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Do You Believe Me?

Public Sector Incentive Systems in Japan, Korea, Spain, and Sweden

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Abstract

This paper presents a theoretical hypothesis for understanding the success of performance-related incentives in the public sector, based on insights developed in the private sector. The paper argues that incentives are more likely to be implemented in administrations in which there is a relative separation between those who benefit from the incentive system (e.g. politicians) and those who manage it (e.g. senior civil servants). Where the interests of both groups overlap (e.g. the careers of senior officials and politicians are intertwined), incentives will be less credible and thus less likely. Narratives from four OECD countries – Sweden, Korea, Spain and Japan – show that performance-related pay is used significantly more in contexts with clearer separation of interests between politicians and senior civil servants (Sweden and Korean) than in countries with a historical integration of careers and activities at the top of the administration (Spain and Japan).

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1. Introduction

Two decades ago, nearly all public servants in OECD countries were paid according to flat salaries and service-incremental salary scales. Since then, we have seen large administrative reforms in the industrialized world and, among them, several aiming at strengthening the connection between outcome and pay for public servants (Peters and Pierre 2001, 1; OECD 2005, 10). Hence, today, significant numbers of public servants are theoretically covered by performance-related pay (PRP) schemes in most OECD countries (OECD 2005, 10, 36). However, despite the large interest in PRP reforms, it is only a handful of countries that have an extended, formalized PRP system, with a real link between performance appraisals and pay (OECD 2005, 38). For most countries, performance-related pay schemes are like flat salaries since pay is scarcely linked to performance (OECD 2005, 11). Why do we have these cross-country differences?

So far, scholars have not been able to explain the large cross-country variation in the real adoption of PRP systems in the public sector. Existing literature has pointed out four major factors affecting the uneven adoption of New Public Management (NPM) reforms in general – and public employees' incentives in particular – across countries: administrative tradition, civil service tradition, party politics, and macro economic pressure. According to these theories, NPM would be the result of Anglo-Saxon administrative traditions (Castles and Merrill 1989, 181; Pollitt 1990), open recruitment procedures to the civil service (OECD 2004; 2005), rule of right-wing governments (Bach 1999; Barlow et al. 1996), or economic pressures (Keller 1999, 58; Selden 2007, 41-42; Thompson 2007, 50). It is true that many countries that are associated with comprehensive NPM reforms belong to the Anglo-Saxon administrative tradition and have open civil service systems, long tenures of right governments and have gone through times of economic pressure. Nevertheless, these are not satisfactory explanations, since one may also find an increasing number of counter-examples, such as the implementation of NPM programs in culturally non-Anglo-Saxon contexts and non-open civil service systems – such as Korea – or by social-democratic governments – such as in Sweden and New Zealand (Hood 1996, 275).

This paper sets out to address the shortcomings of existing explanations by proposing a new hypothesis inspired by theoretical developments in Transaction Costs Economics (TCE). The paper tests the hypothesis with a historical qualitative analysis of the different PRP-reform efforts undertaken in four OECD countries – Japan, Korea, Spain and Sweden – for the last three decades.

The paper is organized as follows. Section 2 summarizes the prevailing explanations in the literature and proposes an alternative TCE hypothesis. Similar to the TCE theoretical insights generated for understanding the difficulties in implementing incentives in many private firms, we define the problem of implementing incentives, such as PRP systems, as a problem of trust. We argue that the reason for the successful implementation of incentives in the public sector does not lie in the “good” or “bad” design of the PRP systems, but in the credibility of those who impose them. It is not difficult to design good incentive schemes. What is difficult is to convince the employees that you are trustworthy and that you will not manipulate the system *ex post* to your personal advantage. The main hypothesis of the theory is that PRP systems will be more likely in those administrations where there is a relative separation between those who benefit from the incentives (e.g. politicians) and those who manage the incentive system (e.g. senior civil servants). Section 3 discusses case selection and methodology while Section 4 offers narratives for the four countries analyzed. Section 5 compares the similarities and differences among the countries and Section 5 concludes.

2. Theory

This section summarizes the main hypotheses developed in the literature for explaining cross-country differences in NPM adoption generally and in public sector pay schemes particularly. It also proposes an alternative hypothesis based on the Transaction Costs Economics (TCE) approach to organizations.

General explanations of NPM reforms, such as the introduction of PRP in the public sector, fall mainly into four broad categories. Scholars have suggested that NPM reforms are dependent on the administrative tradition, civil service tradition, party politics, and economic pressures.

Administrative tradition. According to OECD reports and scholarly writing, the reasons for cross-country differences in incentive systems lie in countries' administrative traditions (OECD 2004b, 6; Peters 1997, 86). The most prevalent division of administrative cultures in the literature has been suggested by B. Guy Peters and includes four categories: the Anglo-Saxon or "public interest" tradition; the Germanic tradition, which would entail northern and eastern continental Europe; the Napoleonic tradition, which includes France and the southern parts of continental Europe; and finally the Scandinavian tradition in the Nordic countries.

Taking mostly into account the early reforms of the 1980s in the UK and the US, several authors have attempted to explain NPM as characteristic of an Anglo-Saxon administrative tradition (Castles and Merrill 1989, 181; Pollitt 1990). It is common wisdom within the scholarship to state that especially the Germanic and Napoleonic administrative traditions are laggards or even non-implementers of NPM reforms (Parrado 2008, 2). In terms of public employees, these traditions would develop more "collectivist" incentives while Anglo-Saxon traditions would foster more "individualistic" incentives such as PRP schemes. Generally speaking, the literature has emphasized that NPM reforms – such as PRP systems – are mainly introduced in countries with an Anglo-Saxon or "public interest" tradition, like in the UK, Canada and New Zealand (Castles and Merrill 1989; Peters 1997; Pollitt 1990). For Asian countries, scholars emphasize the pervasiveness of an administrative culture based on Confucianism (Kim & Lee 2001, 8). The two main legacies of the religious and political spirit of Confucianism, which has lasted for several hundred years, would be the development of strong hierarchies and the elitist nature in Asian bureaucracies (Oh & Joo 2008, 4). Scholars have also claimed that the Asian administrative tradition hampers the adoption of NPM reforms (Cheung and Scott 2003, 12).

