Job Insecurity in the New Model of Public Employment

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Abstract

Since the late eighties, a new model of public sector employment has swept a number of the States in Australia, initially at the senior executive level and now increasingly at non-executive level. This model of 'contract' employment is one in which employees may be terminated at short notice, for no reason, and with very limited termination compensation. This paper analyses the consequences of this new model and, specifically, of dramatically increased exposure to the risk of arbitrary termination or termination flowing from the impact of an 'exogenous' financial or policy shock upon Government. It also reflects on the prospects for the construction of a new 'implicit contract' which might mitigate the adverse consequences of the new model by facilitating the re-establishment of trust in the public sector employment relationship.

Introduction

We are at present in the middle of a period of radical change in the nature of public employment in Australia. The traditional 'career service' model of the public service (RCAGA, 1976, p. 169) has been under growing challenge over the past two decades or more, both domestically and internationally (Mosher, 1982; Nunberg, 1995; Loverd and Pavlak, 1983, pp. 16-18). In Australia, the critique was initiated on the left, largely as a reaction to what was seen as obstruction by the bureaucracy of the Whitlam

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Government. The traditional bureaucracy was criticized amongst other things for being too unresponsive and for lacking innovation as a consequence of its closed nature. A reform agenda was put forward (Wilenski, 1986; Hawker, 1981) which sought to open the public service up to outsiders, to facilitate overtly political appointments at the top as in the US and elsewhere, and to give Ministers greater ability to choose top advisers in tune with their aspirations.

The critique had considerable force. It also had appeal across the political spectrum, driven by a bipartisan perception of the traditional bureaucracy as a "Yes Minister" system (Scott, 1995) and by a legitimate desire to assert political control and mastery of the ship of state. As Rourke (1976, p. 14) has noted "no fear as been more constant in modern politics – shared by revolutionaries and reactionaries alike – than the apprehension that bureaucrats might become a power elite and dominate the governmental process in which they are meant to play a subordinate role". A moderated version of the reform agenda derived from this critique guided many of the public service reforms which took place at the federal level under Labor during the 1980s. Many of these reforms were highly derivative, a key example being the implementation of an attenuated version of the Senior Executive Service model introduced in the U.S. in 1978.

More recently, there has been a radical extension of the new model in Australia. This was initiated at the State level, starting with NSW in the late 1980s, and then followed by Victoria and a number of other States since 1992. Paradoxically, it has been radical governments not of the left but of the right which have led the way in giving full expression to the agenda originally developed on the left.

The traditional career service model was, of course, one in which public servants swapped greater job security for remuneration which was, particularly at the executive level, lower than the private sector (Huijer, 1990, pp. 83-4). The central element of this job security was 'legislated protection against arbitrary dismissal (termination being only for cause and by due process)' (RCAGA, 1976, p. 169; McLeod, 1989, p. 92). This job security was part of the broader 'merit' principle of public service management which arose historically in advanced western countries as a means of avoiding the abuses and inefficiencies inherent in systems where politicians had free rein in the hiring and firing of bureaucrats.

There has for some time been growing agreement that the traditional model makes it too hard to deal with inefficient or unresponsive personnel (eg McLeod, 1994, xiii, 56). Whereas an incremental response to this is to toughen the sanctions against non-performers, the new model pioneered in the States takes a far more radical approach, dramatically raising the level

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of job insecurity for public sector employees, particularly at the executive level. It is the implications of the job insecurity inherent in this new model of 'contract' employment which is the focus of this paper. For the purposes of this paper, 'job insecurity' is defined as the risk of substantial loss as a result of involuntary change in employment status. In this sense, job insecurity refers not only to the risk of losing one's job and status (or of being demoted), but also to the extent of personal loss flowing from such an event – an important determinant of the latter being the degree to which one is insured against loss by means of termination compensation entitlements.[1]

The first defining characteristic of 'contract' employment under this new model is the ability of Government to terminate so-called contracts at will, at any time and with little notice.[2] There are generally no requirements to specify the grounds of termination, no internal or external appeal rights, and few if any other 'due process' requirements.[3] This is in every sense a reversion to the nineteenth century common law doctrine of 'employment at will', or more specifically to the common law presumption of the power of the Crown to 'dismiss at pleasure' (Smith, 1987). From the outset, this was justified as putting public sector executives on the same footing as their private sector counterparts (NSWPD [Assembly], 1 June 1988, p. 1081). And indeed it did precisely that – at least if one has in mind the executive employment practices which now dominate the English-speaking world, rather than those of countries like Japan.

The new model of public sector employment differs markedly from private sector practice, however, in respect of termination compensation. Substantial termination compensation is a common feature of private sector executive employment contracts. Governments have been quite determined to avoid or minimize such 'golden handshakes' for sacked public servants (VPD [Assembly], 3 October 1991, pp. 988-89; 4 November 1992, p. 354; SAPD [Assembly], 8 March 1994, p. 289). Section 42S of the NSW Act specified a *maximum* compensation of one year's salary, with the precise quantum being determined by an 'independent' Statutory and Other Offices Remuneration Tribunal on a case-by-case basis. The Victorians went much further, stipulating in Section 55 of their 1992 Act that there would be *no* entitlement to compensation for termination of contract.[4] More recently, the Carr Government in NSW decided that one year – which had become the norm rather than the maximum (*Australian*, 15 May 1995, p. 4) – was far too generous, and acted to cut compensation back to a maximum of three month's pay.[5]

The implications of this are particularly striking when one recognizes that the semi-monopsonistic nature of Government as an employer consid-

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erably raises the cost of job terminations. If the public service operates as an integrated service, termination is like a private sector executive being fired from his industry as well as from his firm. In the Australian context, this is mitigated a little by the existence of a federal system with a number of different Governments throughout the country. The point nevertheless remains.

