paid to their counterparts in the private sector, and the compression cascades through the management ranks. That can make it difficult to attract and retain the most qualified individuals.

Concerns in using inflation data to adjust salaries

The use of inflation data goes back decades. The policy has been included in numerous labour contracts. The contracts, where the acronym “COLA” is widely understood to mean cost-of-living allowance or adjustment. Reliance on COLA adjustments provides a degree of certainty that pay will increase. The idea is deeply entrenched in labour history.

The idea is also widely used in foreign service pay programmes, since the cost of living and living standards vary widely. The use of cost-of-living adjustments allows the employees in these fields to maintain a somewhat lifestyle comparable to that in their home country regardless of post location. Travel allowances of course also reflect city-to-city differences.

There is a big “however” here though, since inflation and pay increases are driven by different economic forces. They tend to be correlated and the movement of both is generally positive, but the fact that they move in the same direction does not indicate causation.

All employees naturally want to maintain or improve their standard of living, and so naturally react to cost increases. The logic of salary adjustments based on increases in living costs is intuitively reasonable. In periods of high inflation, employers respond for a time by granting large increases; that happens periodically all over the world. The interest in cost-of-living increases is highest in periods of high inflation but often forgotten when costs are stable. The “however” is that remuneration levels within a large organisation like a government agency vary widely, along with individual spending patterns. Overall inflation rates are never a perfect measure of how living costs impact individual employees or their families. The age of a couple, the number and age of their children, and many other factors determine their actual living costs.

For years, salaries increased in most countries at a slightly faster rate than inflation. With the retirements expected over the next decade or so, shortages are anticipated in some occupations. Those dynamics will always govern salary increases, and presumably drive up salaries.

In the private sector, businesses worry about cost increases and remaining competitive. If labour costs rise faster than necessary, that reduces profits. Relying on inflation rates is incompatible with any sort of strategic management of salaries.

Most major increases based on inflation could become a political issue for public employers if salaries rise faster than those in the private sector.

How to allocate amounts for salary adjustments

Market trends have implications for hiring as well as turnover: a recurring thread is that public agencies have trouble competing for specialised talent, and it is strong possibility that compensation is a contributing factor. Decisions to adjust salaries have important implications when budgets are tight, since they involve allocation of limited funds. The dominant practice is relying on across-the-board increases determined in collective bargaining or by a central office. That is changing, albeit slowly.

Salary planning involves two related but distinct decisions. With existing salary programmes, the first decision is on the amount to be budgeted annually for adjustments. Normally the focus is on the amount needed to remain competitive, but in the past two years the issue is ability to pay. The second decision is how to allocate available funds to employees; salary management is best viewed as an allocation question. Employers in all sectors need to know the funds are spent wisely.

The experience of the US government is illustrative of the problems arriving at acceptable answers when salaries fall below competitive levels. The US has adopted and tried virtually every approach to align salaries with market levels, but the critics are far from satisfied.

Box 4.4. Steps adopted to align the US government wage and salary programme with labour market pay levels

Critics contend that US federal employees are paid on average significantly more than that country's average private sector worker, and are eligible for better benefits. That is an accurate statement, but it ignores the fact that the composition of the US workforce has a much higher concentration of knowledge jobs, generally is older with more experience, and is concentrated in major cities where pay is generally higher. The comparison of simple averages has been cited over the past year in a number of media reports, which has fed concerns with the cost of government.

The US government has two core compensation programmes – the General Schedule (GS) salary system covering “white collar” workers, and the Federal Wage System (FWS) covering “blue collar” workers. The GS system is one of the oldest essentially unchanged government salary systems in the world. It was created in 1949 as the merger of several existing pay programmes, and now covers almost 1.5 million employees.

The Federal Wage System covering manual or blue collar jobs was created in 1972 and covers 200 000 workers. It is actually a series of separate wage schedules in over 250 locations. Wage rates are aligned with local private sector pay rates and adjusted each year based on local area surveys. Each local area has a joint labour-management council that administers the programme. One of the important aspects is that since each area is separate and locally administered, the media and critics do not see the total cost, and as a result scrutiny has been minimal.

The primary change in the GS salary system was the introduction in 1990 of locality pay schedules in 35 major cities. This was necessary because federal agencies were finding it impossible to hire qualified people in high-cost cities like New York and Los Angeles. As originally adopted, the locality pay adjustments were based on surveys comparing federal jobs with so-called “benchmark” jobs at each grade level. That practice was discontinued in the mid-1990s when the survey agency switched to a methodology that generates an overall index of pay increases. The new data make it impossible to show comparative job-by-job data. It has now been 15 years since job-specific data were generated, and that contributes to the critics' concerns.

Legislation enacted in 1978 authorised agencies to “experiment” with demonstration projects based on alternative pay systems. There are now roughly 20 “demos”, although several are in the Department of Defense. Virtually all have been based on performance-related pay within a salary band framework. All have been more or less successful.

Box 4.4. Steps adopted to align the US government wage and salary programme with labour market pay levels (*cont.*)

In addition, another 380 000 workers are paid under separate multi- or single-agency pay programmes. This includes an assortment of agencies, particularly those that regulate the financial industry. A large group of healthcare specialists are also paid under a separate programme. These programmes were created in part to provide greater flexibility needed to compete for talent.