Structure of Human Resource Management in the Public Sector. This explanation is similar to the previous one and can be considered as being a complement rather than an alternative to the administrative tradition hypothesis. OECD has, for instance, emphasised the influence of the public service human resources structure on the implementation of NPM reforms generally and PRP systems specifically (OECD 2004; 2005). Civil service systems are traditionally divided into two broad categories: position-

based systems (or “open” systems), and career-based systems (or “closed” systems) (Bekke, Perry and Toonen 1996, 5; Lægheid and Wise 2007, 171). The recruitment process would be the most important base for the dichotomy (Selden 2003, 40). Recruitment within a position-based system is in principle “open” to all who qualify to the position, and not just to employees within the ranks of the public service. Recruitment in a career-based system, on the other hand, often places an emphasis on competitive examinations, and recruit staff at a relatively young age. After the initial recruitment, countries within a career-based system “close” the public service for external competition. Generally, the position based systems are considered more open, flexible, and therefore suitable for human resource management (HRM) reforms, such as performance related pay. The career-based systems are more rigid, but are said to provide more stability and loyalty within the public sector (Lægheid and Wise 2007, 180). OECD admits that although the introduction of PRP policies had previously been limited to position-based systems, it has recently been extended to classical career-based systems as a way of increasing flexibility (OECD 2005, 38).

Party politics. In terms of political explanations, some scholars see NPM reforms as the result of the ascension to power of the “New Right” in the late 1970s-early 1980s (Bach 1999; Barlow et al. 1996; Pollitt, 1993). It is argued that Neo-liberal and pro-market regimes would engender NPM reforms, as they are ideologically motivated both to roll back big government and to introduce more market oriented solutions such as performance-related-pay in the public sector. This ideological component would foster NPM reforms in countries with governments dominated by the political right. This argument is often backed by case studies of the intense NPM-reforms in Thatcher’s UK and Reagan’s US (ibid.).

Economic pressures. NPM reforms in general and HRM changes in particular have also been seen as the consequence of competitive pressures from globalization (Farazmand 1999). Public sector reforms would thus be the result of the challenges created by the competitive pressures derived from economic globalization, or from macroeconomic problems (Cope, Leishman and Starie 1997, 448). Specifically, NPM is frequently described as a response to fiscal stress. Examples habitually mentioned are the NPM reforms in New Zealand and the UK during the 1980s. Related to incentive

systems, it is argued that PRP reforms are almost exclusively found in developed countries which compete in the global economy (Selden 2003, 42).

Transaction Costs. We argue that insights from transaction cost economics (TCE) – developed for explaining the uneven introduction of incentives in what otherwise are very similar private sector organizations – may better help us understand the observed variations in incentive systems in the public sector than the prevailing accounts in the literature discussed above. Unlike traditional principal-agent theory, for which incentives will work if they are technically well designed in a contract, TCE considers that contracts – even the ones which carefully specify an incentive system – are inherently incomplete. There are always behaviors that cannot be specified *ex ante*. Generally speaking, the successful functioning of an organization does not so much depend on how properly designed formal contracts between employers and employees are, but on the existence of “relational” (Williamson 1975) or “psychological” (Levi 2005) contracts between them – that is, informal exchanges made possible by the accumulation of trust.

Organizational trust is particularly necessary for incentive systems to properly function, because of the standard problem of time inconsistency or credible commitment. If the employee trusts that the manager will keep the incentive system in the future and works hard, the manager overcomes one of the most relevant informational asymmetries within a firm: she now knows the employee’s real marginal cost of effort function (Falaschetti 2002,163). This, in turn, may tempt the manager to make opportunistic defections like cutting down the incentive promised to the employee to adjust it to the new information received – e.g. cutting down the incentive from \$20 to \$10 per piece produced once the manager knows how many pieces the employee can produce a day. This is especially the case if the manager is also the owner, because then she obtains a direct benefit from cutting incentives down. Anticipating this opportunistic behaviour, the employee may not work hard to start with when offered an incentive package. As shown by Miller (1992), this result is a Pareto-suboptimal Nash Equilibrium. Both manager and employee would be better off if employees could trust that their manager will reward them as promised and, consequently, they would engage in higher levels of effort than the minimum required.

TCE scholars have explored why some firms succeed in implementing incentive systems while many others seem to be trapped in the Pareto-suboptimal Nash Equilibrium. As in any other situation that involves trust, one cannot expect a definite and clear solution: there is never a probability equal to one that the manager is not going to renege on her promises. Yet TCE literature has emphasized one factor that can explain the efficient introduction of incentive in some private firms: the existence of *separation of interests* -or separation of powers- at the managerial structure of the firm (Miller and Falaschetti 2001, 403). If the owner of a firm (i.e. the one who would obtain the short-term benefits from violating trust) at the same time is its manager (i.e. the one who sets the incentive structure), workers may be reluctant to trust the incentive system. The owner of a company must act as a “passive owner” and rely on a manager whose preferences are different from hers. The key factor that enables organizational trust is thus that, in the eyes of employees, managers must possess *interests that are known to be different from the owners*’ (Miller and Hammond (1994, 22).

This paper argues that, despite the multiple differences between private and public managers, these theoretical insights from TCE may help us understand the uneven introduction of incentives we see across public organizations. To start with, the introduction of incentives in the public sector is subject to a level of uncertainty – and potential opportunistic defections – as high as or even higher than in the private sector. However, the main assumptions in the literature on incentives are more problematic in the public compared to the private sector due to the relative lack of objective measures of output and the complexities of the tasks at hand. It is difficult to assume that public organizations can accurately measure individual, team/unit, or organizational outputs and that pay can be administered in a way which capitalizes on its expected value for potential recipients (OECD 2005, 10). Performance assessment is inherently difficult in the public sector (OECD 2003; OECD 1997) and it requires a large element of managerial judgement (OECD 2005, 12).

