When trying to understand the current New Public Management (or NPM) policies run in OECD countries, one is driven to think that the arguments favouring performance-linked pay appear to have a dominant place in public administration. Moreover, it is quite easy to admit the legitimate desire of a more accountable bureaucracy, designed to satisfy the citizens.

The point in this paper is to assess the possible negative effects on ethical behaviour of a generalized and poorly-defined performance-linked pay system, and the risk of drawbacks superseding its advantages. This approach is based on the notion of “crowding-out effect”, and the idea of a bias implied by unfitted schemes of pay. It should additionally bring about questions around the management of performance pay and its impact on ethics. Actually, performance related pay might as well have detrimental consequences on the compliance with efficient and high-quality public services. This paper aims at proving this possible ambivalent effect of performance related pay on the search of quality.

Today, NPM policies promote efficiency as well as ethics in public administration, which are of course honourable principles to follow. The question raised in this paper is not to discuss the opportunity of these public management objectives, but consists in analyzing the methods used to implement reforms. Could such devices be sometimes harmful for individual performance and effort, yielding to unethical behaviour?

Ethics supposes adhesion to common values and a commitment to performance. Thus it is obviously necessary to consider the reasons of motivation.

Moreover there are two ways ideally supposed to improve ethics in public administration. First, public servants should be personally or “naturally” motivated by their job. Second, the...
organisation should promote efficiency through special performance pay instead of fixed salaries. It appears difficult to make up for the lack of one element with the other. The following explanations will try to show the relationship between effort and pay incentives. Ethical behaviour – understood as the search for performance and quality – should arise from these two characteristics: one is intrinsic to the public servant; the other depends on the administrative pay scheme.

Ultimately, the need for an accurate evaluation of performance implies an efficient screening technique, so as to distinguish “low-effort” from “high-effort” public servants. Screening raises a number of questions about its budgetary feasibility and its consequences in terms of effort. Screening is designed to improve the “personal” or “intrinsic” component likely to determine ethical or unethical behaviour.

While public management currently imports successful methods derived from private management, there is a debate on the efficiency of corporate performance pay. Some authors point out the detrimental effects of bonuses for personal incentives and the respect of administrative ethics: so, would they be the same for public management?

First, the question of optimal incentives will be presented in a configuration where performance pay may have detrimental effects on efforts, namely the “crowding-out effect”. This first issue is about the “institutional components” determining ethical behaviour through performance pay.
Second, the screening procedure, which is bound to assess if public servants are prone to be “hard-workers” or not, will be defined. This is important for the design of optimal incentives even if it is a costly procedure. This second issue concerns the “personal or intrinsic component” determining ethical behaviour and the adequacy of screening.

Third, the delegation of management will notably be a first-choice method to increase the efficiency of screening. This last issue focuses on the human resource management delegation so as to improve performance related pay systems; delegation develops the efficiency of screening and performance related pay. It allows reconciling “institutional” and “personal” components determining ethical behaviour. In the light of these developments, it will be interesting to refine the link between ethical behaviour and the issue of performance related pay. It will perhaps help bring a theoretical background to the current NPM reforms throughout OECD countries.

**Part One: Ethical Behaviour Through the Prism of Performance Related Pay: The Case of the Crowding-Out Effect.**

First of all, why do governments implement pay systems derived from the successful examples of private management?

The reason seems to be that there would be a traditional lack of incentives in public management, which may induce the transformation of bureaus into bureaucracies (in a pejorative sense). This problem would be all the more acute as the budgetary margins for governments have kept narrowing over the last few decades. Thus, as private management requires outstanding performance in a world of generalized competition, public management should use budgetary resources more efficiently.

The well-known risk of bureaucratization will not be stressed here. But the risk of diffuse and general distrust towards traditional public management should be kept in mind. Even if all public servants cannot be assumed to be lazy, conversely one should not suppose that each of them is virtuous. So, the search for improved ethics in public administration is bound to take into account the diverse behaviours of public servants, from the “lazy” bureaucrat to the purely benevolent civil servant. This need for incentives is justified by the development of

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Footnote: Greffe [1999] gives a clear presentation of the main debates in modern public management.
similar devices in private management. Thus ethical behaviour would be favoured by such methods.

In order to face up to this need for greater performance, public management reformers have decided to induce a movement towards the transposition of private rules to public routines, which is notably summed up under the New Public Management (but these reforms are not limited to performance related pay issues).