The Office of Personnel Management (OPM) is, moreover, authorised to approve “special rates” when a local agency office experiences problems hiring because of non-competitive pay. The list of occupations and locations now covered by special rates now is so long, a search engine has been added to help people look for approved rates. This of course runs counter to the local area salary schedules.

Finally, two government-formed companies prominent in the mortgage business, Fannie Mae and Freddie Mac, also have separate compensation systems. These programmes are not required to make salaries public. Executives are paid fully market-based compensation, which with the value of stock options can be significant. Both companies are under intense scrutiny because of their role in the mortgage crisis, and there is pressure to reduce or limit the pay of executives. Over what is now more than two decades, there have been proposals to replace the GS system with a market-based or market-sensitive, pay-for-performance programme. Those replacement proposals have not stopped with the recession.

Unions play a formal role in the annual process of collecting survey data and adjusting pay schedules (although collective bargaining on pay is precluded). Neither the unions nor the current government has developed data defending wage and salary levels. It is readily apparent at this point that the federal payroll will be reduced but how that will be decided is still being discussed. There is an argument for avoiding cuts that might prompt high performers to leave government. That would depend on assembling job-specific survey data relevant to salary planning, but that data has not been collected for almost 20 years.

Source: Data from Office of Personnel Management website, www.opm.gov.

There are several alternative policy formats for switching from a traditional step increase policy to performance-related pay. These alternatives assume that remaining unchanged is a big cost. Budget comparisons should focus on all new funds added to payroll, including step increases and promotional increases.

An important and perhaps obvious point is that granting an above-average increase (or bonus) to one employee necessarily means reducing the

funds available for other employees. That makes performance pay a “zero sum” problem.

A related point is that performance pay cannot satisfy every employee. The clear intent is to recognise and reward the best contributors. Their satisfaction is presumably a priority if the government is to avoid losing them. The alternative policy formats include:

- Setting aside a small percentage of funds budgeted for adjustments, as a pool to be granted as bonus payouts to high performers. This is the simplest policy. If the planned adjustment is a 3.5% increase, setting aside 0.5% and limiting the bonuses to 25% of the workforce can bring the average award to 2.0% on top of the 3.0% general increase. Bonus payments can of course be combined with any salary increase policy.
- Varying the usual step increase policy. Dividing the steps in half doubles their number. For example, a 3% step becomes two 1.5% steps. The number of steps can be linked to performance ratings. An outstanding performer, for example, might move up three steps, an average performer two steps – or one of the original steps, and so on.
- Defining the allowable percentage increase permitted at each performance rating level (*e.g.* a “5” rating might warrant a 6% increase and a “4” a 4.5% increase). This is a more aggressive performance pay policy, straight out of the textbooks. A key is that the aggregate of all increases should not exceed the budget for increases. That means managers need to consider the ratings and increases for each employee in the same time frame. It also means managers have to manage the ratings to some degree. Experience shows that the most difficult problem in defining the policy is reaching agreement on how to handle poor performers. Denying them an increase makes more funds available for the better performers.
- Using what is referred to as a “merit matrix”, a more complex policy. The idea combines the usual performance pay policy with the theory of learning curves. Typically, a newly hired or promoted employee increases his or her value faster in the first few years as they learn the job. At some point their rate of learning slows down and plateaus. A pay policy that recognises an employee’s value should logically follow that pattern. The idea is captured in a matrix where performance ratings are on one side and position in the salary range is on the other. In the textbooks, “position in range” is typically defined by the ratio of the salary to the salary grade

midpoint. Thus a ratio of 0.9 is below the midpoint and 1.10 is above midpoint. With this approach the policy planners have to decide what percentage increase to permit in each cell. Those employees who are lowest in the range and high performers warrant the largest increases. A final point is that this approach works best in a programme where the midpoints have a somewhat consistent meaning, such as alignment with market pay rates (Risher, 2009).

Each of these basic formats can be defined in almost endless variations. Significantly, each defines the permissible increase so employees know what they can expect.

In planning an increase policy, the general assumption is that the distribution of ratings one year is the best estimate of the ratings for the next year. That is to say, if 30% of the workforce was at the highest level, the best guess for the next year is again 30%. This assumption makes it possible in planning to allocate the available increase funds, and test different increase schemes.

It is tremendously important to communicate the organisation's compensation philosophy, especially when there is a change in policy. Experience suggests the transition to performance-related pay – perhaps most difficult change initiative for a public employer – should be managed as organisational change. Experience also shows that the reason these initiatives sometimes fail is that managers are not fully committed to performance management. Communication must be ongoing.

As a final point, the best practice is to undertake a rigorous review of how the policy is working after each round of increases. Another meaningful “safeguard” is to rely on the calibration committees discussed earlier to review proposed increases. That provides employees with greater assurance that the policy will be managed consistently. Employees want to know the organisation is committed to making the new policy a success.