These elements increase the likelihood of opportunistic defections by politicians in their relations with public employees. Research shows that governments have frequent temptations to ex post modify a given incentive system and divert the resources to other ends. For example, according to OECD (2004, 36) surveys regarding the failure of

incentive systems in several countries, it is recurrent to see “disappointed expectations of employees who have been promised money for improved performance and then find it is funded by means of smaller increases in base pay.” OECD admits, very similarly to what TCE authors state for the private sector, that incentives in the public sector create uncertainty among employees (OECD 2004a, 34) and the lack of trust is one of the most serious obstacles to the implementation of incentive schemes (OECD 2004a, 44). Similarly to TCE authors, the OECD addresses this uncertainty through the development of organizational trust. In particular, OECD claims that “PRP [systems] should be applied in an environment that maintains and supports a trust-based work relationship” (2004a, 7) and that “certain preconditions are essential before introducing a PRP system: transparency within the organization, clear promotion mechanisms, and trust in top and middle management” (2004a, 70).

Following the TCE literature on private firms we argue in this paper that the degree of trust within a public organization will critically depend on the degree of separation of interests between the public-sector equivalents of the private-sector “owners” and “managers”. The relevant questions are thus: who are the “owners” and “managers” of a public administration? And when can one say that their interests are “separated”?

Although the ultimate “owners” or shareholders in a democracy are voters, this paper, following political economy arguments, argues that governments – and, in particular, the ministers or cabinet members – are the *de facto* owners. However, unlike private sector owners, members of government are not entitled to the *residual* produced by public employees. Nevertheless, as Hammond and Miller (1994) remark, there are many ways through which politicians benefit from the residual generated by the provision of public policies. For example, as the OECD reports mentioned above show, governments frequently seem to have incentives to disappoint public employees by means of smaller increases in pay than the originally promised ones.

Regarding the “managers” in the public sector, it is difficult to establish a clear-cut classification, given the existence of many cross- and within-country differences. We base our definition here on previous work by public administration scholars who use the concept of “mandarins” for referring to the managerial ranks of the civil service (e.g. Pollitt and Bouckaert 2004, 50-52). Mandarins or managers of the administration would

be the senior civil servants or higher officials, including, among others, positions like permanent secretaries in the UK, or *directores generales* in Spain – that is, those who are responsible for the day-to-day management of public administrations.

The degree of separation of interests between ministers and mandarins has been studied extensively. Yet scholars have failed to agree on one single dimension to capture the essentials of minister-mandarin relations (Pollitt and Bouckaert 2004, 50-52). Following up previous literature, our definition of separation of interests involves two dimensions: *separation of careers* and *separation of activities*. First, there is separation of interests in those systems where the careers of ministers and mandarins are separated – that is, when there is neither politicization of administrative posts nor bureaucratization of political posts. Conversely, the careers of ministers and mandarins become integrated when there is either politicization of administrative posts – i.e. politicization “from above” using Peters and Pierre’s (2004) terminology – or bureaucratization of political posts – i.e. politicization “from below”. Secondly, there is *separation of activities* when political incumbents take political decisions while civil servants take managerial decisions and implement policy. Conversely, there is integration of activities either when civil servants involved in political decision-making or politicians engage in policy implementation. In sum, there is separation of interests between ministers and mandarins the more the careers of ministers and mandarins remain detached from one another and the more they perform their own core activities.¹

The TCE hypothesis would thus posit that public servants, similar to the case of private sector employees, will regard as more credible those incentives managed by mandarins whose interests are *known to be different* from politicians’ compared to those mandarins whose interests are integrated with politicians’. Akin to firms with known differentiated interests at the top of the hierarchy, the more separation of powers at the

¹ Our definition of “separation of interests” thus basically replicates the most prevailing definition of politicization in the literature. For most public administration scholars, there are three main types of politicization: political control over careers (i.e. politicization from above), civil servants’ political involvement (i.e. politicization from below), and civil servants’ participation in political decision-making (Aberbach et al. 1981, Peters 1988, Pierre 1995, Rouban 2007). We only add a fourth element – politicians’ involvement in the management of policy implementation – because it becomes relevant when we are dealing with incentive systems. In fact, what we define as “separation of interests” could also be interpreted as a new and more encompassing definition of politicization that includes one neglected aspect: politicians’ participation in policy implementation.

top of an administration, the more capable public-sector managers will be of credibly committing against opportunistic behaviour. Incentive systems will allow public employees to undertake higher levels of efforts in institutional settings of separation of interests than in those contexts where ministers' and mandarins' interests are intertwined. In other words, the hypothesis derived from this application of TCE theory to the public sector could be stated as follows: *ceteris paribus, the more separation between ministers' and mandarins' careers in a given polity, the closer the link between performance and pay for public employees.*

3. Cases, design and methods

In principle, PRP systems have been nearly universally present in all civil service reforms in the last decades. In practice, only some OECD civil service systems can be considered to have formalized PRP systems since frequently performance rewards are distributed without any formal assessment of individual performance (OECD 2004, 4-5). Literature agrees that there is a great variation in the real implementation of incentives – that is, in the extent to which economic rewards are actually linked to performance appraisal (Ingraham 1996, 260; Thompson 2007, 57). Consequently, the dependent variable of this paper is not the existence (or not) of PRP incentive systems, but, following OECD's recommendation, we focus on the more relevant issue of to which extent there is (or not) a real link between public servants' performance appraisal and pay.

The public service is usually divided into different ranks. Although in most OECD countries PRP systems include almost all government employees (OECD 2007, 119), many countries develop different PRP schemes for the senior civil service and for the rest of the public service. In this paper we will pay attention to PRP systems for middle and lower ranks of the public service, excluding the highest ranks or the “mandarins”, such as State Secretaries, General-Directors, or other elite managerial positions. The reason for this is that our theory – similar to theories in the private sector that explain employees' incentives differently from managers' – is based precisely on public employee's trust or distrust in those managerial senior civil servants or mandarins. The incentives of the latter should be explained according to their levels of trust in politicians' behavior.