How should ethics benefit from this different approach to public management? Usually, only the positive effects of performance-linked pay are stressed. That is, one considers the increase in motivation, both for “shirking” bureaucrats and for “virtuous” ones. Concerning low-effort personnel, introducing performance related pay will develop a new motivation, a purely financial one, which could translate into sanctions in case of insufficient efforts. Concerning high-effort personnel, the new type of management would give an additional interest to their work.

Thus, performance related pay is sometimes considered as a panacea for the issues arising from current reforms. Such a method derives from the principal-agent theory, and it has been used for a long time in private management. Ethics would be safeguarded by sufficient incentives linked to salaries, which could be allowed by the screening of performance and effort.

Unfortunately, this way of thinking seems to be questioned today, owing to the potential perverse effects of performance related pay. Obviously, incentives are the key to performance. But the possible ambivalence of performance effects rests on a dichotomy of incentives.

Some authors distinguish two types of incentives. First, the so-called “intrinsic incentives”, roughly envisaged as incentives and motivation felt by the manager without any external stimulus like financial or status allowances. Second, the “extrinsic incentives”, seen as the “carrot and stick” procedures provided by hierarchical superiors for example. Let us quote Edickinson and Villeval [2004] in order to show the extent of this debate:

“An indication of the existence of intrinsic motivation lies in the fact that a significant proportion of the agents perform at the desired output level when their principal shows no willingness to monitor. Monitoring may undermine intrinsic motivation when the monitoring intensity exceeds its equilibrium level, when the employment relationship is based on interpersonal links and when distributional concerns are at work.” (pp. 5-6).
There could be an interaction between intrinsic and extrinsic incentives. Clearly, experimental economics gives evidence of a possible detrimental effect of increased extrinsic incentives on intrinsic ones. In the absence of extrinsic incentives, there subsists intrinsic motivation which varies among public servants, which constitutes a basis of ethical behaviour.

In a private management perspective, Frey and Osterloh [2005] put into evidence the detrimental pay system currently implemented in companies, and they assess the potential advantages of resorting to public management traditional routines, with fixed salaries. Following a review of experiments on the positive and negative consequences of performance-related salaries, Frey and Osterloh underscore the existence of a “crowding-out effect”, which means that disadvantages may outweigh the advantages of incentives for performance:

“…crowding-out takes place when perceived self-determination suffers from external interventions in the form of monetary incentives or control. (...) [Individuals’] attention shifts from the activity itself to the reward or sanction. The content of the activity loses its importance. A pre-condition for crowding-out to occur is that the individuals concerned have intrinsic motivation, which can then be undermined.” (pp. 15-16).

This call for a return to fixed pay in private management is amazing, whereas public administration throughout the world adopts the opposite reform method. Two additional aspects of the detrimental effects of incentives should be observed. These perverse by-products will arise either from an excess of supervision (that is, excessive control as perceived by the civil servant), or from a lack of performance remuneration relatively to the undermining intrinsic motivation. Thus the crowding-out effect should be considered as a menace to ethical behaviour in public administration.

Now, we can ask the question: are problems of performance pay in private management the same as those in public management? On this point, one can mention a trend that is developing in British warehouses where workers are monitored through electronic devices on behalf of productivity and efficiency: too much control provokes rejection, distrust and plummeting intrinsic incentives\(^3\). There is currently no clear answer to this issue.

\(^3\) Hencke [2005] shows there could be an excess of “monitoring” and “extrinsic incentives” (in our terminology) which undermines global effort and decreases intrinsic motivation among workers. This is probably an example of the “crowding-out effect”. According to trade unions, excessive monitoring would imply consequences totally opposed to those intended:
The question is now to determine the optimal degree of incentives in a public bureaucracy, taking into account the ambivalent effects of incentives on ethical behaviour.

For a graphical presentation, a public bureaucracy with two types of agents will be described. This is a tentative alternative presentation of the “price effect” designed by Frey and Osterloh [2005] under a different focus, since here the objective is to emphasize questions of heterogeneity in public service, as well as screening issues by a hierarchical supervisor. How do they influence ethical behaviour?

First, we have high-effort agents, characterized by a strong intrinsic or inner incentive to do their job properly. That means “natural ethics” is high concerning these public servants.

Second, low-effort agents develop a weaker intrinsic incentive or “lower natural ethics” for their workload.

