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The Paradox of Performance Related Pay Systems: 'Why Do We Keep Adopting Them in the Face of Evidence that they Fail to Motivate?'

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Abstract
This paper considers one of the paradoxes of incentive pay used in Britain's public services, namely that despite much evidence that it does not motivate employees, it continues to be widely used. It is argued that behind this evidence, there are significant examples in which its use has been associated with improved performance. A good part of this is to be explained by the way performance pay links pay and appraisal, and the pressure this puts on line managers to set clearer goals for their staff. There is also some evidence that the goal setting is the outcome of a form of integrative, or positive sum, negotiation between individual employees and their managers, and that it is not just 'top down'.

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1. What Was the 'Decision Problem'?

Pay accounts for a very large fraction of public expenditure, and therefore its potential use to motivate performance has long attracted interest. Its long-established predecessor, 'pay for grade', was widely thought to take people's motivation for granted. Although administratively simple, to most employees, it offered only a small number of seniority-based pay increments within grades coupled with limited opportunities for promotion. The Priestley Commission had observed in 1955 that arrangements for departing from the normal rate of pay and pay progression were 'directly related to special duties or specific qualifications' although increments could be withheld for 'serious inefficiency or disciplinary offences' (Priestley, 1955 §21). Priestley had considered pay for performance, but rejected it on practical grounds: in most Civil Service jobs the merit of individual contributions could not easily be identified, and the inevitable involvement of the staff associations would lead to discussion of its application to individual cases (§24). The Commission did envisage one exception: that of draughtsmen whose increased proficiency could be ascertained by additional qualifications (§319). Nevertheless, the idea of pay for performance was taken up again by a series of government pay bodies, before it became one of the key recommendations of Megaw in 1982. Thus although recent debates have tended to associate the principle of linking pay to performance with the radicalism of Margaret Thatcher and John Major, concern about the underlying issues has a long history. Moreover, interest has not been confined to the UK. A major OECD study (OECD, 2005) shows that many OECD countries have experimented with different methods of linking pay to performance in recent years, as well as with many different ways of implementing it. Therefore, if we are to understand the paradox behind the question implicit in the title, we need to look for longer-run concerns than the passing political ideologies of particular governments.

The Megaw inquiry provides a good starting point because it gave the final push to implementing performance-related pay systems on a wide scale in the British public services. It summarised the key arguments in their favour put forward in the evidence it received. In themselves, those arguments offered nothing particularly radical or new. It would be desirable to have a 'more effective means of rewarding good performance and penalising poor performance' than promotion and downgrading. It was inequitable to reward good and poor performance equally. The limited number of promotions in the Civil Service meant that promotion alone could not be expected to motivate the majority of staff. In the Civil Service in the 1980s, promotion into middle management jobs was very slow for most employees, and would have been exacerbated by 'de-layering' of middle management jobs in the following decade.[1] Finally, many private sector organisations operated successful performance-pay systems (Megaw, 1982 §326). The first three arguments identify the decision problem as dealing with a reward system that was failing to motivate public employees, and whose inequities could quite conceivably demotivate them. The final argument really takes up the practicalities that had led the Priestley Commission to reject linking pay to performance: if private firms, which are themselves often large bureaucracies, can operate such reward systems effectively, then surely the practical problems are soluble.

The emphasis in Megaw, as in much subsequent discussion of performance pay, has focused on individual employees, their incentives, and equity considerations. There is another important strand in the theoretical literature on performance, from organisational economics,

[1] Using data from the National Audit Office, in the 1980s, the period leading up to the introduction of performance pay, in the UK civil service administrative group, a newly promoted Senior Executive Officer could expect to wait, on average, over 20 years to be promoted to Principal, the first grade with significant managerial responsibilities. Promotion rates into the SEO grade were even slower (NAO, 1989).

namely the structure of principal-agent relations within large sections of the public sector. It is argued for example by Tirole (1994) that the multiple demands on government organisations often lead to a lack of clarity in organisational goals. Multiple principals, or in the language of politics, multiple stakeholders, mean that large government departments responsible for administering a wide range of services often face contradictory goals, and that demands from one set of stakeholders often override those of others part-way through the process of implementation. In the UK, clarifying the role of the principal was really the job of the Ibbs, 'Next Steps' report of 1988, which proposed that central government should be restructured into a set of bodies each with a clearer and more limited set of goals (Efficiency Unit, 1988).