We have selected four countries in order to allow for most-similar as well as most-different case comparisons (Gerring 2007, 131-144). To make the most out of our cases, we will make pair-wise comparisons and use both John Stuart Mills' method of agreement and his indirect method of difference (Mill 1967 [1883]; for examples of other empirical studies combining these two logics see Collier & Collier 1991; Moore 1966; Skocpol 1979).

We analyze two countries with a strong link between performance and pay in the public sector (Korea and Sweden) and two countries with a weak link between performance and pay in the public sector (Japan and Spain) (OECD 2005, 38). In the pair-wise comparisons we will pay special attention to three pairs: Japan/Korea, Sweden/Korea, and Spain/Japan. Japan and Korea differ in the implementation of public PRP systems, but they are similar in almost all aspects where scholarly literature has suggested we should find explanations for the implementation of PRP systems in the public sector. Sweden and Korea, on the other hand, are similarly successful in implementing PRP systems in the public sector, but are different in most other aspects. A reverse case is that of Spain and Japan – two countries that have little in common except that they have hardly implemented PRP systems (Bekke, Perry & Toonen 1996; Pollitt & Bouckaert 2004; OECD 2005; OECD 2007). There are three more possible pair-wise comparisons: Sweden/Spain, Korea/Spain, and Sweden/Japan. As both the dependent and the independent variables differ between these countries, it is not as clear what can be learnt from these comparisons and we will therefore pay less attention to them.

Finally, we will also use the within case variation to evaluate our conclusions. In the cases with less general development of PRP systems in the public sector – Spain and Japan – there are some particular organizations which constitute an intriguing exception given their advanced use of PRP that we will analyse.

4. Four Trajectories towards Performance Related Pay in the Public Sector

In this empirical section we offer a qualitative analysis of the implementation of PRP schemes in four OECD countries. For each country, we provide the following narratives:

First, a detailed description of the dependent variable is presented where the following questions are answered: which type of PRP system, if any, did the country adopt and when and how was it implemented?; second, to what extent does the institutional hypothesis presented in this paper offer a convincing explanation? In the subsequent empirical section we provide the comparative pair-wise analysis showing the shortcomings of the existing explanations.

4.1 Sweden

Traditionally Sweden has had a rigid pay and grading structure in the public sector, and until the late 1980s there was a general grading system and highly centralised bargaining system that was applied to the entire Swedish public sector. This started to change in 1985 when the Swedish Riksdag passed the Governments Personnel Policy Bill, making results and efficiency number one priorities. The most important reforms came in the late 1980s and early 1990s when Sweden abolished the salary grade scheme and introduced a performance appraisal system in the public sector. Today Sweden is considered to have a close link between performance and pay in the public sector. At the same time, civil service status was also changed, replacing lifelong employments for employment on a permanent contract basis (OECD 2005, Sweden; Pollitt & Bouckaert 2004, 288, Sundström 2006, 409).

The direct motive for implementing PRP in Sweden was to strengthen the link between outcome and pay in order to increase efficiency in the public sector. Performance related pay was one part of a larger reform process where the Swedish public sector was influenced by the new form of results-oriented management and what has been labelled the “rationalistic steering model” (Sundström 2006, 400).

In comparative terms, Sweden has since the 1990s been considered to be a frontrunner when it comes to performance related pay in the public sector (OECD 2004a, 11; OECD 2004b, 7, OECD 2005, 153-158). It is important to note that, contrary to many other countries, the Swedish system works without a standardised evaluation system. Individual and differentiated salaries are instead negotiated at the local level, and results are publically available. The system is based on transparent pay policies, developed by the management of each organization. According to the OECD, Sweden has – along with

five other countries out of twenty five – the clearest link between performance appraisal and pay in the public sector (OECD 2004b, 17). Generally speaking, comparative public administration scholars agree that Sweden has been fairly successful in implementing NPM reforms (Hood 1996, 277; Thompson 2007, 51).

This paper argues that the advanced development of incentives for public employees in Sweden is the result of high levels of organizational trust in a public administration where the interests of ministers and mandarins are separated. Public administration scholars have traditionally pointed out the existence of the so-called “Swedish administrative model” in this regard. Even though the precise content of this model is disputed, it consists of a relatively big, corporatist, open, rule-oriented, and decentralised public sector (Premfors et al 2003, 51). In addition, comparative studies often stress that the most striking difference between Sweden and other countries is the autonomy of its public sector from interferences from political policy-makers (Pierre 1995, 155).

The ministries are very small in comparative terms. Since 1997, they are organised within one single authority – the Government Offices (Regeringskansliet). Within the Government Offices there are today thirteen ministries with around 4 600 employees, and among them a relatively small number of 200 political appointees (Premfors & Sundström 2007).

More importantly, the Government Offices are almost exclusively focused on policymaking, with no direct involvement in policy implementation. The bulk of state activities, which in most countries take place within the ministries, are in Sweden performed by semi-autonomous agencies. These agencies are not only organisationally separated from the ministries, but the Swedish constitution restricts the issuing of direct orders for both ministries and the government to the agencies. From the theoretical point of view of this paper, it is important to bear in mind that this complete delegation from politicians to agencies involves discretion for managing public employees’ recruitment and pay. The division between policymakers and agencies in Sweden has a long history which can be traced back to the 18th century (Andersson 2004). What is sometimes referred to as a “dualistic” structure of the administration is often considered the backbone of the Swedish administrative model (Premfors 1991; Ruin 1991; Pierre 2004,

41). This dualistic structure of the Swedish public administration, with policy-making clearly separated from policy-implementation, was thus already in place before performance related pay systems were introduced.

Another feature of the Swedish public administration, which according to the theoretical hypothesis of this paper would help create the trust necessary to introduce individual incentives for employees in the public sector, is the very low levels of politicization – both from above and from below. In Sweden, unlike other countries with low politicization such as Korea, it has been argued that politicization is constrained with relatively few formal rules. Low politicization levels would mostly be the result of a “deep internalization” of the values of political neutrality among public servants and citizens in general (OECD 2007/6, 22). Thus, again, one can plausibly assume that this component of our independent variable had also been in place long before the development of PRP systems in the early 1990s. In sum, and in line with the theory of this paper, we have argued that incentives in the Swedish public sector have been possible thanks to the institutional separation of ministers and mandarins. In particular, the division between the political Government offices and the non-political agencies together with the relatively low degree of politicization contributed to the acceptance by public employees of the decentralised performance related pay scheme.

