Globalization and Transnational Capitalism:

Crises, Opportunities and Alternatives

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Aalborg University Press

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Cover: Særpræg ApS
Layout: Lars Pedersen / Anblik Grafisk
Printed by Narayana Press 2009
ISBN: 978-87-7307-956-0

Distribution:
Aalborg University Press
Niels Jernes Vej 6B
DK - 9220 Aalborg
Denmark
Phone: (+45) 99 40 71 40, Fax: (+45) 96 35 00 76
E-mail: aauf@forlag.aau.dk
www.forlag.aau.dk

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Supported by Project 70873070 of NSFC and Research Center for Technological Innovation, Tsinghua University, China

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Investment Climate and Globalization: What's Wrong with the Western Advice?

David Ellerman

Introduction: investment climate for whom?

The improvement of "the" investment climate has become a major strategic focus of western advice to developing countries. I will take the World Bank's recommendations to be representative of this advice. However, we might "complicate" the discussion by recognizing that there are tradeoffs between different groups with different capabilities, interests, and assets. Making the investment climate better for one group may well be at the cost of making it worse for another group. Western advisors, e.g., from the World Bank or IMF, tend to ignore these tradeoffs and to implicitly identify with one group (usually external or foreign investors) and then to count an improvement in the investment climate for that group as being an "improvement" *per se*.

What are the other groups whose "investment climate" tends to get ignored? Private enterprise, particularly in difficult environments, is based on commitment to building the enterprise both on the part of the managers and workers. Over the course of time, they have to make a range of commitments or "investments" in people for firm-specific activities where they will not be able to reap the benefits of their sowing if they do not have some stability and longevity in the enterprise. If you don't know if who will be around tomorrow or next week, then you are not going to make the type of effort commitments or firm-specific investments of

human capital that are really necessary for success; you will focus your efforts to grab what you can while you can.

Investment climate for workers

One person's "stability" is another person's "rigidity." Let us take the workers and managers separately. The World Bank tends to see the legislated or organizational sources of employment stability for workers (e.g., limitations on at-will contracts, not to mention trade unions) as "labor market rigidities" to be reduced or eliminated. Indeed, the Bank has not even been able to conceptualize the role of labor-in-the-enterprise or "human resource management" in its sectorial roadmap, only the "labor market"[1] (which automatically directs the intelligence to the matter of "perfecting the labor market"). Thus little or no attention in actual Bank practice (in the trenches, not in the rhetoric) is given either the learnings of the academic literature of the "What do unions do?" tradition (Freeman and Medoff, 1984) or the human relations strategies of building worker commitment to the firm through commitments by the firm to the workers so that the workers put forth their best efforts, i.e., make their largely firm-specific human capital investments in the firm (e.g., Blair 1995).

For instance, Japanese economists have developed a whole theory about how the "barriers to exit" (i.e., neoclassical "rigidities") work to generate organizational commitment:

> The way in which underpayment of wages in the early years of service and the acquisition of firm-specific skills create barriers to exit is obvious. These exit barriers perform several important functions for the firm as an organizational entity. The first is the incentive function whereby the interests of the firm and the interests of the individual are linked. Unable easily to exit, people can only protect their interests by working to ensure that the firm prospers. ... The interlinking of interests means that when crisis looms, efforts are redoubled. The option of leaving the sinking ship is not freely available, either to the crew or the captain. (Kagono and Kobayashi 1994: 94)

This thinking, however, has not made much inroad into neoclassical economic thinking in the Bank. In constantly prodding client countries to improve "labor market flexibility," the Bank is in fact working *against* the investment climate for human capital investment within the firms. Hence one way in which the discussion of investment climate might be complicated is to recognize that certain policies promoting labor market flexibility in the interests of short-term efficiency tend to cut against the human capital investment climate within firms and to promote grab-what-you-can short-termism.