On the whole, the Megaw and Ibbs reports did not devote much thought to the link between performance pay schemes for the great majority of public servants and the restructuring of organisational goals. Yet, it is evident that if organisational goals are unclear, it is going to be hard to be clear about the job-level objectives of individual employees. Indeed, it is notable that when the Megaw report discussed performance measurement at the individual level, it did so in terms of making use of the existing employee performance appraisal system and adapting it. This graded employee performance according to a number of department-wide criteria. It is as if employee performance could be embraced within the American public service concept of 'neutral competents' (see Kaufman, 1956: 1060; Heclo, 1975: 81): within the government machine each employee has a predetermined job to be done, like a cog in an engine. This may be undertaken with varying degrees of competence and motivation, just as cog in an engine might encounter varying degrees of friction which affect overall efficiency. However, as with a car, direction is determined by the actions of the driver, and the parts of the engine continue to function in the same way. As we shall see later, one of the innovations with performance management has been to focus more on job-level objectives and how they can be adapted.

This chapter argues that the *intended consequence* or perhaps more correctly, *anticipated* consequence of performance-related pay - to improve the motivation of public servants - has proved elusive. When a policy is the result of decisions by many actors, it is not clear whose intentions were paramount. In contrast, the *unintended* or *unanticipated consequence* was that although performance appears to have improved in several cases, it did so by other means than motivation. Notably, it came about because of the emergence of processes facilitating convergence between goal setting at the individual and organisational levels. These have supported a renegotiation of performance standards and priorities at the individual level. This did not come about overnight, but progressively as successive governments and generations of managers grappled with the need to make performance-related pay work in a public service environment.

2. The Story

The story of performance pay in the UK civil service comprises two sub-plots: one at the individual level, and the other at the organisational level. At the individual level, the big step forward in the introduction of performance related pay came just after the General Election of June 1987, which gave the government scope to proceed with its policy of focusing pay on 'merit, skill and geography'. The Civil Service unions' campaign of industrial action came to an end after the election, and within a short space of time, several major unions had reached pay agreements with the Treasury that accepted some elements of pay for performance. An agreement with the FDA (top civil servants' union) accepted a merit points system for senior managers, an agreement with the Institute of Professional Civil Servants in 1987 accepted performance pay for non-industrial civil servants, and an agreement with the Inland Revenue

Staff Federation in 1988 saw the introduction of performance pay for middle-ranking Inland Revenue staff, responsible for assessing and collecting taxes (IDS, 1987; 1988). The latter two agreements introduced the first large-scale performance pay schemes for British civil servants in the twentieth century. Among the stated aims of the Inland Revenue agreement were: 'to provide incentives for improving and maintaining efficiency in the Inland Revenue' and 'to reward sustained high performance' (Inland Revenue, 1989: para 5). In both agreements, the system consisted of provisions for accelerated annual pay increments and additional increments for those at their scale maximum, based on performance appraisals by employees' line managers.

Improvements in the link with appraisal

A notable feature of these early performance pay schemes was expressed in the words of an official of the then IRSF: they had been 'bolted onto' the existing employee performance appraisal system, in the manner originally envisaged by Megaw. The operation of one of these was studied in detail by the Centre for Economic Performance (CEP), that of the Inland Revenue. The 1991 study was funded by the Inland Revenue Staff Federation but with full cooperation from Inland Revenue management which distributed the questionnaire and allowed staff to complete the questionnaires during working time (Marsden and Richardson, 1994). CEP researchers went back to the Inland Revenue five years later, in 1996, with a similar survey of the revised and restructured performance pay scheme, introduced in 1993 (see Marsden and French, 1998).