4.2 Korea

Similar to Sweden, Korea ranks very high in our dependent variable since it has implemented a PRP system that very much links performance appraisal and pay. In addition, it is considered as one of the most encompassing incentive systems in the world, given that all categories of staff are covered by PRP schemes (OECD 2005, 138). Reforms of the public service started in the aftermath of the 1997 financial crisis (Kim & Lee 2001, 10; Namkoong 2006, 9). Traditionally, appraisal and rewards in the Korean public service had almost exclusively been based on seniority, and experts considered that it provided scarce incentives to civil servants – weakening the civil service competitiveness both internationally and domestically (Kim & Lee 2006). This prompted the introduction of PRP schemes in 1999 (Namkoong 2006, 21; Oh & Joo 2008, 2). According to Korean scholars, the general aim of the incentive schemes was to move

from a pay structure based on the rule of seniority, which could not work as an incentive for better job performance, to one based on accountability and performance (Oh & Joo 2008, 13).

One crucial aspect of the Korean PRP system is its ability to identify particularly outstanding performers. The lack of discrimination between excellent and “average” performers has been reported as one of the major traditional limitations of PRP schemes (OECD 2005, 65). In Korea, the lack of differentiation in ratings awarded has been prevented by an increased use of quota systems, which specify the proportion of employees placed in the higher categories of the rating scale (OECD 2004, 28).

Korea’s introduction of a PRP system in the public sector is seen as a “radical change” in a civil service system “traditionally oriented to collectivism” (OECD 2004, 11). However, in the light of the theory of this paper, Korea’s adoption of a well-developed PRP system would not be an exception difficult to understand, but a perfectly even-handed change, given the institutional separation between the careers of politicians and civil servants.

Similar to the theoretical mechanism of this paper, several Korean scholars have pointed out the key role that organizational trust plays in the implementation of PRP schemes: “when public servants do not trust the results of the performance assessment, it is hard for them to accept the variances in pay” (Kim & Lee 2001, 15; Namkoong 2006, 22). Organizational trust has also been a concern for the designers of the Korean PRP schemes. In that sense, and unlike most countries, Korea has moved in the direction of a 360-degree feedback appraisal system where performance appraisal is made not only by superiors, but also by peers, and/or subordinates (PUMA/HRM 2000, Coleman Selden 2003, 42; OECD 2005, 55). The goal of the 360-degree feedback mechanism is to increase organizational trust in the incentive system in order to avoid that “Korean civil servants could have been subject to the careless or unbalanced appraisal from their small number of senior officials” (Oh & Lee 2008, 18).

We argue that the institutional foundation of the organizational trust that has allowed the development of a PRP system in Korea is the separation of interests between politicians and civil servants. Although in the aftermath of WWII an illegal and informal spoils system became an instrument of the ruling Liberal party to assure the loyalty of

civil servants (Kim 2006, 9), General Park's administration enacted a National Civil Service Act in 1963 which established the characteristics of the current merit-based autonomous civil service (Oh 1993, 32; Namkoong 2006, 4). The Korean civil service system is also ranked among the countries where appointments of higher civil servants are "more administrative" (vs. "more political"), right after the UK, Denmark and New Zealand. While the positions of ministers and deputy ministers are politically appointed, the next level immediately below – assistant minister level – is covered by career bureaucrats (OECD 2005, 139). Similarly, it stands as the third OECD country in which dismissals, promotions and arrangements for transfer to another position are decided in a "more administrative" way. More crucially for this paper, Korea leads the OECD ranking on how "administrative" (or less political) performance assessments are (OECD 2007/6, 16-18).

Korea is also one of the OECD countries with more legal restrictions on civil servants' involvement in political activities. Korean civil servants cannot stand for public office or exert high profile party political activity, and they also face limits for other minor party activities (OECD 2007/6, 19). Taking both elements of the "separation of interests" between politicians and mandarins into account – i.e. politicization (from above and below) as well as separation of activities – Korea would very likely represent the OECD country with the highest degree of separation.

4.3 Spain

Spain is a laggard in the implementation of NPM reforms, especially in the field of human resources (Parrado 1996, 268; Thompson 2007, 55). Not only does Spain lack a strong link between performance appraisal and pay, but it is also one of the few OECD countries (together with Greece, Iceland and Luxembourg) which does not possess a formal performance appraisal system as such. As a result, the incentive is almost always a fixed amount related to an extra activity (e.g. longer working hours) and not to performance (OECD 2003, Spain; OECD 2005, 152). Furthermore, PRP tends simply to be added to the base salary of the recipient, thus becoming a permanent part of the basic pay. As a result, they lose the performance-related nature of the reward from the second year onwards (OECD 2004, 32).

Following the theoretical section, we argue here that a lack of separation of interests between ministers and mandarins may have played a role in the inability to implement widespread incentive systems in the public sector. The Spanish public administration is characterized by both extensive top-down and bottom-up politicization. For one, the replacement of the Spanish political-administrative elite after party alternation in power is very significant. There is a large and increasing political appointment area, which includes seven different politically appointed posts in each ministry, where we find individuals belonging both to the realm of politics – politicians that come and go at the will of their superiors – and to the realm of administration – since it offers career opportunities to civil servants (Parrado 2004, 223, Alba 2001, 103). In other words, there is an extensive “politico-administrative circle” in Spain that includes most managerial positions (Molina 1999, 42). In general, and unlike what happens in other countries with high degrees of politicization, such as the US, more than 75 percent of Spanish political appointees during the democratic period have been civil servants (Parrado 2004, 234). A civil servant whose first post is at a high level (grades 26 or 28, out of a total range of 30, are usual for beginners of some *corps*) will have a short career (Parrado 2004, 233). Very early, the civil servant will find that the promotion to a new post will depend on political superiors through an appointment system known as “free designation”, which is the routine for top posts (Molina 1999, 44).