Investment climate for managers

Analogous considerations hold for hired managers, except now it is the owners who are the source of uncertainty. The Bank has an almost exclusive focus on the "investment climate" for external financial investors so, from that perspective, it is key to have ownership always "up for grabs" so that those assets are always "transparently" available to the investors with the highest effective demand. Any restriction of the ownership being up for grabs is a barrier, impediment, imperfection, rigidity, and all around negative thing. Thus the top and middle managers also tend to live "hand to mouth" rather than make long-term firm-specific human capital investments since one never knows who the boss will be tomorrow.

It is like a farmer with an at-will rental contract on the land where the land was always "on the market" so the farmer would have little incentive to make non-recoupable investments. Bank staffs are quite capable of understanding this point when reading de Soto's *The Mystery of Capital* (2000). Without stable property rights, asset users will avoid non-recoupable investments. But this point tends to be forgotten when the Bank's own Capital Market Department is trying to jump-start stock markets all over the world or when voucher privatization was recommended to the transition economies. Managers have problems making long-term commitments to firms in Siberia when they don't know what deals will be made tomorrow by stockbrokers in Moscow.

Here again, it is the Bank's own programs that are discouraging the sort of investment that requires stable mutual commitments where the value of investment is not recoupable other than by staying in the relationship. The conventional wisdom sees such commitments as rigidities and barriers that need to be eliminated to "perfect" the market for corporate ownership and control. The Bank's thinking and much standard economic advice does not recognize the conundrum in the *tradeoff* between the logic of exit and the logic of loyalty and voice (see Hirschman, 1970).

Investment climate for owners

The same logic plays out for the owner. We can distill this wisdom from the academic scribblings of the defunct economist, John Maynard Keynes. Lord Keynes was much concerned with the adverse effects of the stock exchange on real investment. Investment in productive enterprise is largely irrevocable, and the management of enterprise requires a long term commitment and the application of "intelligence to defeat the forces of time and ignorance of the future..."[2] In short, it is based on the logic of loyalty and voice. But when investment is securitized as a marketable asset on the stock exchange, then it "is as though a farmer, having tapped his barometer after breakfast, could decide to remove his capital from the farming business between 10 and 11 in the morning and reconsider whether he should return to it later in the week" (Keynes 1936: 151). The stock exchange panders to the "fetish of liquidity" and thus continually undermines the bonds of long-term commitment that are so important to problem-solving and productive enterprise.

In addition to this continual erosive effect, the stock exchange also absorbs otherwise productive capital in the function of speculation – which Keynes defined as "the activity of forecasting the psychology of the market" (158). Keynes saw no problem when speculation was but a bubble on the stream of enterprise, but it was quite another matter "when enterprise becomes a bubble on a whirlpool of speculation. When the

capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done" (159).

Today, Keynes' "stock exchange" must be updated to the global market for bonds, stocks, and currencies. The dangers to investment in enterprise that Keynes highlighted during his day are even greater in our own. Yet Keynes recognized that there is no simple answer in making investment illiquid as "this might seriously impede new investment...." Few will enter if the door locks behind them. "This is the dilemma" (160).

It is fine for Bank managers to "promote the investment climate," but do they really face up to this "dilemma" – the tradeoff between commitment and liquidity? Improving the investment climate for financial investors on the stock market may undermine the sort of long-term investment in productive enterprise by non-speculative owner-managers – particularly in complex and volatile environments.

Which of these investment climates is most important for economic development? The answer seems clear, and yet the Bank emphasized jump-starting stock market development with such policies as voucher privatization in the transition economies. The Czech Republic threw their companies onto the stock market with voucher privatization to maximize the opportunities for "investors" and the Bank and other aid agencies such as USAID promoted that policy all over the transition economies (e.g., Russia and the FSU as a whole).

Instead of belatedly learning something about these matters, the Bank even sponsored a voucher privatization program in the war-destroyed economy of Bosnia in the late 90s. Voucher investment funds that profited handsomely from the programs in other parts of East Europe then acted as vulture funds swooping into Bosnia to buy vouchers at about 6 cents on the dollar to then get control of Bosnian assets. After they have "tunneled" out the value and stripped the assets, there will be an even poorer investment climate in that country. Here again, the Bank operates to worsen the domestic investment climate, not to improve it – unless one speaks of the investment climate for vulture funds as "foreign investors."

