

# Performance Pay and Wage Inequality: evidence from Germany and Great Britain

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## Abstract

Over the past three decades, the United States witnessed an increase in the fraction of workers that are paid based on their performance using bonus pay, commissions, or piece-rate contracts. Recent research found these payment structures present an important channel through which increasing returns to skill have been translated into higher wage dispersion. Whether other countries experienced similar correlations between pay for performance systems, returns to skill and wage inequality is unknown. We explore these correlations in two countries that experienced similar trends as the US in terms of wage inequality and returns to skill: Germany and Great Britain. We use data from the German Socio-Economic Panel (1984–2010) and the British Household Panel Survey (1993–2008). Adjusting for misclassification error in reported performance-pay status, we show performance-pay wages in Great Britain are closely related to worker’s education and increasingly so over time, which is consistent with firms offering performance-pay contracts in response to changes in the return to skill. Results in Germany are less clearcut. Decomposing wage distributions using reweighing and recentered influence function regressions, we find that the increased prevalence of performance pay explains about 10% of increased wage dispersion in Great Britain over the observed period and is especially important in the upper part of the wage distribution. This link is much weaker in Germany. Overall, these results suggest that performance pay may have played a similar role in the United States and Great Britain, but that it has not been a key channel through which increasing returns to skill have been translated into increased wage dispersion in Germany.

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