Inner motivation is of course predominant as long as the performance bonus both agents are bound to get is low. As long as this bonus increases for low values, intrinsic and extrinsic motivations are aggregated with no detrimental effect on ethical behaviour towards high effort. But above a given bonus value, this negative consequence appears, since intrinsic motivation decreases while attention is increasingly paid to financial and status rewards, or even penalties for insufficient effort. However, there comes a time when performance pay reaches high levels and a large proportion of pay: then, intrinsic motivation might become null, putting into evidence the unique prevalence of performance pay (that is extrinsic motivation) to explain the effort level, according to Frey and Osterloh [2005]. Thus performance-related pay does not yield to a monotonic positive trend on ethical behaviour, because of the crowding-out effect.

Some additional differences are likely to occur between high-effort and low-effort agents. First of all, concerning high-effort agents, one might forecast that intrinsic motivation is dominant relatively to performance pay for higher values than values for low-effort agents. This means that extrinsic motivation is more often crucial to low-effort than to high-effort

“We are having reports of people walking out of jobs after a few days’ work, in some cases just a few hours. They are all saying that they don’t like the job because they have no input. They just followed a computer’s instructions”.

Is this problem of excessive monitoring a specificity of private management, or could we experience it with NPM reforms? Which level of extrinsic incentives starts crowding-out intrinsic ones? Can it be predicted before implementation?
people for global motivation. Also, I assume that intrinsic motivation diminishes quicker for low-effort than for high-effort servants: this aims at capturing the weaker link between effort and intrinsic motivation for low-effort than for high-effort people. *Intrinsic motivation constitutes a lower part of motivation for low-effort agents; moreover, the crowding-out effect – that is the plummeting of inner motivation – is likely to be sharper than for high-effort agents.*

Another important hypothesis has to be made so as to observe the potential detrimental consequence of performance incentives (the so-called “crowding-out effect”): for both agents, the decreasing effort due to the fall of intrinsic motivation should overcome the trend in increasing effort due to rising bonuses. To put it more simply, let us define the productivity of a public servant as his effort level. Then, my hypothesis means that the marginal productivity loss due to a decreasing intrinsic motivation should be greater in absolute terms than the marginal productivity gain due to increasing extrinsic or performance motivation. Without such an assumption, global motivation – that is the sum of intrinsic and extrinsic – would not decrease for certain values of performance pay, causing no global detrimental effect, and this would contradict the experimental proofs described by Frey and Osterloh.

The potential bias of performance pay on intrinsic motivation and ethical behaviour requires additional explanation. In fact, the negative effect might lie on the institutional procedure allowing the viability of performance pay. Any system of rewards grounded on this base needs a process of control so as to check the level of success or failure facing the objectives of public servants. Grossly stated, the problem particularly appears with the notion of “excessive monitoring”. It is probably useful to quote once again Edickinson and Villeval in order to capture this argument:

“[Our experiment] also suggests that the ‘excessive’ use of monitoring by the principals (i.e. beyond its equilibrium level) as well as the reduction of effort by the agents beyond a certain monitoring threshold can be interpreted in terms of mutual punishment. Principals pay to use monitoring in order to punish agents who perform less than desired in the preceding period and agents reduce effort and thus decrease their own expected payoff in order to punish principals whose payoff is directly linked to the agents’ level of performance.” (p. 34).

One alternative way of considering the depressive effect on intrinsic performance appears generally in experimental economics. For example, Delfgaauw and Dur [2004] develop an adverse selection model rationally explaining why public servants would be prone to weaker effort, which however avoids overspending public budgets because of low bonuses. Many
literature examples prove the rationally important intrinsic motivation when performance pay is low; from the introduction of bonuses on, experiments show the reducing intrinsic willingness to effort, due to a greater and greater focus on the “carrot and stick” procedures\(^4\). One should not avoid discussing performance-related pay systems, since they can yield counterproductive results when they excessively depress “natural motivation or ethics” due to an excessive stress on bonuses or penalties. The balance of the two “components of ethical behaviour” (“natural” and “extrinsic”) should be managed cautiously.

**General hypotheses**

A graphical and somewhat analytical view of the ambivalence around the crowding-out effect of incentives can be given. *The type and intensity of incentives have an effect on ethical behaviour, because of different intrinsic motivations among public servants.*

So, two types of public servants are supposed, low-effort and high-effort ones. To avoid any graphical complexity the bureau consists only of two agents, whose identity cannot be assessed *ex ante* by the hierarchical supervisor.