Investment climate for domestic direct investment

There are several ways in which Bank/Fund policies have worked against domestic direct investment.

High Interest Rate Policies

One way was emphasized by Joseph Stiglitz in the way the IMF policies, particularly in crisis situations, tend to push up interest rates to attract foreign capital with the predictable effect of choking off domestic investment and increasing bankruptcies.

Over-valued Exchange Rate Policies

Another policy is the pressure for "over-valued" exchange rates. The net effect is that domestic demand is expended on foreign imports. In theory, this could create healthy competition for domestic industry, but where the gap is too large, it tends to bankrupt domestic industry first. The best thing to happen for Russian industry at the end of the 1990's (aside from high oil prices) was the collapse of the Bank's and Fund's "protect the ruble corridor" policies in the Fall of 1998 so that foreign imported products were priced out of the market. The increased domestic demand for Russian manufactured products led to a revival of Russian industry. Thus growth came from the collapse of the Bank's policy framework in favor of the non-Bank framework of *de facto* protectionism and import substitution.

Blackhole Government Bond Markets

Another way in which Bank policies tend to spoil the conditions for domestic direct investment is the promotion of government bond markets. For instance, early in the post-socialist reforms, great symbolic or totemic significance was attached to creating active securities markets in stocks and

bonds. When the government's budget were not covered by tax collections (it was often cheaper to "buy" an exemption that to pay taxes), then the primary non-inflationary source of domestic finance was the market for government bonds. The high rates offered on government bonds operated as a financial black hole sucking in funds from banks, firms, individuals, and even foreign speculators. That, in turn, sky-rocketed the interest rates available for loans to SMEs so that loan market was throttled in the crib.

When the Russian market for their high-yield government bonds (GKOs) was booming, it was celebrated as a success for the reforms that included bringing "investment capital" into the country. The common criticism in retrospect is that the market developed into an overheated Ponzi scheme and eventually collapsed. But there is a more basic criticism. Even without the overheating and collapse, the GKO-type markets massively diverted funds away from productive investment, and a similar story played out in other transitional economies with government bond markets not quite as spectacular as the GKO scheme. Those analysts who celebrated the "improvement in investors' confidence" that brought in foot-loose portfolio investors to the GKO market had their eye on the wrong indicators. By diverting funds away from direct productive investment (e.g., the SME loan business), the high-return government bond markets detract from, rather than improve, the real direct investment climate. Have the parts of the World Bank Group that were cheer-leading the growth of the "vibrant Russian securities markets" learned any lessons or changed any policies after this debacle?

Open Capital Account Policies

Another Bank/Fund policy that detracts from domestic direct investment is the promotion of open capital accounts. These opportunities generate capital flight out of Russia and many other post-socialist countries. Great harm is done to domestic investment when government officials do not enforce the country's laws against illegal transfers of capital out to secure

and discreet havens in the West. One of the biggest assists that the West can give to investment in these countries is to enact and/or enforce the laws to stop the illegal hemorrhaging of domestic capital from these countries. That, of course, is a second-best policy in the sense that we would all prefer to make the investment climate so attractive that the capital would remain in Russia of its own accord. But after the 90's decade of *de facto* open capital accounts and the yearly exodus in excess of $20 billion, one might consider a second-best policy.

Financial Games versus Production?

Another area where IFI policies have been detrimental to real investment is in the promotion of the financial sector schemes such as the voucher investment funds. I have written elsewhere (1998, 2005) at some length why these funds were non-starters to supply capital or restructuring to troubled companies and why they would end up siphoning or tunneling value out of the companies – as has happened. Government officials all across the map quickly saw "the possibilities" so these Bank policies had "true government ownership." Voucher privatization and its progeny, mandatory second pillar pension "reforms", were not "imposed" on Kazakhstan; the government officials *truly* wanted these "reforms."[3] When the complying government officials finally leave office in these voucherized countries, they tend not to become chemical or electrical engineers in manufacturing companies; they tend to go through the revolving door into the "financial sector" as board members, deal-makers, and the like. The same "motivation" reaches young people. Why go through all the years of study to get become an engineer when very little study and a few connections can get one into the Klondike of "financial engineering" where the real fortunes are being made.[4]

