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Performance-related pay in the United States is becoming less prevalent

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In standard economics textbooks, the entire labor market is aware of a worker's marginal product (that is, the extra output produced through the employment of that worker); that awareness and competition together ensure that workers are paid the value of their marginal products. In the real world, however, a worker's marginal product may be difficult to determine, and circumstances such as uncertainty about a worker's ability and the dependence of effort on wage levels may provide scope for what are known as performance-related pay schemes. Though the definition of performance-related pay is not always consistent across studies, these schemes tend to include any kind of payment system that deviates from a fixed payment per unit of time and that seeks to better align pay with productivity. Such a definition would typically include piece rates, commissions, bonuses, and the like. According to the theory and some empirical evidence, firms will use piece rates and other performance-related pay schemes to elicit higher levels of effort and to attract more productive workers. Such schemes cannot be used everywhere, however, in part because of the costs of monitoring output.

The literature on performance-related pay in the United States and Western Europe has grown substantially in recent years, with interest in this phenomenon coming from a number of different perspectives. Some researchers have focused on the fundamental question of why firms would adopt performance-related pay practices in the first place, others have tried to establish whether such schemes have measurable productivity effects, while still others have searched for impacts on pay inequality both within the firm and on the economy as a whole. Despite a sizeable amount of recent research, many gaps remain in our knowledge, in part because of data limitations.

In "How prevalent is performance-related pay in the United States? Current incidence and recent trends" (*National Institute Economic Review*, November 2013), Maury Gittleman and Brooks Pierce, economists at the Bureau of Labor Statistics, address some fundamental questions about performance-related pay in the United States. These include the following: How widespread is its use at present? What characteristics of employers and jobs are most commonly associated with its incidence? What have been the recent trends in its incidence? What factors are responsible for these trends?

In their study, they used the quarterly microdata underlying the Bureau of Labor Statistics' Employer Costs for Employee Compensation (ECEC) series. They found that nearly two-fifths of hours worked in the U.S. economy in the first quarter of 2013 were in jobs with performance-related pay, broadly defined. Perhaps not surprisingly given its reputation for bonuses, financial activities is the major industry with the highest incidence rate (67 percent), followed by information (57 percent). Leisure and hospitality has far and away the lowest incidence rate (18 percent), followed by construction (28 percent). By major occupation, the business and financial management occupations group has the highest incidence rate (55 percent), and the service occupation group has the lowest (22 percent).

The overall share of performance-related pay has been declining for more than a decade, having peaked at nearly half of the economy in 2001. The authors consider several possible causes for this decline, including industrial and occupational shifts, and find that, while these possibilities provide some insights, they do not have much overall explanatory power. Interestingly, the authors do establish that any potential explanation must also account for a long-term shift in the relative incidence of performance-related pay away from low-wage and toward high-wage jobs.