The approach in most States is that this type of 'contract' employment is intended to cover all senior executive positions in the public service.[6] In addition, there is a trend to extend the contract model increasingly to the lower levels of the public service. At both levels, conversion of former permanent staff has been principally by legislative fiat or pressure.[7]

Advocates of the insecurity model view it as:

- permitting prompt resolution of problems of non-performance, without cumbersome procedural requirements and appeal processes,
- helping to ensure a public service more in sympathy with, and more willing to implement, Government programmes of radical change,
- more generally, permitting the application of a full range of performance-related rewards and sanctions which will, when coupled with an appropriate performance appraisal system, provide the most effective possible impetus for improved performance on the part of senior bureaucrats,
- putting the public service more on a private sector footing, for reasons both of equity and efficiency,
- providing greater flexibility in employment levels at the aggregate level, thus permitting Government flexibility in the face of a more unstable and uncertain fiscal environment,
- providing a means by which incoming Governments may deal with the problem of a public service 'stacked' with partisan supporters of their opponents (as has certainly been the case in some of the State bureaucracies).

These changes have been controversial. Critics have argued that the new model will have a seriously adverse effect on the willingness of public servants to provide 'frank and fearless' advice to the Government, and that it will aggravate the problem of the politicization of the public service.

Another point which has been made is that the behavioral assumptions which underpin the performance-enhancement strategy of the new model is based are seriously flawed in that they regard material self-interest as the key performance motivator and overlook the crucial role of the values of responsibility and commitment (Alford and Considine, 1994, p. 70). The crude version of agency theory which is having such a baleful impact upon

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public sector management at present is one which in this respect has overlooked, perhaps out of ignorance, ideas about human motivation which specialists in human resource management would regard as commonplace. More than thirty years ago, for example, Douglas McGregor launched a devastating attack on a 'conventional organizational theory' which was founded upon behavioral assumptions virtually identical to those underpinning the new public sector model. McGregor vigorously asserted the crucial importance of enlisting commitment, self-esteem and reputation as motivators rather than relying simply upon the "carrot and stick" approach (McGregor, 1960, pp. 33-38, 9-10).

The issues raised by what we will refer to as the 'insecurity model' of public employment have a relevance which goes beyond the States which have adopted it. To date, the Commonwealth Government has not adopted a contract model for the SES (McLeod, 1994, pp. xiv, 100; *Australian*, 31 July 1995, pp. 3, 10). And at the state level, Queensland has been a particularly notable and deliberate abstainer from the new model.[8] However, the future of the Australian Public Service must be regarded as very open, with a substantial risk that much of the insecurity model will be translated from the States to the Commonwealth level in the near future. The federal Coalition has indicated its sympathy for the contract system (*Australian*, 1 August 1995, p. 2). Whether by this it means the full extremes of the new model, or something somewhat more attenuated, is something which time only will tell.

Job Insecurity in the Private Sector

In a private sector context, we have heard a great deal over recent years about the breakdown of the traditional 'implicit contract' between employee and employer. As the *Economist* (17 July 1993, p. 13) succinctly put it, the implicit contract meant that firms gave employees to understand that 'if they made a good effort, their jobs were reasonably secure unless the firm ran into severe difficulties'. Mechanisms such as reduced overtime or shorter hours might be adopted to avoid sackings, and the company would within reason wear the cost of maintaining employees in work during downturns in business. And if sackings were unavoidable, they would at least be carried out in accord with some standards of fairness. Implicit contracts were particularly important at the management level, where explicit safeguards (eg appeal mechanism or access to industrial tribunals) were few and unions largely non-existent (Reynolds, 1992, p. 24).

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The breakdown of this implicit contract has been most marked in the United States, where there is a widespread view that 'there is a movement from an implicit longer-term employment relationship to an implicit "contractor" relationship with a shorter-term feel about it' (Egan, 1994, p. 48). This is often referred to as the 'contingent employee phenomenon', and in its extreme form represents a no-commitments approach to the employment relationship. It has been accompanied by a willingness to breach obligations to employees arising from the implicit contracts of the past. Overall, job insecurity has increased substantially in the private sector, and it is this which has been the inspiration for the new 'insecurity model' of public sector executive employment.