Planning and managing additional payments: allowances and bonuses

All cash payments should be assessed to determine if the practice of planning and managing allowances and award policies are contributing to the functioning of government. Allowances in some countries were justified years ago by circumstances but now are simply an added cost. Bonuses are often best described as deferred base pay, with only vague ties to performance. Expenditures may be warranted by competitive practice or to enhance performance, but it may be that the cost is not justified.

Box 4.5. The United Kingdom's plans to shift to locality pay

The UK government announced in late 2011 that employees of the Civil Service Departments (central government) and their executive agencies would shift to Local Market Facing Pay (or locality pay) from 2012.

Plans are being developed for the transition to the new policy. When they are approved, departments and their agencies will again be permitted to grant limited salary increases following the end of the current pay freeze which went into effect in 2011 as a result of the economic crisis.

The change in practice will affect roughly 470 000 civil servants, including 4 000 members of the Senior Civil Service (SCS).

The change in policy also affects wider public sector workforces, including the National Health Service (NHS) and teachers.

Source: Information provided by David Livingstone from the Efficiency and Reform Group, Cabinet Office, United Kingdom.

In many OECD countries, allowances were established years ago. They can serve a valid purpose when planned to recognise specific job issues such as hardship duties and remote area assignments. In some cases they would be better defined as a one-time bonus (e.g. recruitment) or additional pay for night or weekend work duties, or second language capabilities. Assignments in high-cost areas would be better defined by locality pay and based on prevailing market rates (since that places employees on a par with residents of the area). Other payments (e.g. family allowances) reflect national values but may be difficult to justify as job-related. In today's environment, all payments need to be justified.

To reiterate from the discussion of executive compensation, bonuses in government are generally based on ex post facto assessment of performance. The recipient cannot be certain of the award until it is announced. The practice is widely used, but realistically little evidence has been developed to confirm that payments are justified as contributing to improved performance. When the rationale for an award is unclear or not communicated, it can be a source of irritation to everyone who feels they are more deserving.

Box 4.6. Allowances and bonuses paid to public employees

Additional payments refer to the total of all allowances and bonuses paid to public employees which may take the form of:

- *Guaranteed and regularly paid allowances* which refer to allowances for working away from home or in hazardous circumstances, expatriation allowance for working abroad, overtime payments, cost-of-living allowances, and housing allowances to cover the cost of travel to and from work, but excluding social benefits.
- *Remuneration for time not worked* make reference to annual vacation, other paid leave, including long-service leave; public holidays; other time off granted with pay (e.g. birth or death of a family member, marriage of employees, union activities, etc.).
- *Bonuses and gratuities regularly paid* refer to year-end and seasonal bonuses; profit-sharing bonuses; and additional payments in respect of vacation, supplementary to normal vacation pay, and other bonuses and gratuities.
- *Bonuses and gratuities not paid in a regular fashion* (performance-related pay) refer to ad hoc bonuses or other exceptional payments linked to the overall performance of the employee to which he/she may be entitled.

Source: OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, DOI: 10.1787/22214399.

The typical bonus is small, possibly the equivalent of two or three days' pay or less. The textbooks refer to small awards as "spot" bonuses, since the awards are often made by a supervisor immediately after an achievement. The award then carries recognition value as well.

There are countries where bonus awards are significantly larger. Those payments should be evaluated routinely to confirm that the practice contributes to the achievement of goals. When the payments in the aggregate become significant, they should be added to salaries for comparisons with market pay levels.

In government it makes sense to provide for equal budget percentages across work groups. It would also be important to clearly define the rules governing eligibility, the possible size of awards, and the reasons for considering employees for awards. If employees and their motivation are to

be influenced by the prospect of an award, they must know what they need to do to be considered. And the reasons for the awards should be communicated to everyone.

Awards can range from the single recipient “employee of the month” to group or team awards (the latter were discussed previously). That is dependent on the purpose and the culture.

When problems arise it is usually because the decisions are made by a manager or supervisor who is seen as unfair for whatever reason. That suggests that all awards be reviewed by a committee. Even if the amounts are as small as a dinner for two, employees want to know they can expect to be treated fairly. Problems also arise if the same individuals are recipients year after year. That can contribute to a sense of entitlement, or (more importantly) raise questions about favouritism and bias.

Even with such problems however, few employees would want to see bonuses completely eliminated. They are unlikely to complain, even when they do not understand the reasoning.

Setting the stage for total rewards management

The phrase “total rewards” is used to refer to job characteristics that make the work situation attractive to employees. It encompasses the elements of total compensation discussed earlier and adds a long list of non-financial rewards. It recognises that people work for reasons other than pay and benefits.

The idea is especially important to those employers, including government, that may not pay fully competitive salaries, because it highlights non-financial rewards. However, the idea is relatively new and has not received much attention from government policy makers.

The satisfaction of public service is a unique reward high on the wish list for many government employees. The topic is discussed more often in the context of elected officials and senior executives, but it clearly is important in many public sector occupations. Satisfaction can be a source of motivation, and is triggered by serving a purpose that benefits society.

Also prominent on the list are options for providing increased work-life balance. The possibilities include flexible work hours, unpaid time off, time to provide care for family members, and opportunities for community involvement.