The initial experience of public service performance pay was summarised by a government report, surveying both academic research findings and inside management information, which observed a 'stark contrast between approval of the principle and disenchantment with the practice of performance pay' (Makinson, 2000: 3). [2] The CEP found that in the Inland Revenue, the Employment Service, and two NHS hospital trusts it surveyed, around 60% of employees expressed agreement with the principle of performance pay, while the figure among head teachers was about half of that. Much smaller percentages of employees (about one fifth) thought that it had motivated them. Compared with that, high percentages of employees in each service covered thought that their scheme was divisive and unfair in the way it operated. Between roughly 50% and 85% of employees in the organisations surveyed by the CEP thought that performance pay had caused jealousies in their workplace (Marsden and French, 1998: 8). Even taking account of the more positive findings of Dowling and Richardson (1997) among NHS managers, the commonest failing appeared to lie in a widespread dissatisfaction with the operation of performance pay. It would be tempting to stop the story here, and conclude that the Priestley Commission had been vindicated: the practical difficulties of making performance pay work in a public sector environment were too great and the numbers of employees who were motivated by it, too small to justify the all the management time and effort required to make it work.

However, this was not Makinson's conclusion in 2000, nor was it that of a Cabinet Office report produced about the same time (Bichard, 1999). Both recommended further development and experimentation with different forms of performance pay, albeit along different paths. How could this be so? Two clues could be found in the CEP's study of the Inland Revenue's 1988 scheme. The first harks back to the inequities of the old system that were noted by Megaw. A majority of the respondents agreed with the principle of linking pay

[2] Among the surveys to which Makinson would have had access were those of local government employees by Heery (1998), and Thompson (1993), of Amersham International (Kessler and Purcell, 1993), and NHS managers (Dowling and Richardson, 1998), and the Employment Service, NHS non-medical staff and primary and secondary school head teachers (Marsden and French, 1998).

to performance, around two thirds in the civil service departments, and rejected the idea that it was fundamentally unfair (between a half and two-thirds). It might be the lesser of two evils when compared with the perceived inequity of pay systems that reward equally poor and good performance, and the limited scope for promotion for most employees. The second lay with the line managers, who carried out the performance appraisals, and whom the CEP researchers had asked about the impact of performance pay on their staff. A substantial minority of these managers (22% and 42% respectively in the 1991, and 1996 Inland Revenue surveys) reported that the pay system had led their colleagues to work harder:. Similar findings emerged from other parts of the public service covered by the CEP. Later CEP research on school teachers in England and Wales, for whom a form of performance pay was introduced in the autumn of 2000, similarly found that despite fairly widespread scepticism about its fairness and effectiveness among both classroom and head teachers (eg. Wragg et al., 2001; Mahony et al., 2002 and 2003), other researchers found that there had been a positive effect on pupil outcomes (Atkinson et al., 2004; Marsden and Belfield, 2007). The first of these studies, emphasising incentives, found that pupils of teachers who were eligible for the new performance increases fared relatively better than their peers, and the second, emphasising improved goal setting, found that schools in which performance management had been more effectively implemented, appeared to perform better than their peers in terms of pupil performance. In other words, despite apparent divisiveness and a failure to motivate, there were signs that performance pay was somehow contributing to improved performance. To understand this paradox, we need to return to two important strands of the overall story. The first is that 'performance pay' has not been static, and has evolved as managers and other stakeholders have learned from past problems and mistakes. The second is that performance measurement and goal setting at the organisational level itself has also evolved in ways that are important to the success of employee level performance.

One reading of the development of public service performance pay systems over the period since the late 1980s is that there has been a process of experimentation and learning leading to successive improvements. The first performance pay schemes had been 'bolted onto' the pre-existing performance appraisal systems that had not been designed for pay purposes. Indeed, their results had often been secret, and 'open reporting' only became widespread with the introduction of performance pay and the consequent need for greater transparency. The Inland Revenue appraisal scheme in force in 1988 assessed employees on about a dozen criteria common to the whole department, such as diligence, cooperativeness, and initiative, and for many jobs, only a few of these were relevant. Appraisals were treated like 'tests' in which employees were graded, to use the metaphor proposed by Folger and Cropanzano (1998). In contrast, a 'trial metaphor' could be more appropriate because of the need for procedural fairness. Some of the problems encountered by the first schemes arose because the linking of performance pay to these appraisal systems was felt to be inappropriate and unfair. Many of the criteria of good performance were irrelevant to many jobs, and even where they were relevant, too little recognition was given to the different abilities of employees. The standard criteria were likely to reward always the same employees, while others felt that no matter how hard they tried, their efforts would go unrecognised.