Proponents of the 'contingent employee' relationship typically argue that it provides the pressures and incentives required to secure better and more creative performance from employees. In its crudest form, this boils down to the ancient prejudice which sees fear as the best performance motivator. Experience has, however, graphically highlighted the considerable costs and disadvantages to employers themselves of the new model. There is a wealth of literature which pinpoints a range of adverse impacts upon individual and organizational performance from high levels of insecurity (Buechtemann, 1993; Rosow and Zager, 1984, pp. 16-38). This is supplemented by the observations of management journalists (Lee, 1994; O'Reilly, 1994; Navran, 1994; Nussbaum, 1991; Gottliebsen, 1993) who have identified specific consequences including:

- loss of commitment, morale and motivation,
- reduced investment by workers in acquiring job-specific human capital,
- reduced teamwork and increased selfishness, exemplified by keeping one's skills and knowledge as far as possible to oneself, in order to remain indispensable,
- more 'short-termism' – that is, a heavier discounting of what is in the firm's longer term interests as opposed to immediately-perceptible results,
- greater worker resistance to technological change which is perceived as job-threatening,
- tendency of workers to over-promise in an effort to maintain favour, leading to loss of morale and motivation when they are unable to meet these commitments,
- an increased diversion of effort into external 'profile-raising strategies', from moonlighting for other employers through to the avoidance of work which may be important for one's organization but

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which offers little potential for the construction of an external reputation.

This implies that a significant measure of job security can be in the interest of employer as well as employee. There are two standard theoretical 'efficiency' rationales for job security identified by economics – 'optimal risk sharing' and firm-specific human capital. Human capital considerations make the point that the more important such firm-specific experience and knowledge is for the productivity of a class of employees, the greater the benefits for employers from building a long-term employment relationship, and to make those employees feel that they have sufficient security for it to make sense to invest effort and energy into the acquisition of firm-specific skills. 'Optimal risk sharing' simply says that the more workers are risk-averse relative to the firm itself, the greater the degree of wage stability and job security which it will be in the interests of the firm itself to provide (Aoki, 1984, pp. 14-21). This simply formalizes the notion of a risk/return trade-off in which lower remuneration is accepted in exchange for greater job security.

Taking the analysis a little further, one can distinguish between different types of job insecurity. Three types may be defined: exogenous risk, performance-related risk, and arbitrary risk. Exogenous risk arises from market pressures which might require downsizing or redirection of the firm (the public sector equivalent of this includes both a policy shift to 'small' government and the impact of major financial shocks). Performance-related risk refers to threats to a individual's employment arising from their failure to achieve performance standards which would normally be regarded as adequate to ensure continued employment. Arbitrary risk, on the other hand, refers to threats to employment status which arise from other all-too-common factors, such as office personality clashes, or a desire by a new boss to bring in his own people.

There is no efficiency rationale for providing any measure of insurance against performance-related risk. Quite the reverse. Where it is possible to objectively measure performance, one would wish to provide employees not with insurance against under-performance, but rather with the certainty that if they under-perform, they will be sacked and, conversely, if they perform strongly, they will be commensurately rewarded. Certainly, the two standard 'efficiency' rationales for job security – 'optimal risk sharing' and firm-specific human capital – are relevant to exogenous and arbitrary risk, and do not rationalize insuring employees against the consequences of their own under performance.[9]

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This *a priori* reasoning is broadly consistent with empirical and theoretical research which suggests that:

- the 'perceived fairness' of layoffs is an important determinant of the impact that they have on the work motivations of those who retain their jobs (the 'survivors') (Brockner, Grover, Reed, DeWitt, and O'Malley, 1987),
- an important element in the subjective sense of job insecurity is the 'sense of control' – that is, 'survivors' belief that they or their employer can take some action to help them counteract the negative consequences of job loss (Greenhalgh and Rosenblatt, 1984),
- there is, in this context, an 'inverted U' relationship between job insecurity and work motivation. That is, both high and low job insecurity have adverse effects on motivations – the former because it induces helplessness and the latter because it triggers complacency. A moderate level of insecurity is the best motivator (Brockner, Grover, Reed and DeWitt, 1992).

If job insecurity has all these costs for the employer, why are we seeing so much of it recently? Part of the answer is to be found in the cycle of management fashion, which as in so many other areas of human endeavour seems characterized by periodic repetition of the mistakes of earlier eras. As *Fortune* magazine commented recently in discussing the damage done by the new employment model, 'top managers rarely realize how debilitating their one-sided version of the new deal is' (O'Reilly, 1994, p. 44). But the crucial trigger has been tough times which have left companies unable to provide the level of security offered in the past. The harsh employment practices which have swept the United States over the past decade, and which are increasingly been imported into Australia, are in part a 'necessity' arising from economic decline and 'intensified global competition' (Mandel, 1994, p. 88).

In the wave of downsizing which has swept America and then Australia over the past decade, the morale and other costs of breach of trust were too often forgotten. Now, in the backwash, we are hearing more and more about the importance of 'trust', which is a code-word for the re-establishment of some type of employee faith in their companies. Companies are now 'scrambling to re-establish a relationship with traumatized employees' (Filipczak, 1995, p. 30). It is, however the very essence of an implicit contract that, once broken, it is not easily or quickly re-established. There is a lasting legacy of bitterness and suspicion which is profoundly debilitating.

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The Insecurity Model in Perspective

Within the public sector the transformation in the employment relationship brought about by the adoption of the new 'job insecurity' model in the States has been much more radical even than the changes which have taken place in the private sector. Public servants started off with greater security, and ended up with less.