A different set of rewards are those related to individual development and career advancement opportunities. These include training, support to participate in outside seminars and conferences, tuition reimbursement, on-

the-job rotational assignments, sabbaticals, career coaching and planning, mentoring, and opportunities to acquire knowledge of state-of-the-art techniques. The underlying aspect is a culture that encourages and supports continued learning.

A related set of rewards stem from recognition that employee efforts are valued and important to the achievement of organisational goals. This starts with the performance management system and feedback from a supervisor on the individual's contribution. A variety of recognition practices can be involved. This meets an inherent need for achievement and appreciation, and contributes to a sense of self-worth.

One of the more nebulous but fundamentally important desirables for many people is a culture of respect and a sense that employees are valued members of the work group.

An issue prompted by the recession is the importance of job security and the psychological comfort that follows from the absence of stress related to the possible loss of a job and income. Research shows that employee stress is more closely related to anticipated future actions than to recent events.

The challenge for all employers is to create a management climate that maximises the total rewards of the work experience. The current climate, with its budget cuts and downsizing, makes this an ideal time to focus on practices that have little or no cost. Significantly, experience shows that many managers do not recognise the value of non-financial rewards, and are thus reluctant to use them in day-to-day supervision. The focus on total rewards is a subject that should be inculcated in management training and reinforced by the management philosophy.

The pay-off for employers is the enhanced performance of employees committed to the organisation and its success. When ignored or poorly managed, pay-offs can contribute to increased turnover, absenteeism or acts of non-cooperation. A first step might be to create a task force to consider current reward practices and to identify ways to make better use of non-financial rewards.

Conclusions

Compensation of public officials is always a controversial issue, and even more so during times of austerity. Transparency and fairness seem to be the main elements that should govern compensation planning. Governments need to justify their decisions regarding raising, reducing or freezing salary levels. Involving unions and their members in discussion options for restructuring helps reduce resistance to change. Employees need to know as much as possible about plans for the near future and what they

can expect. That also helps manage stress in the organisation, as employees tend to be more anxious about future actions than to present ones. To inform salary planning, governments have alternatives such as market surveys and inflation data. But the tradeoffs involved need real consideration, as there may be political problems with them.

When planning salaries, governments need to budget annual adjustment amounts that they can afford and decide on how to allocate the available funds. Governments also need to plan carefully for allowances and rewards. These two items were justifiable in the past, but in the current circumstances they are becoming an added cost. Experience suggests that in planning, fairness is the best possible policy. This is because performance pay cannot satisfy every employee.

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Chapter 5

Key considerations in reforming the government compensation system

With agencies now forced to restructure and “do more with less”, ensuring continuous employee commitment has become a priority. Given that employees have to perceive changes positively, it may be that a new compensation system should be implemented in stages. It is recommended that projects to replace existing systems involve five phases: i) confirmation of the need for change; ii) collection of evidence for decision making; iii) planning and development of the new system; iv) implementation; and v) evaluation. Prior to implementation, top management should commit to system assessment at the end of each year, and to correcting problems as soon as they are detected.

Compensation is a core element in the psychological contract with employees. In the past, government compensation systems were certain, inflexible and unresponsive to labour market and organisational developments. Employees knew absolutely what they could expect. Now when compensation levels are frozen or reduced, prospects for future increases diminished, and/or new policies perceived as unfair, the changes can undermine employee engagement and performance.

Now, with agencies forced to restructure and “do more with less”, ensuring continuous employee commitment has become a priority. If mishandled – to borrow a phrase from the Gallup Organization and its workforce studies – employees may become “actively disengaged”

When traditional close supervision is replaced with greater autonomy and freedom to act, employees can perform at significantly higher levels. Pay can be a positive tool to reinforce desired behaviours and establish a “line of sight” to focus on organisational goals. Change is always difficult to accept, however, and needs to be managed with an appreciation for the impact on the psychological contract. Employees have to perceive changes in the system positively if those changes are to serve as incentive.

Reforming compensation systems requires an understanding of what to emphasise and what to avoid so as to minimise the potential for problems and build support for the new system. Planning and implementing a new compensation system, especially where performance is for the first time a consideration, is possibly the most complex organisational change an employer can undertake. The new programme will affect the relationship each manager has with his or her employees. Managers will benefit from support in mastering new skills.

One of the overriding issues is the readiness for change. It may be that a new compensation system should be implemented in stages. If the system is to reward employees for performance, it is essential to ensure that the performance management system is seen as credible and fair. Under any circumstances, employees need to understand the planned endpoint – the nature of the new system. They need to know what to expect and the planned steps in the transition.

The experience of OECD countries on compensation highlights four key considerations in designing more effective compensation systems:

- *Use the compensation system as a management tool* – If there is a common trend in the management of employees, it is a paradigm shift from rule-based governance and rule obedience to managerial discretion and accountability for results. The compensation system

can be an important tool for managers in the new paradigm, especially when responsibility for the pay is decentralised.