The 1993 revised system, 'Performance Management', sought to address a number of these weaknesses, particularly the perceived lack of fairness. The most important innovation of the new scheme was to adopt a 'contractual approach' based on agreements about work objectives for the coming period to be concluded between individual employees and their respective line managers. Their performance at the end of the year would be assessed against agreed objectives. This addressed two fundamental questions. The first was that employees had different abilities, and that it was just as important to motivate those in the middle as the high flyers. The second was that the 'test metaphor' was inappropriate for adapting employee performance to new needs, and the multiple criteria gave little guidance as to work priorities. By holding a discussion with each employee to agree objectives, managers could now use the appraisal process to address new work priorities. The new scheme also marked a definitive break with the practice of length of service increments for employees as they progressed up the pay scale for their grade. Pay progression within grades would be subject to performance. Nevertheless, the CEP surveys found considerable scepticism among employees as many thought that the contractual approach existed in name only, and that many line-managers gave everyone the same quantitative goals (Marsden and French, 1998, Table 2.8).

The link between performance pay and goal-setting figured even more strongly in the performance management schemes for head teachers in primary and secondary schools in England and Wales which took force progressively from 1995, and for classroom teachers from 2000. In this case, the goals might be specific to individual schools and so vary more with local conditions than in large bureaucratic agencies. The accepted wisdom on performance pay for school teachers had been that it was inappropriate for their kind of work, and it was summarised by Richardson (1999) in a paper commissioned by the largest teachers' union, the National Union of Teachers, and by Dolton et al (2003). Nevertheless, the government pressed ahead, capitalising on the earlier experiences by emphasising the place of performance pay within a wider system of performance management, which placed as much emphasis on goal setting as on evaluation for pay. Performance management in schools comprised two components: systematic goal-setting and appraisal for all teachers; and the extension of the old classroom teachers' pay scale with a new 'upper pay scale' on which pay increments would be performance-based combined with a 'Threshold Assessment' required for progression onto the new scale. The new appraisal system placed a heavy emphasis on personal objectives and development needs, and how these fitted into the goals and priorities of the school as embodied in each school's School Development Plan. The CEP surveys found that over 90% of teachers responding reported that they discussed and could influence their objectives, that they agreed them with the team leaders and that they referred to items in their School Development Plan. Such an approach stands in marked contrast to the approach to performance appraisal of the first-generation performance pay schemes.

A general weakness of pay for performance systems, when they depend on judgemental assessments, and on agreeing objectives with line managers, is that they can easily revert to pay for grade and seniority in practice. Line managers depend on the cooperation of their subordinates to get their own jobs done, and this can create a bargaining relationship in which it is tempting to use appraisals and easy objectives as a means of buying cooperation. If line managers lack support systems from senior management, then they are often isolated, and it must be tempting to collude with their subordinates: to go through the motions and fill in the forms for goal setting and appraisal but not to worry about the reality. Megaw noted the rarity with which pay increments were withheld for poor performance, but did not address the organisational pressures which stand in the way of withholding increments.

Improvements in organisational measures

The second strand of the story relates to the organisational level, to clarification of organisational objectives, for which decentralisation held the key, and to stronger pressures on line-managers to take performance seriously, for which better indicators and benchmarking were important. As noted earlier, the 1988 Ibbs 'Next Steps' report began the movement to simplify the structure of the 'principal' within the public services, each agency or department having its own set of goals and performance criteria. Pay delegation enabled these bodies to begin to tackle the task of aligning their reward and employee management systems with their newly clarified objectives. The government's defeat of the civil service unions in 1987 represented the end of central bargaining over pay, and the beginning of a large-scale movement of decentralisation of human resource management, thus enabling closer adaptation of reward systems to the performance demands of each unit. A study by one of the public service unions documents how from 1987 pay became increasingly 'delegated' to departments and government agencies, following the logic of the Next Steps process (PTC, 1996). The same study showed how pay arrangements had become increasingly diverse between agencies. In effect, the new organisational structures, which were geared towards providing a narrower and more specific set of services, had begun to acquire greater autonomy over their human resource and industrial relations systems. Although at the time it was common to associate these moves in the contemporary public debate with privatisation, in fact, some countries, such as Sweden, had long used an agency-based structure for the delivery of public services without any hint of privatisation because of its greater role clarity.[3]