Prior to these changes, most public servants were no doubt under the impression that they had much more than an 'implicit' contract governing their employment. After all, employment conditions were laid down in legislation, or in subordinate legislation and derived rules. After the changes, not only have public servants on the new 'contracts' found themselves liable to termination at will with limited termination payment entitlements, but they face a number of other substantial disadvantages relative to their private sector counterparts.

Discussion of the changes which have occurred in the States tends to be subsumed in a broader discussion of the merits of contract vs tenure employment in the public sector. Internationally, of course, there has in a number of countries been increased use of fixed-term contracts as a basis for senior public service appointments, although few countries have gone anyway near as far as the U.S. in this respect (Nunberg, 1995, pp. 27-31). However, the debate about tenure vs contract is essentially irrelevant to the evaluation of the new insecurity model, because the new model is in no meaningful sense a contractual one. The central property of a contract system is, of course, that it implies no commitment to continuing employment upon the expiry of the fixed term of the contract. That is, the formal link between continuation of employment and standard of performance is broken at that stage. The distinctive feature of the model pioneered in NSW is, however, that this is true not only at the time of contract renewal, but at all time during the currency of a contract as well ... and with negligible compensation.

So when the Commonwealth's Management Advisory Board endorsed a measured increase in the use of contract employment at the SES level, but on the basis that 'their termination ... be for reasonable cause and by a specified due process' (1993, p. 20), it was quite far removed from the spirit of the new insecurity model. Similarly, the Commonwealth Government's move in 1993 to place Department heads on contract is qualitatively different, in that those dismissed can expect reasonably generous early retirement benefits under S 76 of the *Public Service Act*. These moves are consistent, in a way that the new insecurity model is not, with the conclu-

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sions of a recent World Bank review of the lessons of public service reform in advanced industrialized countries that:

> Conditions of service may be either with permanent civil service tenure or on a fixed-term basis. If they are the latter, terms should be long enough to ensure continuity, and the remunerative and career rewards must justify the extra risk assumed .... in giving up public service permanency. (Nunberg, 1996, p. 30).

Even such entitlements as are specified in the 'contracts' governing executive employment under the insecurity model cannot be regarded in the final analysis as committing their employer, because unlike other employers, government has a 'crown prerogative' to change the terms of the arrangement if it wishes, and to do so even with retrospective effect. In the final analysis, all that the public employee has is the hope that government will not choose once again to legislate to repudiate its commitments. It is important to note in this context that legislation establishing the new model typically is very thorough in excluding judicial review of any type.

In addition, and in marked contrast to the contemporary rhetoric about flexibility of employment conditions through tailored contracts, there is little if any scope for negotiation about the terms of public service employment contracts, which are tightly constrained by legislation and centrally-determined service-wide policy. This is an instance of a broader phenomenon of contradiction between rhetoric of decentralization in employee relations and a reality of continued centralization (O'Donnell, 1995, p. 206).

It was suggested above that to base public sector employment arrangements upon recent private sector practice may represent not so much the adoption of 'best practice' in employment relations as the adoption of practices which characterize the losers in the international competitive game.

An obvious issue here is whether, like hard-pressed private corporations, State Governments faced with financial crises may also have had no choice but to move to the new model of public employment.

While there is no doubt that financial difficulties in States like South Australia and Victoria have made substantial reductions in public sector workforces unavoidable, one cannot conclude from this that the adoption of the new model has been a necessary prerequisite of fiscal adjustment. In South Australia, for example, large-scale downsizing was achieved through genuinely voluntary departures (Robinson, 1995), in marked contrast to Victoria (Robinson, 1994, p. 234). It can of course be argued that achieving necessary adjustments in aggregate workforce numbers via voluntary de-

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partures entails certain costs. However, these need to be put in the context of the substantial broader costs of moving to the 'insecurity model'.

At a theoretical level, moreover, government cannot be regarded as just like a private corporation. The crucial difference is that the latter is a limited liability operation, whereas the former is not. A private corporation cannot call upon its shareholders for more than the value of their equity, whereas there is no legal limit to the extent to which government can call upon the resources of taxpayers. In a crisis, therefore, the manner in which the costs of adjustment are allocated between public sector employees and taxpayers is purely a matter of policy and political choice. Although for State governments in Australia vertical fiscal imbalance constrains the options for allocation of costs to taxpayers, limiting revenue-raising options while leaving expenditure-cutting options less constrained, this qualification does not invalidate the general point.

This has an important implication for 'optimal risk sharing' in the public sector vs the private sector. Because government is less constrained than private corporations in the degree of insurance it is able to offer its employees, it makes ready sense for government to provide greater job security while paying lower wages. It is – in the language of economics – 'Pareto optimal', because both employer and employee are better off. The fact that private corporations do not do the same may reflect more their inability to do so, rather than the undesirability of doing so. It is striking that the highly successful, financially strong private corporations have often been those that have chosen to provide the greatest job security.

The absence of formal legal or contractual guarantees means that, to the extent that public servants employed under the new-style contracts can have any sense of job security, it can only be through expectations which they form of the manner in which their employers will exercise the great discretionary power which they now possess. It can, in other words, only be through the development of trust – of a new 'implicit' contract.

