The regulation of executive pay across the European Union

Summary of an international comparative study by the European Institute of Public Administration, in cooperation with the Dutch Ministry of the Interior and Kingdom Relations

Introduction

Since the financial crisis in 2008 and the implementation of austerity measures, rewards for high public officials have once again come under intense scrutiny in various European countries, both in political arenas and public opinion. In the Netherlands, this resulted in the adoption of the Standards for Remuneration Act (in Dutch: Wet normering topinkomens), which entered into force on 1 January 2013. The act caps the remuneration of all high public officials of public and semipublic entities at the level of a national government minister's salary. In 2017, the cap amounts to € 181.000. Every system of rewards for public officials and their acceptance by society are determined by different cultural, economic and political factors.

These recent developments, and the excepted variety of executive pay systems across the European Union, were reasons for the European Institute of Public Administration (EIPA www.eipa.eu) to conduct a comparative study on the topic of the regulation of executive pay. EIPA conducted the study in cooperation with the Dutch Ministry of the Interior and Kingdom Relations between May 2014 and the end of 2016. The study focused on similarities and differences across countries regarding:

- political and societal debate and discourse on the issue of regulation of executive pay;
- policies and methods implemented by countries to regulate executive pay;
- remuneration standards and caps;
- the way regulation is organized and implemented in practice.

The study was conducted in three phases. It kicked off with an exploratory comparative inventory of the policies in the 28 EU member states, followed by a more in depth analysis of policies, methods, standards and the practice of regulation in eight member states (Netherlands, Belgium, Italy, Poland, France, Germany, Sweden and United Kingdom) and finally the deepening on executive pay regulation in Italy and Poland. The case studies were both chosen to provide an adequately balanced of current policies in the European Union, and to develop comparative insights, define possible best practices and draw lessons with regard to the Dutch situation.

This summary highlights the key findings of the study.

Two main policies for the regulation of executive pay

The study has shown that executive pay systems of EU member states have been subject to reforms in the last decade. In many of them, additional regulatory measures have been taken since 2008. Two main policies have been identified. The first is a cap on the salaries of high public officials, linked to various formal or informal reference points. The second is the introduction of performance-related pay. Some member states chose one of the two policies, others have combined them:

- About one-third of the member states have maintained their existing pay systems and have not introduced additional regulatory measures since 2008.
- Denmark, Finland and Poland introduced additional regulatory measures in the early 2000s. Another 16 member states followed after the onset of the economic crisis in 2008.
- In total, 11 member states were found to have implemented a binding cap policy in the public and/or semi-public sectors: Croatia, Cyprus, France, Italy, Ireland, The Netherlands, Poland, Portugal, Slovenia and Spain.

- Performance-related pay policies were found in 17 member states.

The political and societal debate about the regulation of executive pay and the arguments used vary greatly across member states. Nevertheless, two underlying perspectives can be identified in those debates. The first perspective pertains the call for efficient use of public funds and appropriate and moderate pay levels in times of economic crisis and austerity measures. Excessive rewards and bonuses cause public outrage and political attention, leading to a call for transparency and regulation of executive pay. The second perspective involves the competitiveness of the job market in the public sector versus the private sector and the need to attract qualified professionals and executives for government institutions. These perspectives seem to compete in each member state, at least to some degree. But, which one dominates over the other and which motives and arguments are used, varies across member states and may shift over time. The political and societal debates in eight member states have been analyzed in detail and are described in the PART I of the study.

Policies, methods and standards for the regulation of executive pay

A closer look at the eight member states (Netherlands, Belgium, Italy, Poland, France, Germany, Sweden and United Kingdom) in phase 2 of the study led to the following conclusions about the policies, methods and standards for the regulation of executive pay in those countries:

Public sector

- Most countries use a base salary for executives, defined by pay scales. Some countries regulate the degree of deviation from the base salary that is allowed, by defining multipliers, limiting variable pay components or a maximum percentage. This goes for Belgium, France, Germany, Italy, Great Britain and Poland. In Sweden, base salaries are periodically negotiated by an external expert committee.
- The Netherlands and Italy additionally introduced a pay cap by law, which sets an absolute maximum salary for executive public officials. In both countries, the cap is linked to the remuneration level of a particular function.
- Member states in which performance-related pay and bonuses are not extensively used, tend not to introduce additional regulatory measures. When very little deviation from base salaries as defined by pay scales is possible, there seems to be no need for a cap. Oppositely, member states where government institutions have greater autonomy in individually negotiating salaries with high public officials, more often take additional regulatory measures.
- Four out of eight member states do not use any form of performance-related pay for high public officials. Some of them are currently reviewing the possibility to introduce such a system.

Semi-public sector[1]

- Four out of eight member states implemented a cap to regulate executive pay in state corporations or non-governmental institutions (The Netherlands, France, Italy and Poland). The Netherlands en Italy linked the cap to a remuneration level of a particular function (just as they did for the public sector), while France and Poland use a multiplier system. In Poland, executive pay is capped at six times the average monthly salary in the private sector. In France, the maximum remuneration for executives is twenty times the average lowest salary paid in public corporations.
- Although more member states apply a cap in their semi-public sectors than in their public sectors, these caps often leave exemptions to certain positions or companies.

1 Drawing comparative conclusions about the regulation of executive pay in the semi-public sectors of the member states is more difficult, because these sectors vary greatly in definition and scope across various member states.

- Member states which do not apply a cap often use external committees to discuss and set executive pay levels. These committees vary in the level of independence from the national government and include cross-sectoral comparisons in their reviews.
- Systems for performance-related pay are more pervasive in the semi-public sectors of member states than in the public sector. They are used to both regulate and maximize bonuses and to provide incentives for good performance and to increase the competitiveness of the job market.

Recommendations with regard to the Dutch case

In phase 3 of the study, two cases were deepened: Italy and Poland, because these two member states have implemented a general remuneration cap with similar legislation as in the Netherlands. A few recommendations were derived with regard to the Dutch Standards for Remuneration Act, of course with the note that one should be careful to simply copy good practices from one system and context to another.

- To improve competitiveness of the Dutch (semi-)public job markets, more performance-related pay components could be introduced in pay systems.
- Furthermore, the percentage of resources devoted to performance-related pay components could be prescribed to ensure performance-related pay is actually implemented.
- Instead of using a standard as an absolute remuneration cap for all high public officials, the Netherlands could consider leaving the determination of standard to an external committee in which the interests of both employers and high public officials are represented.
- Instead of using a standard as an absolute remuneration cap, the Netherlands could consider introducing multipliers, similar to the Polish public sector.
- The study also suggests to introduce a mechanism to sanction bad performance and ‘not positively contributing to the public cause’, instead of simply regulating executive pay regardless of performance.