Another important factor in increased organisational efficiency in public services, which has also attracted a very bad press for its dysfunctions, is the use of performance targets for organisations (e.g. 'Target practice', The Guardian 30/04/05). Yet good statistical performance measures are also at the heart of coordination within large multi-unit systems, such as the national office networks of public agencies, and the school system. Without benchmarks between units, higher management faces an almost insoluble problem of information asymmetry vis-à-vis lower levels of management. How can a minister or a senior manager judge whether a tax office or a hospital is being run efficiently unless its performance can be compared with that of similar units elsewhere? Just as with individual employees, performance measures can be used both to rank achievements, and as a diagnostic tool, enabling top management to ask the right questions of local management. It also enables it to identify good local practice that might be generalised, and weak local performance that might call for assistance.

The Inland Revenue provides an interesting example. When the author was looking for measures of organisational performance that might be compared with the appraisal scores awarded to individual employees across units and over time, it became clear that fundamental changes had occurred. Just as the first employee performance measures had built on the pre-existing system for grading employee performance according to fixed criteria, so the first organisational measures had focused on accounting measures of performance. The Inland Revenue's annual reports in the late 1980s, when dealing with efficiency, focused on finance and on volumes work handled within particular deadlines, such as the percentage of tax returns processed within x weeks. By the mid-1990s, as performance management became better embedded, the Inland Revenue was also reporting performance measures based on statistical sampling, such as the percentage of work done right first time. If employees are given incentives to 'clear post' under performance pay, then there is an obvious risk that quality will suffer. Yet without comparative measures of error rates it is hard for senior management to gauge whether the higher rates in one office are due to the complexities of the work or to poor management. Local managers might also be under pressure from their staff to turn a blind eye to errors in order to help them meet volume targets and qualify for performance pay.

Narrowing down the functions of the principal, and developing more reliable and more relevant measures of organisational performance, assists central management in sustaining the performance of local management. It also provides local management with the guidance and discipline needed to operate goal setting, appraisals and performance pay at the local level. Arguably, it helps local managers to resist the organisational pressures towards indulgency mentioned earlier.

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[3] I am indebted to Niels Schager of the Swedish public employers for this observation.

Schools represent an interesting further development of this convergence between individual and organisational performance management. This convergence occurs formally in the references in individual teachers' priorities to the objectives outlined in School Development Plans, but also through the pressures of the 'quasi-market' that exists within the school sector to attract pupils as a consequence of parental choice (Glennerster, 2002). The 1988 Education Act devolved a number of powers from local authorities onto schools and their governors thus giving them greater autonomy. At the same time, the government developed a national framework for schools in England and Wales, including establishment of a national curriculum, a system for assessing school and pupil performance, with publication of performance tables, and external evaluation by inspectors from the Ofsted (Office for Standards in Education). The changes were aimed at informing parental choice, and so providing quasi-market discipline on school managements. Thus local management had the autonomy to manage key resources in schools, but subject to the pressure to attract pupils. Schools with good academic results, or which offered special facilities, could hope to attract more and better pupils as well as per capita funding. Although schools were not allowed to select, attracting a large number of applications from families that value their education increases their chances of receiving more able and more motivated pupils. Equally, schools which fail to attract such pupils will find themselves recruiting from a more limited pool of applicants. Thus, such a quasi-market puts pressure on the management teams in schools to ensure they attract motivated students and their families.