The prognosis for the development of a new implicit contract is discussed further below. However, given that the perceived fairness of layoffs is a crucial determinant of survivor reactions, it is reasonable to assume that, however they seek to conduct employment relations in the future, jurisdictions such as Victoria[10] will find rebuilding of trust at least as much of a challenge as those companies, mentioned above, which are struggling to overcome deep employee distrust and loss of morale after vigorous and often brutal downsizing exercises.

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The Costs of Extreme Job Insecurity in the Public Sector

In the absence of a new implicit contract, it is reasonable to expect that the public sector will experience the same downside consequences of extreme job insecurity that have been felt in the private sector. There are, however, some more specifically public sector consequences which need to be identified.

On the premise that there are important differences in relevant skills between the public sector and the private sector (McLeod, 1994, p. 96; Huijer, 1990, p. 82), it is clear that the bulk of public sector managers are not able to transfer suddenly to private sector jobs, even if they were available. No sudden personnel haemorrhage is therefore to be expected. Rather, the responses one would expect are more gradual, and include

- increasing difficulties in quality recruitment;
- losses of quality personnel in areas with the most transferable skills;
- a tendency for capable public servants to discard the notion of career government employment, and to focus instead on the medium-term aim of a successful move into the private sector;
- concentration of staff profile amongst least risk-averse people.

The Australian Public Service has been notable for 'sustained ability .... to recruit strong performers in any educational or training category' (Russell, 1993, p. 25). This has been less the case for State public services. There is considerable reason to fear that the new job insecurity model will, over time, create serious problems in both recruitment and retention. To some (eg Porter, 1984, p. 130) this may be a thoroughly desirable thing, leading to a transfer of talent from unproductive to productive activities. This is, however, not a credible view for those who regard the quality of public sector management as of great importance to our success as an economy and as a society.

One of the prime inspirations for the new model was the worthwhile aim of opening up the public service. It is therefore paradoxical that one of the effects of the changes has been to make it much harder to recruit executives from the private sector. The 1994 fiasco in which the NSW Government tried unsuccessfully to recruit a private sector high-flier as Olympic Games CEO clearly demonstrated graphically that private sector executives are not 'enamoured with the idea they can be wheeled out the door so easily, and cheaply', particularly when the jobs in question are likely to be fraught with 'political intrigues' (*Australian,* 18-19 June 1994, p. 21). Apart from those with nowhere else to go, and those drawn from the Government's political party who believe that their political connections will buy them adequate

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security, it has to be expected that there will be a great shortage of outsiders willing to take the risk of senior public employment. The exception would be those who are able to do so on temporary leave from a more secure base. Even those with excellent reputations and highly marketable skills would have much to fear from the risk of arbitrary termination at short notice and with little termination compensation, because the reality is that the more senior someone is, the longer the typical search time taken to find another appropriate job.

A further serious concern is the potential impact of the new 'job insecurity' model upon public service loyalty to the Government. The danger here is that the new model makes public servants so dependent upon the goodwill of politicians that they have much greater incentives, on the one hand, to act disloyally towards a government which appears to be on the way out and, on the other hand, to go too far in demonstrating their 'loyalty' to strongly positioned governments.[11] Such conduct has no doubt always existed. However, with the introduction of extreme job insecurity, ingratiating oneself with the Opposition may become a matter not merely of ambition, but of survival itself. This may be reinforced by a tendency on the part of incoming governments to assume, unless proven to the contrary, that senior public servants are biased towards the party formerly in office. The consequent pressure to take some action to signal to a powerful Opposition that one is 'on side' will be reinforced by the knowledge that, in failing to do so, one may be leaving oneself open to 'white-anting' by any bureaucratic rival or enemy who has already built links with the Opposition.

It might be thought that politicians of all people would be singularly well equipped to detect opportunism of this type, and, having done so, would view such conduct with grave suspicion. In fact, however, the evidence suggests that they are often naive in this regard, taking at face value public servants who may themselves be extremely canny 'politicians'.[12]

As distasteful as these behavioural realities might be, they do need to be explicitly recognized. It is simply naive to base public service employment structures on assumptions which, whether explicitly or implicitly, underestimate the readiness with which even very decent people will sacrifice ethics when they believe that their personal survival, and the wellbeing of their families, is at stake. Too many discussions of the ramifications of contractual and other models of public employment seem to be characterized by high-minded, but quite unrealistic, assertions that quality public servants will not allow their integrity to be compromised by such pressures (eg Wilenski, 1986, p. 219). Nor does it make sense to discount the behavioural

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impact of the quantum leap in insecurity under the new model (Baxter, 1991, p. 281, Baxter in *AFR*, 11 April 1995, p. 17).

Safeguards and Compensation?

Might it not be possible to mitigate or offset some of these potential adverse effects through offsets or safeguards? There are three obvious candidates for this task: salary compensation, bars on political control of personnel decisions, and objective performance measurement.

