

Special Symposium: Personnel Economics: Old Wine, New World?
To be convened by Russell Ross (University of Sydney) and Keith Whitfield
(Cardiff University)

Since the 1980s, economists have become increasingly interested in issues in the realm of Human Resource Management. This change has been associated with the advent of the sub-discipline called Personnel Economics, which has largely been associated with the work of Ed Lazear of the Stanford Graduate School of Business. The seminal work in this area is the collection of essays based on his Wicksell Lectures – *Personnel Economics*, MIT Press, Cambridge, Mass., 1995. Lazear's main theme is that social scientists outside of economics have been extremely good at identifying issues that need to be examined, but not as good as economists at giving answers thereof. He sees this as resulting from the power of economics to uncover the general principles underpinning real world situations. In relation to what he terms personnel issues, this is seen to require the extension of standard production theory to cover the detail of the employment relationship with appropriate adjustments for the detail of the real-world situation. The task is therefore defined as finding, "... simple models that do well in describing important components of worker behaviour." (Lazear, 1995, p.2).

Lazear asserts that there are four main themes in personnel economics:

- 1) It is largely normative, that is prescriptive as well as descriptive.
- 2) A personnel system is an entire structure and must be viewed as such, rather than as isolated parts.
- 3) Personnel economics typically depends on relative comparisons rather than absolute ones.
- 4) Economics is better placed than the other social science disciplines to understand the complexities of work-related phenomena.

The key theoretical building blocks for personnel economics are agency theory and contract theory, and, empirically, it has benefited from the recent development of firm-level data-sets, such as the Australian Workplace Industrial Relations Surveys. A great deal of the analysis is also a development and extension of human capital theory.

Personnel Economics is dominated by studies that deal with various forms of compensation, explaining in terms compatible with basic theory why particular forms have arisen. For example, explanations are given for the varying use of payment systems based on input (such as time) and output (such as sales) measures, the use of tournaments to motivate workers, and the existence of differing wage structures in different institutional settings.

Among Personnel Economics' distinctive contributions has been the integration of the concept of the job into labour market analysis, thereby giving a demand-side dimension to analyses that were previously (overly) focused on supply-side concepts. Thus, for example, an explanation has been given for the commonly-observed rising experience-earnings profiles that differs from the human capital supply-side

explanation by focusing on internal incentive structures rather than differential investment in specific human capital.

Another contribution relates to the introduction of the concept of tournaments into labour market analysis. This breaks the traditional link between an individual's wage and his/her marginal product. The key postulate of tournament theory is that workers can be motivated by comparison to their peers (Lazear and Rosen, 1981). By linking future high-paying jobs to an individual's relative performance in the current job, he/she can be motivated to supply more effort in the present. This is seen to have the potential to motivate workers at least as well as piece-rates or some other output-based incentive system.

Personnel economics also links to the emerging debate about the relationship between HRM and strategy, and the impact of HR initiatives on organisational performance. A key contribution has been explanations for why some governments make it mandatory for firms to introduce some form of employee involvement in decision-making. In a classic paper, Freeman and Lazear (1995) explain that the mandatory nature of the German Works Council system results from the likelihood that the amount of employee involvement would be sub-optimal in its absence.

There has been a plethora of work in recent years using Personnel Economics as its theoretical base, particularly in the areas of pay determination, performance appraisal, and employee involvement. This has been accompanied by the development of journals solely devoted to the subject, a separate *Journal of Economic Literature* classification (M5) and numerous conferences on the subject (Lazear and McNabb, 2004).

Not all those working in the area view the development as overwhelmingly positive, and some have suggested that the costs may well outweigh the benefits (see, for example, the critiques of Freeman, 1988 and Jacoby, 1990). For such researchers, Personnel Economics might well be described as little more than old wine in new bottles. Jacoby, for example, has suggested that the whole approach within which it is located – the New Institutional Labour Economics - is problematic. His main complaint is that it focuses on too narrow a set of behavioural assumptions, and thereby factors out of the analysis concepts that are of crucial importance for the understanding of key labour market phenomena. He therefore suggests that a broader form of rationality is needed than the narrow *homo economicus* rationality of the NILE school.

Personnel Economics has not had a strong impact on HRM research in Australia (Ross and Whitfield, 2008). While there have been some papers using Australian data that have taken a theoretical position emanating from Personnel Economics (for example Drago and Garvey, 1997; Preston and Crockett, 2004; Brown and Heywood, 2005; Brown, et al., 2007), these have been the exceptions rather than the rule. Whether this is because of a lack of acceptance of the central tenets of Personnel Economics or of an appropriate body of data (such as the two recent British Workplace Employment Relations Surveys, both of which post-date the most recent Australian Workplace Industrial Relations Survey) is a moot point.

The main aims of the proposed symposium are to: 1) Outline the advantages and disadvantages of Personnel Economics for the analysis of issues in the HRM area. 2) Examine the role that Personnel Economics has played in Australian research. 3) Present recent work in progress that has used Personnel Economics as its theoretical basis.

The first part will involve a Socratic-like dialogue between Robert McNabb and Keith Whitfield (both Cardiff University, UK) on the advantages and disadvantages of adopting a Personnel Economics approach to the study of issues in the HRM area relative to an approach emanating from an alternative economic position or from a different field or discipline. The aim will be to encourage a discussion of the pros and cons of adopting a Personnel Economics approach.

The second part will be based on a paper by Russell Ross (University of Sydney, Australia) and Keith Whitfield (authors of the recently-published book *The Australian Labour Market: Third Edition*, Pearson, Sydney, 2008) that will outline Australian work using the Personnel Economics approach as its basis, examine the contribution of this work to the HRM field, and ask why there has not been more research of this type. The aim will be to encourage a discussion as to whether there should be more Personnel Economics oriented research in Australia and, if so, how this might be brought about.

The third part of the symposium will examine two papers that are indicative of research in the Personnel Economics domain. One will be by Andrew Pendleton (University of York, UK) and will focus on the increasing use of multiple types of contingent pay scheme at the same workplace. Personnel economists view this as a response to the mixed effects of individual schemes, and suggest that those workplaces with multiple schemes will, other things equal, have stronger performance than those that have individual schemes only. The 2004 British Workplace Employment Relations Survey is used to test this hypothesis. The second paper will be by Michelle Brown (University of Melbourne, Australia) and will focus on the theory that individual performance pay increases effort but may reduce the incentive to help co-workers. Using data from an original survey of finance industry employees subject to individual performance pay, it is demonstrated that those workers who report they do not help co-workers earn significantly more; this result is particularly strong for those workers with the strongest individual performance pay incentives. Moreover, when those workers report that their co-workers help them, they also earn significantly more. These dual results are consistent with a strong incentive to free-ride on the helping effort of others in the face of individual performance pay.

It is anticipated that the papers from this symposium will be published in leading international journals in the field, possibly the *International Journal of Human Resource Management* and/or the *Australian Journal of Labour Economics*.

Key References

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