- *Incorporate flexibility into the new compensation system* – In contrast to the stability of the past, as the fiscal issues are addressed, public employers will be forced to reorganise and restructure work processes. Traditional pay programmes are likely to be an impediment to necessary changes. If problems are anticipated, the pay issues should be addressed as early as possible.
- *Use the compensation system to influence employee behaviour* – One purpose of compensation is to influence employee behaviour – to accept a job offer, to work diligently and, for the better performers, to commit to careers with their employer. New policies and practices should be evaluated in terms of the projected impact on employee behaviour throughout the transition.
- *Use the compensation system to improve performance* – Planning for the transition to a new pay programme should include considerations of how it will influence employee performance, both in isolation and in combination with other practices. These practices should send the message that performance is a priority.

Compensation systems in government generally have a long history and numerous stakeholders. Until now, “new” systems have rarely been new; the framework may change but current salaries and the internal hierarchy (or relative salary levels) have continued, with minor change, in a replacement system. The decision to truly replace or significantly modify a compensation system in the wake of the financial crisis is bound to be highly political. The monetary cost is naturally a contentious issue, but one that should be manageable in planning. Possibly more costly is the potential damage to working relationships and anger toward the organisation and its leaders.

To avoid or minimise possible problems and build support for change, it is recommended that projects to replace a compensation system be planned to incorporate five phases:

1. Confirming the need for change

As one of the early steps, it would be advantageous to evaluate the existing compensation system – to identify and convey problems to confirm the need for change, but also to decide if components of the existing system should be continued. Focus groups composed of managers are a simple but proved strategy to develop the needed understanding. Another alternative is the creation of a task force composed of representatives from the more prominent stakeholder groups. The members would be responsible for reviewing relevant information and making planning decisions. It is critical

to develop a communications strategy to keep employees and stakeholders informed of plans and progress. Everyone needs to know what they can expect as the project unfolds.

2. Collecting evidence for decision making

A related early step should be an assessment of how salaries compare with the pay of similar jobs in the private sector. It is important to know which jobs are underpaid as well as any that are paid above market levels. It is especially vital to identify essential occupations with which agencies have reported recruiting or turnover problems. Market data will be needed to reconfigure the salary grades or bands.

Given the importance of evidence-based policy decisions, it may be useful to study “best practices” in other countries. While there are no “textbook” answers, there are core principles and proved practices. Initiating a search for best practices sends the message that there is a commitment to develop a truly first-class system. Perhaps more importantly, there should be an attempt to understand the mistakes made by other countries.

3. Planning and developing the new system

The planning should involve both managers and employees. They need to “live with” a new system that will affect everyone’s career. Their involvement should be more than superficial town hall-style meetings. Experience shows that their buy-in is essential. The first issue for them to consider is developing a consensus on the nature of the system that will best meet the near-term needs of government.

Government leaders, with background information and input from unions as well as stakeholder groups, should define the goals for a new compensation system along with a statement of compensation philosophy. Everyone should agree on how the new system will serve the needs of government. The goals presumably will include cost savings, transparency, and improved government service. Managers and employees need to understand the goals. The public also needs to understand how the new system will serve the country.

Other basic questions need to be discussed: i) the role and responsibilities of the central Human Resource office in programme administration, ii) the roles of managers and other individuals involved in programme administration, iii) the decisions delegated to managers, iv) the relative importance of performance, v) the degree of planned alignment with market pay rates; and vi) the process and criteria to be used to assess the programme. The answers to all of these questions should be agreed upon.

While developing the new system, several technical issues need to be considered:

- The salary schedule or structure needs to be defined to encompass the lowest- and highest-paid jobs. The number of grades (or bands), their format, and size of steps (if any) need to be decided.
- A decision process for assigning jobs to grades needs to be developed and tested. As a rule, the most prevalent jobs are used in the development and testing. Agreement needs to be reached on “correct” grades.
- Policies, regulations and administrative procedures need to be drafted.
- Credible market data need to be collected.
- The cost for full implementation needs to be estimated and final approval secured.
- Training material for managers and employees needs to be developed.

4. Implementing the new system

It will be advantageous to create a Project Management Office (PMO) or task force, staffed with a group of people who can devote time to the work of planning and implementing the new system. The PMO team should report to a senior government leader – this needs to be seen as an important project – and staffed with credible senior, recognised specialists. Their composite expertise should include: salary management, training, employee and union relations, change management, technology, law, history of the current system, and public relations. It is a mistake to manage the changeover as an HR project or staff it with people whose ongoing responsibilities will always be their first priority. The cost of the office may be a concern, but it is justified by the problems that could be caused by the failure of a new compensation system.

One of the current trends is the delegation of day-to-day programme management to agencies and to their managers. That will require agreement on what agencies and policy makers can and cannot control. It also prompts the need to decide how inter-agency comparative analyses will be carried out. The role of managers will also have to be redefined, and steps taken to prepare them for this new role.

In implementing the new system, other issues need to be considered:

- The first step should be a review of job descriptions. Employees should have an opportunity to confirm the accuracy of their description. This work can start early in the project.
- Jobs then need to be assigned to salary grades or bands using the preferred methodology. All grade assignments should be reviewed by committees.
- Each employee's salary will need to be positioned in new grades based on time in position.
- If performance-related pay is adopted for the first time, it will trigger a need for manager and supervisor training and a review of the performance management process.