The idea that increased risk should be offset at least in part by increased salaries is an integral part of the new 'job insecurity' model, at least at the senior executive level. Notwithstanding the relatively greater risk exposure, salaries have – with the partial exception of NSW – probably not increased to private sector executive levels. Indeed, there are signs that the political imperative to be seen to be paying senior public servants salaries which are less extravagant than their private counterparts remains alive and well.[13] This is also consistent with experience in the U.S. after the introduction of the SES (National Academy, 1981, pp. 17-18, 33; Nunberg, 1995, p. 28). More fundamentally, the notion that one can 'compensate' for the lack of adequate termination compensation through a salary risk premium is flawed. This is because it is largely impossible for risk-averse employees to use such a 'risk premium' in order to buy insurance against job insecurity, because the necessary external insurance markets are (for good reasons of 'moral hazard') largely non-existent. The absence of such external insurance markets has the consequence, firstly, of *greatly* increasing the salary premium necessary to render people indifferent to assuming the additional risk. It has the further consequence that, even if such a large salary premium is paid, the behavioural implications of high exposure to arbitrary and exogenous risk will not be neutralized. This is consistent with the great resistance State bureaucrats have shown against moving to contracts.[14]

What this suggests is that the less the degree of trust in the employment relationship, and the greater the degree to which executives consequently feel exposed to non-performance related risk, the greater will be the need for explicit contractual terminations payments. The size of these payments will, moreover, need to be related to the cost to the executive of termination, which is of course determined in part by the expected difficulty, and time taken, to find new employment. It also highlights the fact that, notwithstanding the critical attention deservedly given to excessive 'golden handshakes' in the private sector, and not withstanding that their magnitude is in part a reflection of the excessive managerial power which is such a problem in the

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Anglo-Saxon corporate governance model, there nevertheless remains a core efficiency rationale for providing adequate termination compensation in an employment relationship where there are few if any guarantees of fairness, and where consequently there is high arbitrary as well as exogenous risk.

One possible means of containing the risk which confronts public sector executives is to expressly limit, by legislation, the involvement of the politicians themselves in hiring and firing decisions. Concretely, executive employment below chief executive officer level might be made the province of the CEO rather than the Minister. This was not the approach of the original NSW model, which made terminations decisions the prerogative of the Governor in Council (S 42Q). Subsequent legislation has, however, taken a different tack. The Victorian Act states that in such matters CEOs are 'not subject to direction but must act independently' (S 14). When introduced into Parliament, the 1994 South Australian *Public Sector Management Bill* made CEOs subject to ministerial direction in these as in other matters, although this was changed as a concession to public service concerns (SAPD [Assembly], 2 November 1994, p. 903). This principle has, properly been reaffirmed by the recent Commonwealth public service review (McLeod, 1994, p. 42).

While this is all to the good, one should not be naive and assume that legislative principles necessarily represent reality. The reality in places like Victoria has undoubtedly been that Ministers and their advisers have had considerable direct control of firing decisions. It is well-known that 'black lists' were drawn up after the 1992 election. And when a department head may be fired at ministerial whim, it is safe to assume that at least some of those department heads will have little trouble making an 'independent' decision to fire someone whom the Minister suggests warrants such treatment.[15]

Finally, there is the notion that objective performance appraisal limits exposure to arbitrary risk. It is this which underpins Ken Baxter's remarkable assertion that 'the contract system ... reduces the capacity for capricious dismissal or sidelining' (1991, p. 282). This view is representative of the pervasive current tendency within much of the Australian public sector to overlook the informational problems which substantially and unavoidably limit the potential precision and objectivity of performance measurement. This is notwithstanding the wealth of literature in the principal-agent tradition and in organizational economics more generally which draws attention to precisely this type of problem (eg Fama, 1980; Williamson, 1987). These measurement problems are very evident in the private sector (O'Reilly, 1994, p. 50), and are necessarily much greater in the core public

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sector where, as is well known, there are a special set of problems in measuring outcomes and outputs.

Baxter's faith in the capacity of contracting to reduce arbitrary risk reflects not merely a misplaced confidence in the objectivity of performance appraisal, but also an implicit confidence that the Ministers and chief executive officers who exercise largely unfettered power under the new model will exercise that power on the basis of objective and dispassionate judgements of performance. However, the inherent subjective element of performance appraisal makes it a process which is open to what Oliver Williamson would refer to as 'opportunism'. The question of how far the process will be subject to opportunistic abuse brings us to the key question of trust and the possible development of a new understanding between employer and employee in the public sector.

A New Implicit Contract?

How far the potential adverse implications of job insecurity are realized depends crucially upon the degree of trust in the employment relationship. A crucial question is therefore: can a new and sufficiently sturdy 'implicit contract' be built out of the ashes of the old employment relationship, so as to contain the fallout from the new 'insecurity model'?

We will have to wait for some time before we know the answer to this question. There are, however, a number of reasons to fear that the development of such a new implicit contract may be even more difficult in the public than in the private sector.

It would appear that it is a core aim of the new model to eschew any insurance against exogenous risk to contract employees. It would therefore take a marked shift in policy for a new implicit contract to create a sense amongst those affected that, if they perform well, they can expect some protection in the face of service-wide downsizing, or decisions to dramatically cut or eliminate particular programs. The rational expectation is, rather, that under such circumstances contracts will simply not be renewed.