Intrinsic motivation (or “personal ethics”) is respectively named \(e_H\) and \(e_L\) for the high-effort and the low-effort agents. It is known to decrease more sharply for low-effort agents, due to lesser job involvement. *This constitutes the “personal” determinant of ethical behaviour.*

Every agent earns a fixed remuneration \(w\), identical for both (high-effort and low-effort agents). A performance bonus might be added. It is clear that without performance-linked pay, the fixed pay \(w\) is not a fair way of reward for effort since intrinsic motivation varies across the workforce. Thus as imperfect as it may be, performance pay might be a way of solving this problem.

The “productivity” of bonuses on effort (that is the incidence of performance pay on effort) is assumed to be constant and identical for both agents, in order to keep a focus on the only distinctive characteristics of agents, that is their intrinsic motivation. Thus, the extrinsic motivation of some bonus level \(B\) is given by \(\varepsilon B\) for one particular agent. *This constitutes the “institutional” determinant of ethical behaviour (through performance-related pay).*

\(^4\) The reader should fruitfully consult recent articles in the bibliography so as to be introduced to the core examples of the crowding-out effect.
Thus, individual effort (quality of ethical behaviour) is simply the sum of intrinsic and extrinsic motivation. The effort produced in the bureau is simply the sum of individual efforts. Once again this assumption is made so as to concentrate on different intrinsic motivations, rather than on any other characteristic. Then, the bureau effort is conceived as the sum of intrinsic efforts and extrinsically-led motivation due to performance bonuses.

*Graphical approach*

By now, it is possible to represent graphically the level of intrinsic efforts for our two public servants, as well as the extrinsic motivation induced by performance pay:

![Graphical representation](image)

The previous graph allows considering the individual incentives in a separate way. However, it is obviously necessary to add up these two forms of extrinsic and intrinsic motivation so as to determine the global individual motivation for the high-effort servant as well as for the low-effort one. Adding vertically the intrinsic and extrinsic curves, the individual motivation is obtained in the following graph.
In this presentation, which of course depends on previous hypotheses, it is clear that low-effort and "high-effort" personnel will not react identically to the same performance-linked pay stimulus. In order to maximize effort for each category of agents, the supervisor cannot use the same strategy of incentives since a given level of bonus may undermine effort for one and promote it for the other. **Thus ethical behaviour is not grounded on the same performance-pay devices among low-effort and high-effort agents.**

Whoever the agent, three intervals of performance pay may be observed in such a presentation.

First, under a certain level of bonus (B1 for low-effort, B2 for high-effort), intrinsic motivation is not crowded out with extrinsic incentives. Thus, such a marginal bonus is only seen as an interesting supplement for effort. In other words, we are in an area of increasing productivity of effort. This is probably the objective of any supervisor or reformer aiming at obtaining some increase in effort inexpensively. **Ethical behaviour benefits from performance-pay since there is not yet an excessive monitoring: extrinsic motivation is a complement to personal motivation.**

Second, above this first level of bonus (B1 or B2) and up to a second limit (B3 for the low-effort public servant, B4 for the other), intrinsic motivation is crowded out with extrinsic motivation. Servants become increasingly concerned about additional rewards depending on results rather than their activity itself, which drives them to reduce their personal and
voluntary effort. Due to some precedent assumptions, this is an area of decreasing effort productivity, since the extrinsic marginal productivity is supposed inferior to the intrinsic marginal one. Ethical behaviour suffers from excessive stress on incentives or penalties: public servants substitute extrinsic motivation for their personal inclination to effort and ethical behaviour.

Third and final, above this second limit (B3 for the low-effort servant, B4 for the other), motivation only subsists as extrinsic incentives. The explanation lies in the absence of intrinsic motivation, underscored by experimental economics. All activity is then submitted to performance-pay remuneration, which has taken a tremendous part in salaries; people only focus on the huge consequences of performance pay and penalties. This is of course a polar case since voluntary motivation becomes marginal or null in the determination of effort. However, this is again an area with increasing effort productivity. Ethical behaviour is characterized by a full crowding-out effect on incentives: effort only depends on the "institutional" determinant of ethical behaviour, which is performance-related pay.

One of the main issues to be solved by the authority defining performance pay consists in understanding and assessing the “limits” concerning every public servant, which vary among individuals. This problem will be discussed later.

By now, it is necessary to define the effort produced in the whole bureau, as the sum of individual efforts. It is easily obtained, as the vertical sum of global incentives for the two servants.
The “one bonus for everyone” situation:

This is a frequent problem in adverse selection issues. And it diminishes the quality of extrinsic incentives on ethical behaviour, since different agents cannot receive different adequate incentives. The supervisor cannot distinguish the type of incentive for each agent.