5. Evaluating the system

As the plan evolves, the administrative workload should be evaluated. This is staff time as well as the time that managers will need to devote to salary management. It is essential that adequate time and resources be committed to managing a new system. Any policies that are expected to need added resources should be reconsidered. The delegation of programme management will require relevant training.

Finally, prior to implementation, top management should commit to evaluating experience at the end of each year, and to correcting problems as soon as they are detected. A suggested strategy for assessment is to start with a survey of managers and employees and discuss the results in focus groups. There should also be an assessment of administrative costs. Changes will undoubtedly be needed.

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Annex A
Extent of union involvement in HRM issues and sources of financial support, 2010

	Base salary/ Social benefits	Additional remuneration and performance pay	Right to strike/ Minimum service	Work conditions (number of working hours, part- time work)	Employment framework (statutory rules, etc.)	Code of conduct	Introduction of new management tools	Government restructuring (delegation, institutional change, changes to the budget process)	Funding of civil service unions
Australia	●	●	●	●	●	○	●	○	No public funding
Austria	○	○	n.a	○	●	●	○	○	No public funding
Belgium	●	●	●	●	●	●	●	○	Partial public funding
Canada	●	●	●	●	●	●	●	n.a	No public funding
Chile	○	○	n.a	○	●	●	●	n.a	No public funding
Czech Republic	●	●	●	●	●	●	●	●	No public funding
Denmark	●	●	●	●	●	●	○	○	No public funding
Estonia	○	○	n.a	○	●	●	●	○	No public funding
Finland	●	●	○	●	●	●	●	●	No public funding
France	●	●	●	●	●	●	●	●	Partial public funding
Germany	●	●	n.a	○	●	●	n.a	n.a	No public funding
Greece	○	○	●	●	●	●	○	○	Partial public funding
Hungary	●	○	●	●	●	●	●	○	Mostly public funding

● Agreement with union is mandatory ● By law, union must be consulted ○ Consultation with union is voluntary ○ Union not normally involved in negotiation process

	Base salary/ Social benefits	Additional remuneration and performance pay	Right to strike/ Minimum service	Work conditions (number of working hours, part- time work)	Employment framework (statutory rules, etc.)	Code of conduct	Introduction of new management tools	Government restructuring (delegation, institutional change, changes to the budget process)	Funding of civil service unions
Iceland	●	●	● ●	●	● ●	●	○	○	No public funding
Ireland	○	○	○	○	○	○	○	○	Partial public funding
Israel	●	●	●	●	●	○	●	○	No public funding
Italy	●	●	●	●	●	●	○	●	Partial public funding
Japan	●	●	n.a	●	n.a	n.a	n.a	n.a	No public funding
Korea	○	○	○	○	○	○	○	○	No public funding
Mexico	●	●	●	●	●	●	●	○	No public funding
Netherlands	●	○	○	●	●	○	○	○	Partial public funding
New Zealand	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	No public funding
Norway	●	●	● ●	● ●	● ●	○	○ ●	●	Partial public funding
Poland	●	●	●	●	●	●	n.a	○	Partial public funding
Portugal	●	●	●	●	●	○	●	n.a	No public funding
Slovak Republic	●	○	○	●	○	○	○	○	No public funding
Slovenia	●	●	●	●	●	●	●	●	No public funding

● Agreement with union is mandatory
 ○ Union not normally involved in negotiation process
 ○ Consultation with union is voluntary
 ● By law, union must be consulted

	Base salary/ Social benefits	Additional remuneration and performance pay	Right to strike/ Minimum service	Work conditions (number of working hours, part- time work)	Employment framework (statutory rules, etc.)	Code of conduct	Introduction of new management tools	Government restructuring (delegation, institutional change, changes to the budget process)	Funding of civil service unions
Spain	n.a	n.a	●	●	●	●	○	○	Mostly public funding
Sweden	●	●	●	●	●	○	○	○	No public funding
Switzerland	●	●	●	●	●	○	○	●	No public funding
Turkey	●	●	○	○	○	○	○	○	No public funding
United Kingdom	●	●	○	●	○	○	○	○	No public funding
United States	○	○	○	○	○	○	○	○	Partial public funding
Brazil	○	○	○	○	○	○	○	○	No public funding
Russian Federation	n/a	n/a	n/a	○	n/a	n/a	n/a	●	Partial public funding
Ukraine	●	●	○	●	●	●	●	●	No public funding

● Agreement with union is mandatory ● By law, union must be consulted ○ Consultation with union is voluntary ○ Union not normally involved in negotiation process

n.a.: Not available.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Data for Luxembourg are not available.

For further country-specific information as well as details on the methodology and factors used in constructing the index see Annex E at: www.oecd.org/gov/indicators/govataglance.

Source: 2010 OECD Survey on Strategic Human Resources Management in Central/Federal Governments (information obtained from responses provided by countries for questions number 108 and 109).