At the same time, the presence of civil servants among the political elite is very pervasive. Many senior party members, many MPs and around 50 per cent of ministers (and a higher proportion of junior ministers) are civil servants (Molina 1999, 52). This is a tradition with strong historical roots, which has persisted even in times of high political instability, such as the Second Republic (1931-1936) when civil servants occupied almost 60% of all political positions in the government (Alba 2001, 93). The first democratic government in the 1970s was in the hands of the UCD, which could be defined as a “civil servants’ party”, since its elites were almost exclusively recruited from the administrative *corps* (Alba 2001, 104).

Spain thus combines an extensive politicization of promotions to all senior civil service posts with a high degree of bureaucratization of the political elite, generating a very similar profile between politicians and top officials (Serrano 1993, 14; Molina 1999,

51). The demarcation line between the political and administrative spheres in the Spanish case is thus “almost nonexistent” (Alba 2001, 93).

It is inherently difficult to identify whether the mechanisms of our theory have played a significant role in the lack of implementation of PRP systems in Spain. Nevertheless, when analyzing the failure of PRP systems, the OECD recognizes that politicization is one of the main obstacles. Public employees are more likely to accept PRPs if they feel that the process of distribution of incentives is “fair” – even if they know that incentives could sometimes be disadvantageous to them when they do not manage to perform appropriately. OECD explicitly states that politicization impedes this: “where the level of political appointments is high, ‘procedural justice’ mechanisms [i.e. PRP systems] may be harder to set” (2004, 39). In presence of extensive politicization of the managers of the administration, PRP systems will likely have a “demotivating impact” on public employees (OECD 2004, 39).

In the Spanish case, scholars have found several instances of opportunistic political defections in relation to civil service payments – similar to the ones depicted in our theoretical model. For example, the PSOE government (1982-1996) signed an agreement on the annual wage increases for the period 1994-1997 with several civil service representatives. In 1996, the Minister of Public Administration of the newly elected Partido Popular (PP), Mariano Rajoy, violated the terms of the agreement and cancelled any wage increases, arguing that the political conditions had changed. For some scholars, this extensive politicization diminishes organizational trust, so that many civil servants cannot trust a system of rewards where “being one of ours” is the rule. This has in turn forced many qualified senior managers to migrate to the private sector (Alba 2001, 99). The pervasive politicization of the Spanish central administration has produced a growing process of de-professionalization (Gutierrez Renon 1990) as well as “uncertainty and unpredictability in the administrative machinery” (Alba 2001, 99).

As already mentioned, the Spanish case also illustrates the relevance of within-country differences. While the bulk of the Spanish central administration has not been able to implement encompassing PRP systems and would follow the pattern depicted above, other parts of the Spanish state apparatus have developed some of the most advanced PRP systems within the OECD context. The paradox, as stated by Parrado

(2008, 1), is that Spain, “a representative of the Napoleonic tradition”, has, nevertheless, “undergone considerable managerial changes” in some particular agencies. Most notably, that is the case of the Institute of National Social Security (INSS), where the productivity bonus represented 22.1% of total salaries in 2000 (OECD 2005, 59).

The INSS, unlike the mainstream Spanish administration, is a “semi-autonomous public body”, characterized by “a certain degree of autonomy and functional disaggregation from the parent ministry” (Parrado 2008, 25). Thus, while in the mainstream Spanish administration – where we see high integration between bureaucrats and politicians – incentives play a minor role, in other public organizations with more autonomy and disaggregation – where one can plausibly assume a higher degree of separation of interests – incentives are fully implemented. The case of the Spanish INSS would thus provide more empirical support for the claim by OECD reports as well as academic studies that an administrative structure based on autonomous agencies was key to the success of incentives in the UK (Thompson 2007, 52; OECD 2003, UK; OECD 2004a, 63).

4.4 Japan

Since World War II there have been a number of administrative reforms in Japan, often aimed at making the Japanese government more efficient. However, several of the reform suggestions were at that time seen as unfeasible and were not implemented (Masujima 2005, 295; Yamamoto 2003, 11). Similar to the other countries in this analysis, an economic crisis – in the case of Japan the 1990s “lost decade” – triggered major administrative reform attempts. External pressure generated by economic recession and international criticism forced Prime Minister Hashimoto to initiate the largest reorganization of the public sector since the war. The Hashimoto reforms encompassed some New Public Management principles, mainly concerning policy evaluation in the ministries. Nevertheless, the implementation of the policy evaluation allows each government organ to decide on which programs that are to be evaluated. This has prompted Yamamoto to conclude that “the application of NPM principles has been rather limited” (Yamamoto 2003, 16). In comparative terms, Japan is often considered a laggard when it comes to implementing New Public Management reforms (Hood 1996, 281-282;

Nakamura 2001; OECD 2007). More importantly, regarding incentives for public employees, Japan has not implemented a real link between performance appraisal and pay (OECD 2005).

We argue in this paper that one major reason for why Japan has not developed PRP systems that really link outcome and pay is the lack of separation of interests between politicians and mandarins. The literature has pointed out that one very important factor for the failure of NPM reforms in Japan is that the bureaucratic elite strongly opposed them. Scholars underline that Japan is a country with long mandarin traditions where bureaucrats do not limit their role to policy implementation, but they are generally considered powerful also in the policy-making process. In one of the clearest examples of lack of separation of powers, bureaucrats frequently took active part in discussions in the Japanese legislature the Diet up until the end of 1999 (Nakamura 2001; OECD 2007). In a comparison between administrative reforms in the UK and Japan, Lesley Connors concludes that “the bureaucracy was regarded as a legitimate source of policy generation to an extent not countenanced in Whitehall” (Connors 2000, 113).