Against this background, the introduction of performance management for classroom teachers provided the missing part of the jigsaw for those schools that wanted to use it positively. Pupil progress had been pressed by the government as one of the key performance criteria for teachers. It is one of the few measurable outputs that are relatively independent of management indulgency, and it has a special significance for families making their choices about which schools their children should attend. At the outset, there was widespread concern that using pupil progress would mean return to a discredited system of payment by test results that ran from 1863 to 1890 in England (NUT, 1999 §4) or that the link would be applied in a formulaic way in many schools.[4] The arguments against, summarised by Richardson (1999) and Dolton et al (2003), were that pupil progress depends on the contribution of many teachers, and that pupils' socio-economic background and their own motivation were factors that influence progress but over which teachers have little control. Linking pay to pupil performance would induce teachers to 'teach to the test'. In practice, the good practice case studies used as guidance by the Education Department highlighted a rather different approach, at least in theory, using data on pupil progress to diagnose problems, for example with the attainments of particular categories of pupils, and to work out strategies for addressing them which could form part of a teacher's individual or team objectives for the coming year (DfEE, 2000). The CEP's interviews with practitioners and its own panel survey work suggested that growing numbers of schools, albeit a minority in 2004 (the date of the last survey wave), were gradually taking advantage of the new system to integrate classroom performance management with school goals and priorities, and that those that did so were achieving relatively better pupil test results.

[4] For an account of the nineteenth century system, see (Nelson, 1987). The operation of the scheme was the subject of several government reports. The detailed evidence of the Newcastle Commission of 1859 provides the background of why it was set up under the Revised Code of 1861. The Cross Report of 1887 provides the detail of why it was disbanded. I am grateful to Peter Dolton for this information.

3. The Consequences

Summarising the academic research and private management and union information then available, the 2000 Makinson review outlined a number of benefits that could accrue to organisations when performance pay schemes are operated well, and by implication, that the schemes then in force were failing to achieve. To paraphrase: well operated schemes clarify objectives and engage employees more directly with the goals of the organisation; they motivate employees by linking an element of compensation to the achievement of targets rather than length of service; they reward achievement and identify areas of under performance; and they foster a culture based on teamwork and fairness (Makinson, 2000: p.2).

How much should a government be concerned by such consequences is unclear. One argument put to the author in an academic seminar was that if the government was using closer monitoring through appraisal to pressurise employees to work harder, then many of the negative employee judgements reported could be expected. It is the price to pay for making people work harder for the same general level of pay. Over time, those who were really discontented would leave, those who remained would grow accustomed to the more demanding work routines, and new recruits would not know any different. In our conversations with some managers, it was acknowledged that staff were working harder and efficiency had improved, but there was also concern about sustainability over the longer term.

The reason for concern became evident in the light of events that occurred in 1997 shortly after the CEP's survey at the then Employment Service, and which were reported in the Guardian and Financial Times newspapers. The scheme in operation there had shown many of the signs of disenchantment, perceived unfairness, and that the feeling that performance objectives were just a numbers game. Job placements were one of the key performance indicators for both individual employees, and for their offices. In contrast, many employees replied that what they liked about their work was helping unemployed people find new jobs, and thought they were contributing to a valuable public service (Marsden and French, 1998). The way their performance pay scheme worked was that if they took too long with their placement interviews, which might help job seekers find a more suitable job, they would risk missing their targets, and their pay would suffer. Thus when interview times were squeezed, many felt that they were being asked to go for volume rather than quality of placements. There is a grey area in recording placements that lead to a job: does one record sending someone along to any potential employer as a placement, or does one count only successful placements? And should one count placements that last only for a couple of hours, because the job seeker realised the job is not suitable? Under normal times, employees are held back from manipulating placement data by their view of the intrinsic value of their work. If this is eroded, then one might expect more opportunistic use of their discretion. A few weeks after the CEP's survey, a number of reports in the Guardian and Financial Times appeared to the effect that employees and offices in the agency were systematically over-reporting job placements, according to the journalist, by up to one third. In some cases, according to the Guardian, offices were double-counting placements with major employers not just within but also between offices. The issue was discussed in Parliament and an internal enquiry set up, but it was allowed to lapse after the General Election.[5]

[5]. After the union drew their attention to the Guardian reports, the CEP researchers tried on several occasions to investigate this further after the election, but it seemed that neither management nor unions wanted to rake this up again for obvious reasons. See Financial Times 29/3/97 'Labour paves way for anti-sleaze fight', and Guardian 29/3/97 'Jobcentres 'fiddled figures to boost employment statistics'', and 1/4/97 'McDonald's job data 'abused''.