Annex B

Salary negotiations and determination of pay, 2010

	Remuneration based on independent examining committee	Remuneration based on recommendations of the president/prime minister, etc.	Centralised collective bargaining between government and unions			Decentralised collective bargaining within the limits of the allocated payroll of envelope			Individual bargaining	Pay indexed to other variables			Frequency of salary negotiations or revisions		
			A single, comprehensive negotiation for the entire central/national/federal government sector	Negotiations at the central level, with adjustments by department/sector	Negotiation at the central level, with possibilities of adjustments at the decentralised level	Single negotiation by sectoral branch	Negotiation by branch, with adjustments at the decentralised level	Decentralised negotiation		No	Yes, to inflation	Yes, to other variables	Annual	Every two years	Other
Australia	-	-	●	-	-	-	-	▲	-	●	▲	-	-	-	-
Austria	-	-	●	-	▲	-	-	-	-	●	▲	-	●	-	-
Belgium	-	-	-	●	-	-	-	-	-	-	●	▲	●	●	-
Canada	▲	-	●	▲	-	-	-	-	-	●	▲	-	-	-	●
Chile	-	-	●	▲	-	-	-	-	-	-	-	-	●	-	-
Czech Republic	-	-	●	-	-	-	-	▲	▲	●	▲	-	▲	-	-
Denmark	-	-	●	-	-	-	▲	▲	●	-	-	●	▲	-	▲
Estonia	-	-	-	-	-	-	●	▲	-	●	▲	-	▲	-	-
Finland	-	-	-	-	●	-	-	▲	-	●	▲	-	▲	-	●
France	-	-	●	▲	-	-	-	▲	▲	●	▲	-	▲	-	-
Germany	-	-	●	▲	-	-	-	-	-	●	▲	-	-	●	-

● Apply to Base Salary

▲ Apply to the range of possible bonuses

(-) Not Applicable

	Remuneration based on independent examining committee	Remuneration based on recommendations of the president/prime minister, etc.	Centralised collective bargaining between government and unions			Decentralised collective bargaining within the limits of the allocated payroll of envelope			Individual bargaining	Pay indexed to other variables			Frequency of salary negotiations or revisions		
			A single, comprehensive negotiation for the entire central/national/federal government sector	Negotiations at the central level, with adjustments by department/sector	Negotiation at the central level, with possibilities of decentralised level	Single negotiation by sectoral branch	Negotiation by branch, with adjustments at the decentralised level	Decentralised negotiation		No	Yes, to inflation	Yes, to other variables	Annual	Every two years	Other
Greece	•	▲	-	-	-	-	-	-	-	-	-	-	-	-	-
Hungary	-	-	•	▲	-	•	▲	-	-	-	•	-	•	-	-
Iceland	•	-	•	•	•	-	-	-	-	▲	-	-	-	-	•
Ireland	-	▲	-	-	-	-	-	-	-	•	▲	-	▲	-	-
Israel	-	•	•	▲	-	-	-	-	-	-	-	•	-	-	-
Italy	-	-	-	▲	-	-	-	-	-	▲	-	-	▲	-	-
Japan	•	▲	-	-	-	-	-	-	-	•	▲	-	▲	-	-
Korea	-	•	-	-	-	-	-	-	-	-	-	•	▲	-	-
Mexico	-	-	-	-	-	-	-	-	-	-	•	-	•	-	-
Netherlands	-	-	▲	-	-	-	-	-	-	▲	-	-	▲	•	-
New Zealand	-	-	-	-	-	-	▲	•	▲	▲	-	-	-	-	▲
Norway	-	-	•	•	•	-	-	-	-	•	-	-	•	-	-
Poland	-	•	-	-	-	-	-	-	-	-	-	•	-	-	-

• Apply to Base Salary

▲ Apply to the range of possible bonuses

(-) Not Applicable

	No salary negotiation		Centralised collective bargaining between government and unions			Decentralised collective bargaining within the limits of the allocated payroll of envelope			Individual bargaining	Pay indexed to other variables			Frequency of salary negotiations or revisions		
	Remuneration based on independent examining committee	Remuneration based on president/prime minister, etc.	A single, comprehensive negotiation for the entire central/national/federal government sector	Negotiations at the central level, with adjustments by department/sector	Negotiation at the central level, with possibilities of adjustments at the decentralised level	Single negotiation by sectoral branch	Negotiation by branch, with adjustments at the decentralised level	Decentralised negotiation		No	Yes, to inflation	Yes, to other variables	Annual	Every two years	Other
Portugal	-	-	●	●	▲	-	-	-	-	●	▲	-	●	▲	-
Slovak Republic	-	-	●	-	-	-	-	-	-	-	-	●	●	▲	-
Slovenia	-	-	●	▲	-	-	-	-	-	-	●	▲	●	▲	-
Spain	-	-	-	-	-	-	-	-	-	-	●	▲	●	-	-
Sweden	-	-	-	-	●	-	-	●	●	-	-	●	●	-	▲
Switzerland	-	-	●	-	-	-	▲	▲	-	-	▲	-	●	▲	-
Turkey	-	-	●	▲	-	-	-	-	-	-	●	▲	●	▲	-
United Kingdom	-	-	-	-	-	-	▲	●	-	●	▲	-	●	-	●
United states	-	▲	-	-	-	-	-	-	-	●	▲	-	●	▲	-
Brazil	-	-	●	-	-	-	-	-	-	-	-	-	-	-	-
Russian Federation	-	●	-	-	-	-	-	-	-	-	●	-	-	-	●
Ukraine	-	-	-	-	-	-	-	-	-	●	▲	-	-	-	-

● Apply to Base Salary

▲ Apply to the range of possible bonuses

(-) Not Applicable

How are base pay and the range of maximum bonuses negotiated?