The integration of interests between politicians and mandarins is, if any, even stronger regarding career patterns. Traditionally, there is also a close connection between the elite bureaucracy and the dominant party, the Liberal Democratic Party (LDP). The first non-LDP government for 38 years was formed in 1993, and LDP returned to government in 1996 (Nakano 1998). This one-party dominance has had implications for the relationship, specifically between elite bureaucrats and ministers. The relationships with the politicians have large effects on the prospects for promotion and post-retirement employment, so-called “*amakudari* positions”, for bureaucrats. What is more, it is not uncommon that elite bureaucrats become involved in politics. Through the 1970s a majority of the Japanese Cabinet were former bureaucrats. Today the new deputy ministers are often former bureaucrats and it is not uncommon that bureaucrats, after their retirement, become members of the Diet as LDP representatives (Connors 2000, 113). Another important aspect of minister and mandarin relations in Japan is the partnership between elite bureaucrats and fractions of the ruling party. Sectional organised groups often of MP:s from LDP, called *zoku*, are closely linked with producers and elite

bureaucrats. These groups distribute spoils and are experts in different policy sectors, and have significant policy influence (Painter forthcoming).

Akin to the Spanish case, Japan also illustrates the relevance of within-country differences. While most of the Japanese public administration has hardly implemented encompassing PRP systems, some particular public organizations have developed more advanced incentive systems. Again, institutional factors, and the dissimilar levels of trust they may create, could be useful to understanding those differences. Similar to the creation of autonomous agencies in Spain in the 1990s, the Hashimoto reforms in Japan also included a process of agencification inspired by developments in the UK after the Next Steps in the late 1980s. Organizations legally separated from the Japanese government – known as Independent Administrative Institutions (IAI) – were set up to perform policy implementation functions. If the institutional setting of non-politicized independent agencies has created the necessary trust to efficiently implement PRP systems in countries such as Sweden, the UK or the Spanish INSS, something similar can be argued for the Japanese case. There is a notable consensus in the literature regarding the positive effects that the creation of autonomous agencies has for the successful implementation of incentive systems (Thompson 2007, 52; OECD 2003, UK; OECD 2004a, 63).

In Japan, regarding the degree of separation of interests in the newly created IAIs, it can be claimed that the process of agencification was limited and, to start with, recruitment was in practice restricted by the rules for national civil servants (Connors 2000, 117; Yamamoto 2003, 17-21). On the other hand, IAIs are closer to an ideal-type autonomous agency than the mainstream Japanese administration. IAIs are managed more by output control, through so-called management by objectives, and steps have been taken so that both Chief Executives and other agency personnel are to be recruited from outside the bureaucratic ranks. Consequently, the theory developed here would predict incentives to be more implemented in IAIs. Although still in an embryonic stage, the literature points out that, at least in principle, performance related pay has been introduced in the IAIs (Yamamoto 2003, 19).

5. Comparing Japan, Korea, Spain, and Sweden

In this section we will make three pair-wise comparisons, where one is based on a most-similar case logic, and two on a most-different case logic. As is shown in table 1, Japan and Korea are similar in almost all theoretically relevant aspects, with the exception of minister and mandarin relations, and the implementation of PRP systems in the public sector, discussed in section 4. They have also implemented large administrative reform packages at almost exactly the same time in the late 1990s (Bekke, Perry & Toonen 1996; OECD 2005; OECD 2007). These facts make the cases ideal for a most-similar case comparison (Gerring 2007, 131).

Table 1
Minister and mandarin relations, administrative tradition, right party dominance, HMR structure and PRP systems in Japan, Korea, Spain and Sweden.

Country	Minister/ Mandarin relations	Link between performance appraisal and pay	Open/ closed public service	Administrative tradition	Years of right party dominance, 1985-2004	Centralisation/ decentralisation of human resource management
Japan	Integrated	Not linked	Closed	Confucian	19	Centralised
Korea	Separated	Linked	Closed	Confucian	12	Centralised
Spain	Integrated	Not linked	Closed	Napoleonic	8	Partly decentralised
Sweden	Separated	Linked	Open	Scandinavian	3	Decentralised

Comment: Country values on the minister/mandarin relation dichotomy are based on the references in section 4, the link between performance appraisal and pay are based on (OECD 2005, 38), the value for the open and closed dichotomy are based on (OECD 2007), values for the administrative tradition are based on (Peters 1997; Burns 2007), the yeas of right party dominance comes from the Database of Political Institutions, available in the Quality of Government Database (Teorell, Holmberg and Rothstein 2008), and the Centralisation/decentralisation of HR management data are from (OECD 2005).

Considering the traditional scholarly explanations of NPM reforms, Japan shows several of the characteristics of a non-NPM reformer. Japan has a closed civil service, with a legalistic administrative tradition. It has also a highly centralized human relation management of the public service. These three features speak against NPM reforms in a traditional perspective. On the other hand, there are two traditional explanations that

speak for NPM reforms in Japan. The first is the strong influence of right parties in Japan: during 19 of the 20 years analysed in this study a right party – the LPD – has dominated the government. Two economic factors also speak for NPM reforms; Japan is a rich industrialised country, but it has had severe economic difficulties during the 1990s, which called for a restructuring of the state. As mentioned in section 4, this was also a motive for the administrative reforms of the late 1990s in Japan (Connors 2000; Masujima 2005; Nakano 1998; Painter forthcoming; Yamamoto 2003).

Judging only from the Japanese case it would have been easy to draw the conclusion that the administrative tradition, the closed recruitment, and the centralised HR management can explain Japan's reluctance to implement PRP reforms in the public sector. This would however have been a mistake, which becomes clear in the comparison with the Korean case.

In terms of administrative traditions, Korea not only belongs to the career-based tradition, but it also has one of the most closed career civil service systems, with lifetime employment guarantee and with almost no room for lateral entries (Namkoong 2006, 8). Even Korean public administration scholars are conscious of the possible lack of transferability of NPM due to the cultural and historical differences between Korean and Western societies (Kim & Lee 2001, 8). Some authors also emphasize the strong hierarchy and elitist nature as a result to the religious and political spirit of Chinese Confucianism, which has lasted for several hundred years, and the Japanese colonial rule in the first half of the 20th century, if any, reinforced it (Oh & Joo 2008, 4). The PRP system in Korea is also designed and applied at the central level, and is highly centralized (OECD 2005, 138). Together with the Czech Republic, Korea has a low degree of human resources delegation and has developed strong links between performance appraisal and pay, which runs against the hypothesis of decentralization of HRM as a prerequisite for the introduction of incentive schemes. What is more, the Korean right have dominated the government for 12 of the last 20 years, and political center parties have dominated for the rest of the 8 years. The left has not dominated the government a single year between 1985 and 2004.