What about arbitrary risk? A new implicit contract would mean, in effect, the development of an informal code of conduct amongst those wielding the power to hire and fire under the new system, sufficiently strong to remove high levels of anxiety about the risk of capricious termination. Is it a realistic expectation that such a code of conduct will develop?

In part, the answer to this question will depend upon the evolution of management culture within the public service following the rupture with the past ways. Values of equity and fairness do not simply evaporate

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overnight, and there will undoubtedly always be many senior executives and some Ministers with an inherent sense of appropriate conduct. On the other hand, a certain proportion of those driven to seek bureaucratic or political power are possessed of a psychology such that they derive considerable satisfaction from wielding arbitrary power over others.[16] The new 'insecurity model' not only gives free rein to such individuals, but probably gives them advantages in the promotion game. Casual empiricism certainly suggests, moreover, that a combative, aggressive and arbitrary management style is very much in favor in, say, the Victorian bureaucracy, notwithstanding the enormous damage such an approach does to employee commitment and trust.[17]

At a deeper level, there are characteristics of the political process which substantially raise the degree of arbitrary risk to which senior public servants will be exposed under the new contract model.

There is, for a start, an endemic tendency for politicians to make bureaucrats the scapegoats for their own mistakes – what one analyst has referred to as the 'Pharaoh syndrome' (Halachmi, 1994). For example, as Baxter himself has acknowledged, 'when a government is in decline and is hunting around for a scapegoat for its own ineptitude .... civil servants are sometimes appointed or sacked (or both in quick succession) without real regard to merit' (1991, p. 280). It may well be, in fact, that the recent sacking of the head of the South Australia Premiers Department is an example of precisely this.

This is a particular danger for bureaucrats working in difficult or highly politically-sensitive areas, where becoming a bureaucratic scapegoat may now mean not transfer to another job, but the sack with minimal compensation. There is a tremendous danger that the supply of good bureaucrats prepared to work in such dangerous areas will become even scarcer.

To this one must add the risk of arbitrary sackings at a senior level when there is a change of government. This would, of course, not be a serious problem if incoming governments were able to differentiate accurately between, on the one hand, efficient public servants who were committed to serving loyally the government of the day, and, on the other hand, those who were really part of the former government's entourage. But there is reason to believe that incoming ministers are often not able effectively to make that judgement. There is a tendency for bureaucrats to be held responsible for Government mistakes, or controversial policies, unless they follow Mr Howard's unfortunate recent advice that they should expressly and publicly dissociate themselves from the government (*Australian*, 1 August 1995, p. 2).

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The risk associated with a change of Government is analogous to risk from hostile takeovers in the private sector, which are often the occasion for 'breaches of trust' with employees (Shleifer and Summers, 1988), and which often result in a bloodbath at management level. One might therefore expect every election which seems seriously in contest will under the new arrangements produce acute feelings of threat in the public service. And it is probable that the incidence of change of government is greater than the incidence of hostile takeover for the average large firm.

All of this is greatly reinforced by the fact that Australia appears to have 'caught up' with world best practice in the area of populist political attacks on the bureaucracy. Years back, Mosher (1982, p. 187) observed that in the U.S. it had "become inviting if not mandatory that aspirants for high elective office, and even incumbents in them, run their campaigns against .... the bureaucracy". In Australia today, parties have gone well beyond mere general attacks on 'fat cat' bureaucrats as a campaign strategy, and now frequently make pledges to cut the senior ranks of the public service an express part of their campaign platforms. Recent examples of this include the campaign which elected the Carr Government to office in New South Wales, and the campaign platform of the Labor Party in Victoria in the 1996 State election (*Australian*, 7 March 1996, p. 4).

There are a range of important issues which this raises about the political dynamics of relations between the bureaucracy and governments under the new model which await analysis.

Inextricably linked with this analysis is the danger of excessive politicization of the bureaucracy. This issue has received sufficient attention, and does not need further analysis here. Suffice it to say that experience with analogous executive employment practices for senior public service executives in the U.S. provides ample empirical justification for a belief that the new employment model will greatly exacerbate the problem – already a problem at the State level in Australia – of an inappropriate degree of politicization of the bureaucracy (Nunberg, 1996, p. 28; Mosher, 1982, pp. 185-86).

Conclusion

The new model exposes public sector executives to a level of insecurity which may exceed that to which private sector executives are exposed, even given the increase in private sector job insecurity over the past decade or so. It does so notwithstanding that it is, arguably, efficient and in the taxpayer's interests for the public sector to provide greater job security (and,

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as a corollary, lower pay) than the private sector. It is reasonable to expect that the high levels of insecurity implicit in the 'contract' model will do considerable damage to the conduct and quality of the public service.

The new model tends to view job insecurity solely as a factor compelling workers to lift their performance. However, it is well substantiated that job insecurity can and does have quite the opposite effect, especially when people believe themselves to be at substantial risk irrespective of how well they perform. Insofar as the exponents of the new model recognize this, they assume that the discretionary power to fire will be used in a such a manner as to give good performers a strong sense of security. This paper suggests that there are a number of reasons why this may not be a realistic assumption. Some of these are generic considerations which apply to both private and public sectors. Others are more specific to the public sector. It is suggested that there may be greater risk of arbitrary termination in the public sector under the new model than is generally the case in the private sector.