The aggregate effort function displays five intervals of values for performance bonus, taking into account that this graph represents the “one unique bonus for everyone” situation.

First, under the B1 bonus level, both intrinsic and extrinsic motivations increase for both agents, and this bears evidence of a rise in the productivity of performance pay. Then, extrinsic incentives are plainly legitimate and efficient without any perverse by-product. There is no crowding-out effect; thus personal and extrinsic motivations are complementary determinants of ethical behaviour for both agents.

Second, between B1 and B2, global motivation in the bureau decreases, because of the faster decrease in intrinsic motivation for the low-effort one compared with the steady increase of intrinsic motivation for the high-effort one. The global effect is negative due to previous hypotheses. Here begin the limits of a common performance-pay mechanism. The crowding-out effect only concerns the low-effort agent; thus personal and extrinsic motivations are substitutable for the low-effort one and complementary for the other. Aggregate effect is negative for the whole bureau ethics compared with the previous case.
Third, between B2 and B3, both intrinsic motivations diminish whereas extrinsic incentives keep rising. Once again, the global effect is somewhat negative because of the assumption concerning the slopes of intrinsic and extrinsic curves. Then, for both agents, the motivation for their job is changing towards a reward-seeking activity. **The crowding-out effect concerns both agents; personal and extrinsic motivations are substitutable for both. Aggregate effect is negative again for the whole bureau compared with the previous case.**

Fourth, between B3 and B4, intrinsic motivation for the low-effort type is null and this agent simply works thanks to the increasingly large performance bonus (or even penalty) he might be awarded. For the high-effort one, intrinsic incentives are still positive but keep on decreasing with the growing bonus. The net consequence is a rising global motivation for the whole bureau. Behaviours are now almost completely guided by the large performance pay. **The crowding-out effect concerns both agents and especially the low-effort one (personal motivation is null now compared with the tremendous part of variable pay, which can affect salaries positively or negatively).**

Fifth and last, above B4 both agents’ work is based on the “carrot and stick” principle. None of them is motivated by intrinsic incentives. But such a situation is only guaranteed by a very large performance-linked pay, which is a somewhat scarce configuration in public administration. **The crowding-out effect is maximum for both agents, whose salaries are completely dependent on performance (there is a huge variable part in salaries). This makes public servants pay too much attention to performance pay, yielding to a counterproductive effect on ethical behaviour.**

Rejecting the eventuality of excessive bonuses, the optimum in the “one bonus for everyone” case (or “no-screening” case) is B1 since it maximizes the bureau effort, understood as ethical behaviour, under the “one bonus for everyone” constraint. But, even if the “low-effort” agent maximizes its contribution, the “high-effort” one would have benefited from higher performance bonuses.

Actually the bureau objective should be the maximum effort for everyone. It is only permitted through personally-defined incentives, requiring **ex ante** screening. But this advantageous method is not free from drawbacks.

If the objective is to maximize effort for the whole bureau, it is now compulsory to distinguish two cases: one allowing perfect screening of the type of agents, and the other illustrating adverse selection and information asymmetry.

Case 1: Screening and identifying agents is impossible

This is the former graphical example.
Supposing B1 is the pooling contract for both public servants, it is obvious that this is an optimum to the low-effort agent only. To the other one, intrinsic incentives are still growing, and this should have justified a higher bonus.
It is certainly important to propose a simple analytical presentation of the equilibrium in the no-screening (NS) configuration.
The budgetary cost of public management in the pooling case is the sum of fixed salary and bonus premium for both agents. The cost function is thus:
\[ C_{NS} = 2(\omega + B_1) \]

The effort provided in the whole bureau still depends on different intrinsic motivations and identical extrinsic incentives in the pooling case. Effort is then:
\[ E_{NS} = (e_L + \varepsilon B_1) + (e_H + \varepsilon B_1) \]
\[ \quad \iff E_{NS} = 2\varepsilon B_1 + \sum_{k=L,H} e_k \]

The no-screening strategy is not the first-best optimum since one agent does not maximize his effort. Thus ethical behaviour could be improved through screening.