The lesson would seem to be that if management pressure employees too much, then some of the safeguards against abuse that arise from the intrinsic value of the work, such as belief in providing a public service, can be undermined. In the Employment Service, it could be argued that these beliefs held potentially opportunistic behaviour in check – if you believe your job is to help people then there is no point in faking the numbers. If the intrinsic value is downgraded, and if employees are also penalised for giving attention to that rather than sustaining the desired case throughput, then the system can tip out of control, as appeared to happen on that occasion.

4. The Paradox: Unintended Consequences – Renegotiation of Performance

If intended consequences are anticipated, then one might take Megaw's statement of the argument as an indication of the likely results anticipated at the time should performance pay be adopted. The committee's consultations had been widespread, and the case was a reasoned one. If there was a gamble over risk, it concerned whether managers would have the ability and resources to be able to find solutions to the problems that could be expected to emerge on the way. Priestley bet one way, and Megaw the other. As can be seen from the story so far, the risks were high: potential demotivation of individuals, and the possible loss of control of whole performance management systems. On the other side, there were the risks from doing nothing: with motivation undermined by limited advancement, by the inequities of good and bad performance being equally rewarded, and by lack of opportunity for management to underline new work priorities. So far, we have seen that management has been able to learn from experience and revise schemes, so there is some justification for Megaw's optimism. This much, one could argue, was anticipated at the beginning.

There were however consequences sketched out neither by Megaw nor by Makinson, but which I should like to argue could prove of fundamental importance. This concerns the issue of renegotiation of performance standards and priorities, and the creation of channels in which such renegotiation could become an on-going process as organisational goals evolve. In some cases, this could provide the means for an integrative negotiation between management and individual public employees. This could be important also for the private sector, but arguably is more so in the public sector where employment protection is stronger, and it is harder to dismiss employees who lack motivation of who refuse to accept new work priorities.

A first clue is provided by the Inland Revenue's experience in which productivity and performance seemed to have increased with the development of performance pay even though staff found the system divisive and un-motivating. Part of the evidence for this was that, depending on the organisation, between a quarter and a half of the line manager respondents to the CEP surveys thought that performance pay had caused employees to work harder (Marsden and French, 1998: 8). Their view is significant because they carried out the performance appraisals on which performance pay was decided. Other organisational indicators were also reviewed in Marsden (2004), where the author sought to reconcile these two apparently contradictory observations. A key part of the underlying story was about renegotiating performance standards rather than motivation. The decisive change came with the introduction of annual agreements on work objectives and appraisal and the attribution of performance pay according to how well these agreements were achieved. As suggested earlier, the previous system generally assumed that the job determined the different dimensions of performance, and employees might work more or less well. Its successor introduced the idea that within the job, employees might have different and variable priorities, and that these could be adjusted by the goal setting process. Clearly, the findings of the second CEP survey of the Inland Revenue show that many employees thought their line managers still functioned according to the old model, applying the same targets to everyone, and that these were quantitative. But not all employees reported things being this way, and substantial numbers experienced the new system of agreeing work priorities and goals in a positive way, and they tended to achieve better performance levels as measured by their appraisal scores.

In many respects, the CEP study of classroom teachers provides a better illustration of this process, in part because of the design of the research, and in part because schools offer multiple units in which management actions as well as employee responses can be studied in conjunction. In schools too, the initial emphasis had been upon rewards and motivation. When introducing the new performance pay package, the Education Secretary spoke of the need to motivate: 'we can only realise the full potential of our schools if we recruit and motivate teachers and other staff with the ambition, incentives, training and support' (DfEE 1999: 5). In the first year of operation, 2000, the reaction to the new performance management system and the threshold assessment in the great majority of schools was to fill in the government's forms and take the money. This may have been partly due to conservatism, but partly also because many schools needed the pay increase to simply retain staff. Without adequate numbers of teachers, the finer points of performance management seemed irrelevant in many schools. However, interviews with the organisation responsible to implementing the threshold indicated that some schools were using the new system not just to 'fire-fight' but as an opportunity to reform the way they were managed[6]. In particular, some head teachers saw it as a way to start to refocus the classroom activities of their teachers on the collective goals of the school. This line of enquiry was followed up by the CEP survey, which found that that growing numbers of schools were beginning to use it as a means of aligning teachers' classroom activities better with the school's own objectives. By the fourth year of operation, the authors estimated that around 20-25% of the schools in their sample had moved to this 'reformer' strategy. Moreover, the schools that did this, tended to outperform their peers in terms of the test results of their students (Marsden and Belfield, 2007).