In all these administrative characteristics the Japanese and the Korean cases are very similar. Regarding all the possible independent variables discussed here it is only in

the minister/mandarin relations that the two cases differ. Therefore, the successful implementation of a PRP system in Korea, and the failure of PRP in Japan, speaks against traditional explanations and for the explanation suggested in this paper. This conclusion is also strengthened by the comparison between Sweden and Korea.

Unlike the previous comparison, we can consider Sweden and Korea to be most-different cases following the standard definition in the literature (Gerring 2007, 139). As one may see in table 2, they belong to different administrative traditions and to dissimilar civil service cultures; while Korea has had long tenures of right governments, in Sweden governments have in the last decades predominately been from the political left; and while human recourse management is centralized in Korea, it is decentralised in Sweden (Bekke, Perry & Toonen 1996; Pollitt & Bouckaert 2004; OECD 2005; OECD 2007). Nevertheless, both Korea and Sweden have successfully implemented a PRP system in the public sector and they rank among the OECD countries with the clearest link between performance appraisal and pay in the public sector (OECD 2005, 38). Except for the minister mandarin relations, this success is the only of the theoretically relevant characteristics that is shared between Korea and Sweden.

Neither Sweden nor Korea come from the Anglo-Saxon administrative tradition (sometimes also referred to as “public interest”) that is often associated with NPM reforms. Instead they come from two other – and different – administrative traditions. Sweden has a legalistic tradition and belongs to the Scandinavian administrative tradition (Pierre 2004, 41). Contrary to Korea, Sweden has an open recruitment process with one of the most decentralised HR management systems of all OECD countries (OECD 2005, 37). What is more, the Swedish case also challenges any claims of NPM reforms as an effect of a neo-liberal agenda of right-wing parties. In sharp contrast with Korea, most NPM reforms in Sweden were introduced by the Social Democrats (Hood 1996, 277; Pollitt & Bouckaert 2004). According to both Pierre (2001) and Sundström (2006), the dividing line between pro- and anti- reform actors did not go between the political right and the political left in Sweden. Reforms were instead advocated by actors within the Agency for Administrative Development (Statskontoret), the National Audit Office (Riksrevisionsverket), and the Ministry for Finance (Finansdepartementet) (Pierre 2001, 136; Premfors 1999, 163; Sundström 2006). Therefore our conclusions from the

comparison between Sweden and Korea are that administrative tradition, recruitment processes, HR management, and party politics can not explain the implementation of PRP-reforms in Sweden and Korea.

If we now turn to the third pair-wise comparison, the one between Spain and Japan, the Spanish case seems to fit the administrative culture hypothesis as a representative of the Napoleonic tradition. But as we have already seen, this conclusion is not as evident in comparison with Japan, who belongs to another administrative tradition. The two countries share the same closed structure of recruitment to the public sector, which speaks for that explanation, but differ when it comes to HR management. Spanish governments have also, contrary to governments in Japan, been dominated by the political left.

As in Japan, NPM reforms have hardly been implemented in Spain on a large scale. Nevertheless, although this is true if we refer to the Spanish administration as a whole (or on average), this is far from evident if we look at some specific Spanish public organizations that have implemented notable NPM features in the recent years. And again, this observation does also seem to hold for Japan, although to a lesser extent.

The existence of these notable within-country differences is one of the arguments to disregard explanations of NPM based on national administrative traditions. As Parrado (2008, 2) remarks about Spain; “this idea could be questioned by talking to and training senior civil servants and public managers of different government levels in Spain. It is not uncommon to witness that public managers working in identical or very similar services from different organisations or sites do not talk the same language when faced in the same room. Some are performance oriented, work by results, practice merit payment and run their services in a managerial fashion while others are entrenched in the old bureaucratic culture less prone to change.” The example of Spain indicates that the causes of variations in NPM should not only be sought at the cross-country level (e.g. administrative or legal traditions), but also at the cross-organizational level. Some organizations succeed in introducing NPM and others fail; and thus organizational theory arguments, such as the ones deployed here, seem especially appropriate to shed light on this puzzle. This is also underlined by the Japanese experience with the IAIs. As mentioned in the previous section, it is in these relatively independent agencies, where

the connection between mandarins and ministers are broken, that NPM reforms - and among them a PRP system - have had the most impact (Yamamoto 2003, 19).

6. Conclusions

In this paper we explain that such widely differing societies as Spain and Japan end up possessing similar incentive systems in the public sector which, in turn, are different from those of (also dissimilar) countries like Korea and Sweden. The theory of this paper comes from developments in transaction-cost economics, which consider that the main obstacle for the implementation of high-powered incentives in an organization is the lack of trust. The paper has offered theoretical arguments and empirical evidence showing that this trust-problem may be decisively reduced in public organizations when the interests of ministers and mandarins are separated.

Unlike common wisdom in the literature, this paper does not argue that incentive systems require a certain historical legacy, an open HRM structure in the public sector, or right party dominance. Moreover, although economic pressure does seem to trigger attempts to establish incentive systems in all countries analyzed here, and thus it can be considered as a necessary cause, it is far from being a sufficient one, since periods of economic crisis were not sufficient to set up encompassing incentive systems in countries like Japan or Spain. The paper argues that what an incentive system requires the most is a suitable institutional design: an organizational structure with relative separation of interests at the top. When institutions separating the interest of ministers and mandarins are in place the paper shows that incentives can be implemented even in the most theoretically reluctant cultural environments, like in the closed-civil-service traditions of Confucian Korean, or in certain sections of the Confucian Japanese and the Napoleonic Spanish administrations.

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