Case 2: Screening and identifying agents is possible now

The main difference with the previous configuration is to be found in the ability to determine who is a low-effort type and who is not.
If budgets are somewhat limited, the best solution would perhaps be to maintain positive intrinsic value for public jobs. The screening opportunity might be a very useful method to improve management.
Considering and identifying each agent’s type, the supervisor should refuse a pooling equilibrium allowing the same bonus for two different agents. Efficient screening yields an informational advantage for the managing authority. So as to maximize bureau effort, the efficient way is to maximize each individual effort inside this bureau. The no-screening situation had induced a second-best solution due to the traditional inefficiency of pooling contracts when individuals are heterogeneous. Thus, efficient screening makes the principal propose B1 to the “low-effort” public servant, and B2 to the “high-effort” one (see graph). The contract remains identical for the “low-effort” agent but it differs for the other, when it is compared with the pooling equilibrium. This result is quite familiar to specialists of informational economics. Moreover, it is efficient since extrinsic and intrinsic efforts coexist. There is an increase in global effort because of separated contracts: no crowding-out effect takes place. Ethical behaviour cannot be improved then through any change in incentives.

On an analytical basis, the screening (S) configuration yields the following results. The budgetary cost is heavier now, because the optimal bonus for the “high-effort” worker is higher than in the pooling situation. The cost function is:

\[ C_S = 2\omega + \sum_{k=1,2} B_k \]

The bureau effort is however increased by the opportunity of profiting from the stronger intrinsic motivation of the “high-effort” worker. Now this public servant is awarded a more adequate remuneration contract. The bureau effort comes to be equal to:

\[ E_S = \varepsilon \sum_{k=1,2} B_k + \sum_{l=L,H} e_l \]

The graph below gives a general view of the optimal character of screening.
In terms of effort, screening is thus always likely to yield effectiveness. It allows implementing more adequate policies of performance-linked pay. It might be seen as a tool for improving motivation through incentives. If public servants are prone to effort, performance pay is a useful way to reward ethics. If they are not, it may be profitable to reach a certain level of quality through extrinsic incentives and penalties. Anyway, performance-linked pay can be designed as a successful mechanism provided it includes the perspective of intrinsic incentives.

However, despite the numerous advantages of screening, we may wonder whether the supervisor can afford it. It is effective, but is it efficient? There is a trade-off between its advantages in terms of effort and its drawbacks in terms of cost.
What screening changes on individual ethical behaviour

First, the excess cost of screening in order to improve the performance pay system consists of two parts. One is the additional cost \( S \) needed to process information about public servants and their intrinsic willingness to work. The other is the additional budgetary cost required to increase the bonus intended for the high-effort servant. Total excess cost \( \Delta C \) is:

\[
\Delta C = S + (C_S - C_{NS})
\]

\[
\iff \Delta C = S + \left[ 2\omega + \sum_{k=1,2} B_k - 2(\omega + B_1) \right]
\]

\[
\iff \Delta C = S + (B_2 - B_1)
\]

Second, the additional effort induced by a better performance pay system only depends on the changing contract for the high-effort worker. This is to be explained by the transition from a pooling to a separated equilibrium. Thus excess effort \( \Delta E \) is:

\[
\Delta E = E_S - E_{NS}
\]

\[
\iff \Delta E = \varepsilon \sum_{k=1,2} B_k + \sum_{l=H, L} e_l - \left( 2\varepsilon B_1 + \sum_{m=L, H} e_m \right)
\]

\[
\iff \Delta E = \varepsilon (B_2 - B_1)
\]

To estimate the potential value of screening for ethics management, it is necessary to compare the utility gain of increased efforts and the utility loss of rising budgetary costs. Such a calculus allows to assess if the hierarchical supervisor, representing public administration itself, benefits from implementing deeper control and screening. Assuming that the utility loss of one monetary unit equals one, the trade-off will justify screening if:

\[
U[\varepsilon (B_2 - B_1)] > S + (B_2 - B_1)
\]

Thus, the sponsor uses cost-benefit analysis. Designing detailed extrinsic incentives should be preferred to a pooling performance contract if the social “productivity” of switching “high-effort” types from the pooling to the separation equilibrium supersedes the financial loss implied by differentiated bonuses.

But by now, it is necessary to determine general conditions for improving the efficiency of screening.
Part Three: Delegating Human Resource Management so as to Improve Screening and to Develop Ethical Behaviour through Better Incentives Devices.

Actually two parameters are quite important in order to meet these objectives. 

