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## [Review of the book *Personnel Economics*]

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## [Review of the book *Personnel Economics*]

### **Abstract**

[Excerpt] What is personnel economics? Despite its name (non-economists may be put off by the use of the word “personnel,” which was left behind by what is now called human resource management about a quarter century ago), personnel economics deals with issues of fundamental importance in the workplace. As the editors explain in the introduction, “The literature is distinguished from other parts of labour economics primarily by its focus on problems that are central to business.” Thus, personnel economics is economics, it is that part of economics that deals with workplace issues, and it is firmly grounded in labor economics. Whether you call it personnel economics, workplace economics, an economic approach to human resource management, or something else, the field is breaking exciting new ground, asking questions that simply were not asked when I and others of my academic generation were learning labor economics.

### **Keywords**

personnel economics, human resources, management, labor economics

### **Disciplines**

Human Resources Management | Labor Economics | Labor Relations

### **Comments**

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*Personnel Economics*. Edited by Edward P. Lazear and Robert McNabb. Northampton, Mass.: Edward Elgar, 2004. xx, 655 pp. ISBN 1-84064-892-9, \$390.00 (two-volume set, cloth).

This two-volume collection of papers, totaling 43 articles and nearly 1,000 pages, is part of the International Library of Critical Writings in Economics series published by Edward Elgar. The highlights of the new field of personnel economics are collected here, along with other highly relevant papers from economic theory and other branches of economics.

What is personnel economics? Despite its name (non-economists may be put off by the use of the word "personnel," which was left behind by what is now called human resource management about a quarter century ago), personnel economics deals with issues of fundamental importance in the workplace. As the editors explain in the introduction, "The literature is distinguished from other parts of labour economics primarily by its focus on problems that are central to business." Thus, personnel economics is economics, it is that part of economics that deals with workplace issues, and it is firmly grounded in labor economics. Whether you call it personnel economics, workplace economics, an economic approach to human resource management, or something else, the field is breaking exciting new ground, asking questions that simply were not asked when I and others of my academic generation were learning labor economics.

The collection is divided into seven parts: theoretical foundations (subdivided into basic, tournaments, and measurement); theoretical issues; the job; personnel strategy; piece rate pay; profit sharing, tournament pay structures, and other incentive schemes; and executive compensation. The only new material in these two volumes is the very interesting introduction to the collection. Otherwise, these papers are reprinted here in facsimile form. Indeed, most of these articles are already in my file cabinet.

Newcomers to this field may naively suppose that personnel economics is so central to management that its most important papers would have been published in the top management journals. However, this is not at all the case. Only one of these papers was published in such a journal, the *Journal of Business*. All but one of the rest appeared in the top economics journals or in this *Review*. (The one remaining paper is drawn from an edited volume.) It is indeed

laudable that the economics discipline has been open to personnel economics and lamentable that the management field has not been.

If there is one single question that economics "owns," it is how to allocate scarce resources among alternative uses. We economists start with a clearly stated purpose, we build parsimonious models, we analyze them formally, and we test them empirically. Indeed, I find it difficult to understand how one can purport to advise companies on resource allocation issues without adopting an economic framework.

What are the core features of personnel economics? I would list five.

First, personnel economics, like other branches of economics, values parsimony. In Lazear and McNabb's words, "Economics brings to these issues an analytical rigour and an approach that focuses on stripping away their complexity and identifying underlying general principles."

Second, personnel economics follows orthodox microeconomics in assuming purposeful behavior. In the case of a business, the presumed objective is to maximize profits. For example, in talking about Henry Ford's decision in 1914 to double wages, the editors assert flatly that "the question is whether this is profitable for the firm." Those who believe in balanced scorecards or multiple stakeholders will not find themselves comfortable around personnel economists.

Third, personnel economists always give equal weight to benefits and to costs. You will not find a personnel economist saying that something should be done because it produces benefits or that something should not be done because it is costly. The question always is whether or not the benefits outweigh the costs.

Fourth, how large the benefits and costs are may be far from obvious. This is where formalism and rigorous modeling come in. You cannot do personnel economics without such formalism and rigor any more than you can do physics without them.

Finally, interactions are expected to matter. Theoretically, calculus and other tools of multivariate optimization lead us to expect that the optimal amount of one thing ordinarily depends on the optimal amount of another. The exceptions are when it is always worthwhile to do something (such as make clear to employees what the organization's bottom line is) or never worthwhile to do something (such as increase revenues or reduce costs at the expense of profits).

If the seven sets of issues addressed by this

collection of papers interest you and if you find the personnel economics approach appealing, or at least worth considering, *Personnel Economics* would be a wonderful collection to own. However, the \$390 price tag puts this two-volume set beyond the reach of many of us, even those of us with substantial book budgets. The cost also makes these volumes an unlikely choice as required classroom texts. It would therefore not be surprising to find that most readers will be consulting their libraries' copies. Those who do will be well rewarded.

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*HRM and Performance: Achieving Long-Term Viability.* By Jaap Paauwe. New York: Oxford University Press, 2004. xxi, 252 pp. ISBN 0-19-927390-1, \$119.50 (cloth); 0-19-927391-X, \$49.50 (paper).

This book is written to support Jaap Paauwe's long-held belief that much of the research and writing on the link between human resource management (HRM) and performance has suffered from too narrow a definition of performance and too limited a conceptualization of HRM. The book is less a critique of what has come before than a proposed course correction for the field. Drawing heavily on ideas from strategic management, industrial relations/institutional theory, and a vast international stream of research on the various links from HRM to performance, Paauwe puts forth a new model of HRM, which he calls "Contextually Based Human Resource Theory" (CBHRT). In the early chapters, he traces the origins of both contemporary business strategy and strategic human resources; later in the book, he offers his own thoughts and research findings.

The CBHRT model is robust and complex (hence the need for a book and not an article), and should prove interesting to academics, consultants, and practitioners. It allows the user, when analyzing specific HR environments, to recognize both "outside-in" dynamics (the five Porter forces model, for example: the bargaining power of customers, the bargaining power of suppliers, the threat of new entrants, the threat of substitute products, and the intensity of competitive rivalry) and "inside-out" forces (such as those stressed by the re-

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