* No information available for Spain and Ukraine.

Australia – Base salary and performance bonuses are set through enterprise agreements, negotiated at the agency level, under the Fair Work Act 2009. Belgium – The negotiations of all pecuniary advantages are negotiated for the federal level in a centralised committee. Having regard to some specificities in the departments or sectors, adjustments are possible and in that case, they are negotiated in the sector committees (joint sector committees composed of government representatives and unions). Canada – Negotiations are pursued separately for each of the 27 bargaining units that, between them, represent all of the unionised employees in the Core Public Administration (CPA) except for senior management cadre and members of RCMP. Separate agencies manage their own collective bargaining separately from the CPA negotiations. Chile – Only the President can present bills pertaining to the modification of civil servant remuneration. Nonetheless, there is an annual negotiation process to better sectorial salaries. Finland – The Senior Civil Service has a pay system of its own. The SCS pay system is designed and controlled by the Office for the Government as Employer. Germany – Civil servant pay (base salary and bonuses) is increased in line with the results of collective bargaining of public employees. Ireland – The Performance Related Award Schemes are applicable to certain senior grades (but not the most senior grades) in the Irish Civil Service. This Scheme was suspended in 2009 and no payments were made in respect of performances in either 2008 or 2009. Israel – The DWLA negotiates directly with teachers, government workers, and a portion of the health sector. Negotiations take place at two levels: the national level and the professional level. Netherlands – Annual salary negotiations are carried with trade unions about the remuneration system (scales, bonus-system, etc.). Poland – There is no collective bargaining in Poland's Civil Service. Portugal – In collective negotiations, trade unions give their opinion concerning the content of the measures, making demands that they deem fair and just. However, it is always incumbent upon the government to make the final decision in default of agreement, unilaterally imposing the position that is deemed more suitable. Sweden – Bonuses are not generally in use. Pay is connected to each individual employment, not to the actual post. Pay increases are negotiated either at the occasion of employment, annually, or when needed. The notion of base salary hardly exists. United States – Pay scales are established by statute, and adjusted by the president and/or congress. Bonuses are handled at the agency level. Commonly, there is no negotiation over wages or bonuses.

Pay indexed to other variables

Belgium – Some bonuses (indemnities or complements) are subject to indexation. Denmark – Base salary and bonuses are indexed to the development of pay in the private sector (pay adjustment scheme). Israel – Base salary could be indexed under certain negotiation schemes. Korea – Both base salary and bonuses could be indexed taking into consideration standard living expenses, inflation, and the average wage of the private sector. Netherlands – Base salary is indexed according to the evolution of salaries in private sector. Poland – Pay may be indexed to other variables (e.g. inflation) by parliament decision. Slovak Republic – Base salary could be indexed according to the evolution of salaries in private sector. Sweden – Base salary is not indexed. However, the increase of budget appropriations are indexed to several variables, like the pay increase in private white collar sector, cost increases of rents, etc. United States – Base salary is generally governed by changes in the Employment Cost Index, but that amount can be overridden by the president or congress.

Frequency of salary negotiations or revisions

* No country conducts a biannual (twice a year) negotiation.

Russian Federation – Salary negotiations or revisions are not established.

Belgium – Base salary revision can be every year or every two years depending on the function, level and period (starting of career, middle of career) of the public servant. Canada – In the case of unionised groups, negotiations for both base salary and bonuses are conducted every two to four years depending on the duration of the applicable collective agreement. Agreements often vary in duration. For unrepresented groups, a negotiation is conducted every year. Denmark – Negotiations for base salary are usually conducted at the central level every two to three years. Negotiations for bonuses are not decided at the central level (at least once a year). Finland – Base salary negotiation take place normally between one and two years. Iceland – For base salary, a collective agreement is made commonly every third-year period. Ireland – For base salary, negotiations are established by national agreements every two years as a minimum. Israel – Base salary negotiations are conducted every three to four years. Italy – Base salary negotiations are conducted every three years. United Kingdom – Base salary negotiations are conducted annually but departments sometimes negotiate multi-year pay deals.

Source: 2010 Survey on Strategic Human Resources Management in Central/Federal Governments of OECD Countries (information obtained from responses provided by countries for questions number 51, 57 and 58).

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Public Sector Compensation in Times of Austerity

Contents

1. Current trends in the compensation of public employees in OECD countries
2. Public sector compensation management in a changing world
3. Managing compensation in a post “New Public Management” era
4. Policies and practices governing public sector compensation planning
5. Key considerations in reforming the government compensation system

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