First, the impact of bonuses on efforts (that is, the productivity rate of extrinsic incentives) should be a first-choice variable to legitimate or not the screening procedure. The incidence of performance pay on effort cannot be estimated without mutual confidence and without examining specific administrative features. To determine if screening could bring improvements through deeper efforts from the high-type individual, the decision should be decentralized as much as possible, as specific and optimal rules of personnel management cannot be designed in a very centralized way.

Second, the screening cost \( S \) should not be excessive to allow a “separation equilibrium” on bonuses in financial terms. This is the other side of screening, beyond its advantages on effort. If screening is too costly the optimal method is to keep implementing the same salaries for both agents. However, it lowers global effort. When screening becomes cheaper, the pooling equilibrium is no longer required since it is now financially possible to define a dichotomy of wages taking into account high-effort personnel. Thus it improves global effort in the public bureau. Summing up these arguments, the best way to design the first-best pay scheme, that is using screening, is probably to define the screening authority in the most decentralized way. This certainly advocates increasing hierarchical delegation in human resource management in public service.

Both arguments about the adequacy of screening advocate for a larger decentralization of personnel management when the objective is to profit from differences in effort intensity. That is, it is probably too difficult to define an appropriate policy of wages in a very centralized way. Even if the general perspectives should remain a prerogative of top management, it may be necessary to take into account the peculiarities of personnel characteristics by delegating the wages policy.

The point underlined in this paper is thus the following: it is not possible to reform performance pay without reforming the methods involved to assess efforts. But such screening methods cannot be envisaged without some delegation of evaluation, from the top to the bottom of public hierarchies. Even if, of course, general directives should be given to coordinate and standardize the methods as well as the types of remuneration.
So there must be a trade-off between the need for adequate bonuses – which requires deep delegation – and the need for equity throughout all public hierarchies – justifying some centralization.

It is probably necessary to underline the link between ethics and management delegation now. This objective requires first to be reminded of the nature of ethical behaviour determinants.

If we conceive ethics as being the will and efforts aimed at achieving certain goals as some standards of quantity or quality, then the previous argumentation yields to emphasize two sorts of ethics. Ethics is determined through “personal” qualities and motivation of public servants (their sense of general interest for example), as well as through “institutional” mechanisms like performance pay.

Personal ethics is an inner quality of each individual and cannot be evaluated without screening before or after recruitment. This sort of ethics can hardly be influenced and such skills for public service should be recognized by hierarchical superiors through experience and long-term relationship. The question surrounding this refers to recruitment. Due to its intangible and personal specificity, personal ethics – as a synonym for intrinsic motivation – should be considered as given by public management. The optimum way of increasing the average level of ethics should come from an improvement of recruitment, which is not part of the main theme of this paper, i.e. the links between performance pay and ethics.

Institutional determinants of ethics as extrinsic incentives depend on performance-related pay systems. The difference with “personal ethics” rests on the ability of modulating effort through the optimal level of bonuses. Whereas “personal ethics” is strongly determined \textit{ex ante} with modes of recruitment, “institutional determinants of ethics” benefit are based on the performance pay system.
Ethics and Personnel Management: A Public Servant's Example

**RECRUITMENT**

- *Adverse Selection Problem* (high-effort vs. low effort)

**LEARNING BY DOING**

- *Screening and Performance-Pay* (high-effort vs. low effort)

**Time**

- *Once-and-for-all determination of intrinsic incentives* i.e. "PERSONAL DETERMINANTS OF ETHICS"
- *Evolutive design of extrinsic incentives* i.e. "INSTITUTIONAL DETERMINANTS OF ETHICS"

Ethical behaviour is then a composite variable. It consists of a personal part and a part that may be influenced by adequate incentives through performance. This means that personnel management should display mechanisms of evaluation before recruitment as well as during activity with performance pay. However, this does not come without problems like the so-called “crowding-out” effect. One cannot provide the same incentives to all public servants.

All these considerations justify a decentralized system of performance pay management. But hierarchical delegation also finds its explanation in the current wave of reforms favouring performance pay.

When referring to Frey and Osterloh [2004], one may wonder if standard administrative pay (without bonuses) would not be preferable when the crowding-out effect is too large. To answer such a question, only experiences in reform will tell.

Anyway, the diversity of the concept of “ethics” suggests a profound screening procedure to adapt pay to every public servant. Being able to estimate critical points triggering the crowding-out effect for every servant is very fruitful. So is identifying if one public servant is likely to be a “low-effort” or not. This requires experience for the hierarchical supervisor. An over centralized management strategy cannot provide satisfactory results on such issues.
Thus decentralized evaluation of each public servant is needed in order to identify their intensity of intrinsic incentives as well as the level of extrinsic incentives required for obtaining a given effort standard. The optimal system should be designed in an evolutionary way and should be highly adaptive.