Industrial relations theorists have developed an elaborate theory of problem-solving, or 'win-win', bargaining at the collective level. Thus Walton and McKersie (1965) contrast this form of 'integrative' bargaining with the more familiar form of 'distributive' bargaining that occurs in pay negotiations. The same intuition can be applied at the level of individual employees within performance management as a way of analysing how performance management and performance pay can be used to reorder work priorities. The reason this has to be at the individual level is that job performance is delivered by individual employees, and although this may be influenced by the culture of the workplace, in many jobs information asymmetries mean that managers depend heavily upon the agreement of individual employees to work in a particular way. As an example, one might consider the problem in schools at the time of the 1999 Green Paper. Many teachers have a strong commitment to their professional ethic, and believe in the importance of educating the whole person. Speaking of 'teaching to test' is the common way of denigrating what is felt to be excessive emphasis on exam results. Yet, with the quasi-market, schools are under pressure to give more attention to pupil attainments in national tests and in exams as they reflect a parental concern about their children's life chances. As mentioned earlier, head teachers could try to impose a greater emphasis on teaching aspects of their subjects that lead to exam success as opposed, say, to developing a deeper understanding of the issues. However, the monitoring costs would be high unless teachers focused on exam success voluntarily. Head teachers might ease the dilemma for their colleagues in the classroom by using other resources to free up more of teachers' time for both kinds of teaching, for example by reducing administration. However, there might be no

[6] Cambridge Educational Associates.

guarantee that this would bring the school much closer to its targets for exam performance. Teachers might use most of the extra time for the more general aspects of their subjects. On the other hand, if the extra resources are made available as part of a problem-solving negotiation, with agreement on resources provided and a commitment to certain outcomes, then one can see a greater likelihood of a mutually beneficial outcome, for the teacher's professional satisfaction and the school's performance needs. What the goal setting and appraisal discussions bring to the process is a framework within which such discussion can take place, and the outcomes monitored. Performance pay enters less as a source of motivation, than as one of the resources management can bring to the negotiation.[7]

The unintended consequence of the long road travelled by performance related pay and performance management in the public services has been the emergence of a new channel for employee voice, this time at the individual rather than the collective level. Voice mechanisms have been explored extensively in collective bargaining and in commercial relations[8], but they have received little attention in individual employee-management relations. These have commonly been conceived as relations of subordination, and this type of thinking is prevalent in the idea that managers need to motivate their staff to perform and to define their work objectives. The emphasis on subordination obscures an equally important aspect of employment relations, namely, that the employment relationship is also a contractual form enabling agreement on the supply of labour services in exchange for a wage or a salary. Free labour markets and high degree of skill and professional competence such as one finds among many public sector occupations results in a considerable degree of individual level bargaining power which is reflected in the discretion such employees can exercise in their work. When such employees accept a job offer, there is an agreement on mutually acceptable patterns of working. If the relationship is a long-term one, it is unlikely that the employer will find these remain beneficial forever, and so it will need an opportunity to adjust them to new organisational demands. This gives rise to a need for renegotiation of the package of benefits to both parties. In the example from schools, the renegotiation has focused on adapting teachers' professional goals in the classroom to those of their schools. In the Inland Revenue, an important organisational goal was to try to adopt a more 'customer-' or 'citizen-oriented' approach towards taxpayers which meant greater sensitivity to individual cases. Both involved changes in employees' work priorities. The CEP surveys caution against assuming this process has become generalised, and that former ways of managing, or not managing, performance have disappeared, but they do show the logic behind it and which could lead to wider diffusion. Imposition and compulsory retraining can achieve a certain amount, but on their own, without agreement, it is an uphill struggle. Without employee agreement, there must remain doubts about sustainability, and loss of control like that at the Employment Service, remains a constant threat.

[7] This example, and another example based on the CEP work on performance management in the NHS, are developed in greater detail and more formally in Marsden (2007).

[8] For a recent example in employment relations see Willman et al (2006).

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