Notes

1 And, of course, unemployment benefits.

2 Generally 28 days.

3 The one safeguard is that the new model typically includes provisions whereby non-contract, non-executive level public servants appointed to executive level jobs may elect to sacrifice some salary in order to retain a 'right of return' to the top grade of the non-executive stratum. (Similarly, department heads appointed from inside may elect to retain a right of return to the executive stratum.) Given the extensive scope which exists in the new model for the demotion (or worse) of non-executive officers, this can operate as a safeguard only insofar as Government chooses to respect the concept. This raises issues of trust and responsibility to which we return below. In any event, there is an increasing trend, particularly in Victoria, to put non-executive positions also on a contract basis.

4 This clause had existed for many years in the Victorian *Public Service Act* which preceded the *Public Sector Management Act*. In the absence of the due process and justification rules which had previously applied, however, the clause gained a whole new meaning.

5 Letter from Mr Carr to the Chairperson, The Statutory and Other Offices Remuneration Tribunal, 18 May 1995.

6 The Carr Government in New South Wales recently attempted to apply the system to the senior ranks of the police force, but backed off after a strong reaction against the move. *Australian*, 17 January 1996, p. 5; 23 January 1996, p. 6.

7 Slow progress in overcoming the considerable resistance of formerly 'permanent' Victorian SES officers to conversion onto contracts was one of the key factors which led to the sacking in September 1994 of the department head responsible for achieving that conversion, Mr George Brouwer (*Australian*, 22 September 1994, p. 4). In a number of Victorian departments, new non-executive recruitment

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has been by contract and promotions of permanent staff have been solely by contract.

8 The Goss Government reversed legislation enacted by the previous National Party Government in 1988 which was used to place most senior level staff on contracts (Coaldrake, 1991, p. 252; McDermott, 1993).

9 It should be noted, however, that there are successful private sector employment models in countries such as Japan which even provide security from performance risk (Thurow, 1985, p. 173).

10 For a representative illustration of the conduct of the Victorian Government in downsizings, see *The Age*, 13 June 1995, p. 3. Also Robinson, 1994, p. 234.

11 Whether for this or for some other reason, it is a distinctive feature of the new bureaucracy in Victoria that top bureaucrats have been playing a vastly more publicly political role than ever before.

12 Two recent instances help to illustrate the point. In Victoria in 1992, the incoming Coalition Government appointed a particular individual as head of a department, under circumstances which suggested that the appointment bore some relation to services received while the Coalition was in opposition. Shortly after the appointment was made, a former Labor minister outlined in Parliament the manner in which the person concerned had ten years earlier leaked to the Labor Opposition in order to ingratiate himself in the period just before it won office in the 1982 election (VPD [Council], 28 August 1992, pp. 52, 67). The individual was, as a result of this revelation, quickly removed from his post. The other example is drawn from NSW where in 1987, the then deputy Commissioner of the NSW police force, Mr Tony Lauer, had a series of secret meetings with the then leader of the Liberal Opposition, Mr Greiner, with his adviser Gary Sturgess and the shadow police minister, Mr Ted Pickering. Mr Lauer made a good impression, and was subsequently promoted to Commissioner by the Liberal Government. Although at the time very impressed, Mr Pickering later came to feel that he had been taken in. It took, he later commented, 'quite some time' before he recognized that Mr Lauer 'was a superb politician and he just went and ingratiated himself politically' (*SMH*, 5 August 1995, pp. 1A-4A).

13 For example, in the same breath as enunciating a policy of market-linking, the South Australian Premier was to be found in 1994 boasting that the remuneration of the newly-appointed Head of the Department of Premier and Cabinet was 'well below the level of remuneration recommended by an independent remuneration consultant' (SAPD [Assembly], 8 March 1994, p. 288).

14 See note 5. The most striking example of this resistance was the threat in 1993 by the Coalition-appointed head of the Victorian Schools Directorate, Mr Spring, to resign his position unless his contract was varied to provide greater notice and compensation in the event of termination.

15 Since these words were originally drafted, the Semple case in New South Wales has provided a particularly graphic affirmation of their validity. Although at time of writing the investigation of the matter by the State's Independent Commission against Corruption had not been completed, the outline of the case appear clear. Semple, a department head, was fired after the career public servants responsible for merit protection and job classification carried out a job evaluation which downgraded his position thus triggering an automatic 'spill' of the position. It has become clear that this downgrading was in response to pressure from top ministers, who wished to get rid of Semple without being seen to have fired him. The case underlines how little reliance can be placed upon nominally 'inde-

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pendent' merit protection agencies when the public servants who run them are completely at the whim of ministers. (*Australian*, 3 May 1996, p. 3; 7 May 1996, p. 5; 8 May 1996, p. 4).

16 It has been said of one prominent Victorian department head that 'people are scared shitless of him and he loves it', *The Age*, 6 September 1993, p. 4.

17 See, for example, 'Audit Finds Department Managers Below Par', *The Age*, 8 January 1995, p. 3.

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