Concerning extrinsic incentives, the procedure should be very individualized, justifying decentralization. It should take into account the crowding-out effect or the risk-adverse individual specificity. Without much experience from the past, the procedure should avoid any deterministic ambition and should prefer pragmatism rather than “golden rules”.

Concerning the identification of intrinsic incentives, that is the understanding of every public servant’s personality, experience is important. Besides, we should benefit from the traditional typology of Downs [1967] about ideal types of public servants.

In his seminal work on public bureaucracy, which studies the relative subjectivity of evaluation, Downs supposes a dichotomy of public servants. On the one hand, there are “purely individualistic” public servants whose main aims are power (climbers agents), or security (conservers). On the other hand there are “mixed” servants, characterized by both individualistic and altruistic values: they may seek lobbyism (zealots), have several objectives (advocates), or they may be very close to the idealistic benevolent servant (statesmen).

According to our discussion on ethical behaviour, seen as the compliance with public service norms, the statesmen are the closest to the ethical optimum, whereas “purely individualistic” servants (in Downs’ terms) are likely to show lower ethics since their objectives are split between individualistic and organisational rules.

So, it is possible to superpose the ideal type "statesmen" and the “high-effort” agents with high intrinsic incentives, as they work on behalf of a strong ethics of public service. But his typology may be less adequate for other ideal types. However, such typologies might be useful for practitioners in public administration in identifying the optimal degree of extrinsic incentives for heterogeneous servants. While developing new methods of management without true experience from the past, practical reform implementation should not neglect insights into theoretical administrative sociology.

In this paper, I only emphasized the individual performance pay methods and their effects on ethical behaviour. However, it is sometimes difficult to assess individual performance, whereas a better measure exists with collective performance. Public outputs are often the result of a common effort, complicating the individualisation of bonuses, whatever they are
(financial awards, status advantages…)\textsuperscript{5}. In such a case, the pooling equilibrium seems to be more practicable. However, future research should put more light on this point.

**Conclusion.**

The goal of this paper was to provide a perspective on ethical behaviour in public administration, mainly through a dichotomy of motivations and incentives, and also to try to explain the paths we can follow if improving effort is an objective.

Actually, distinguishing intrinsic and extrinsic motivations allows asserting that the same performance pay mechanism does not induce the same effort to low-effort and to high-effort agents. Then the question of screening arises. In order to implement an effective performance-linked pay system, it is necessary to identify the “type” of agents, which also refers to their degree of intrinsic incentives. Without a screening procedure, it is impossible to define a first-best mechanism of performance pay so as to improve ethics through bonuses: the hierarchical principal would be obliged to hope for “personally” motivated agents or to reinforce the quality of recruitment *ex ante*. Of course, the earlier this screening is implemented, the better. But such screening is not always possible during the recruitment phase.

Once screening is done, a “separation equilibrium” for performance pay, maximizing total bureau effort, may be designed. Without screening, the principal cannot propose anything else than a pooling equilibrium undermining global productivity due to a lack of extrinsic incentives for “high-effort” agents. Optimal ethical behaviour depends on the individualization of incentives, taking into account personal qualities of public servants.

This underscores the need for a decentralized way of managing human resources in public management. There is a dual approach of ethical behaviour, through “personal” and “institutional” determinants, which requires deeper delegation.

\textsuperscript{5} As Trosa [2004] presents the problem:

« Dans la plupart des cas, l’activité administrative n’atteint son but que grâce à un travail d’équipe et de réseaux. (…) il vaut souvent mieux envisager une reconnaissance collective de la performance, reconnaissance dont les formes les plus appropriées ne seront pas toujours de nature monétaire. » (p. 35). [In most cases, administrative activity only reaches its goal through teamwork and networks. Envisaging a collective assessment of performance, whose most accurate forms are not necessarily monetary, is often better]
Finally, it clearly appears that reforms of personnel management in public administration will not become efficient as soon as they are implemented. The complexity of specific schemes of pay will need time to be efficient. And reformers should never forget that no improvement in performance will be possible if there is no mutual trust. After all, ethics understood as the search for performance should also prevail in hierarchical relations throughout the whole public administration.

**BIBLIOGRAPHY**