Investment climate for foreign direct investment

I have taken some pains to emphasize that improving the "investment climate" for one group may make it worse off for some other groups. In spite of some nods in the direction of domestic investors, Bankthink (i.e., groupthink within the Bank) tends to interpret "investment climate" in terms of the foreign investors who are supposed to bring capital, technology, and management/marketing know-how. But does Bank think at least understand foreign direct investors?

Buying Shares on the Market versus Private Transactions

One common but persistent fallacy is the idea that foreign investors will want to come into the country through the stock market. This belief is one of the (non-cargo-cult) reasons for all the push in the World Bank Group for stock market development. But once a company is broadly owned on a stock market, why would a well-heeled foreign direct investor want to start buying shares off the market? Share owners would start holding out for higher prices from the deep-pocketed buyer or might even hold onto shares looking forward to large capital gains in the future. In either case, the foreign investor would find broad stock market ownership as an impediment, not a help, to obtaining 100% ownership. The investor would much prefer a clean private transaction for the whole company than the self-frustrating attempt to buy bits and pieces on the open market.

Indeed, some companies in the post-socialist world have deliberately worked with IFI support to do a public offering as a way to fight off being purchased by a foreign company. Once the stocks were scattered to the four winds on the stock market, the foreign company would be discouraged from trying to put all the pieces together again.[5] Here again, my point is not to argue that this was good or bad but to complicate the discourse by highlighting the tradeoff. When the IFIs are promoting the flotation of the better companies, they are at the same time thwarting

foreign direct investment in the companies of the most interest to the multinationals.

Share Deals or Asset Deals?

Indeed, most foreign investors would think twice before doing a share deal at all. If the investor really wants 100% ownership, then an asset deal (e.g., part of a greenfield or brownfield investment) might be far cleaner with no complications of hidden liabilities or employment expectations in enterprises that will need some restructuring. For instance, when IKEA bought a furniture company in Romania as a going concern, they made it clear that one of the plants was problematic and that if it was not profitable in one year, they would have to shut it down. The Federal Government was in full agreement and the deal went through. After a year, the plant was not profitable so IKEA announced the closing (while continuing to operate other plants). The next day the local police arrived to notify the IKEA managers that they had violated local laws and would have to leave. The Federal Government said it was a local matter. IKEA ended up negotiating a new agreement and learned a hard lesson about buying a company as a going concern.

Dating Before Marriage?

Another persistent fallacy is the idea that foreign companies will come in and buy a company without having some prior trust-building getting-to-know-you relationship. This might take the form of a trade relationship, subcontracting production agreements, technology licensing agreements, or sales/service representation. And if that is one of the main paths to investment, then the investment climate work should include *the climate for trade relationships as well as production, technology, and sales/service agreements*.

There seems to be considerable implicit resistance in the IFIs to recognizing that companies can acquire export markets, technology, and know-how all without selling equity – as did the Japanese or Koreans.

Whatever the reason, this leads to the under-emphasis in the IFIs on these intermediate forms of involvement which are beneficial in their own right and which may or may not lead to foreign equity investment. A comprehensive program to promote the benefits of "foreign investment" would include the promotion of these forms of foreign involvement. Dating before marriage – involvement before investment.

Transfer Pricing vs. Dividends: Misdirected Corporate Governance Policies

Another area of misdirected "investment-climate"-related policies is in the sphere of protecting minority shareholders. There seems to be the remarkable assumption that majority or controlling shareholders who are trade-related to a company "should" take value out of the company only through dividends to be equally shared with the free-riding and passive "minority shareholders." However, it is quite normal and to be expected for controlling trade-related shareholders to take their value out in a variety of other ways such as transfer pricing and licensing agreements. It is hopeless to try to extend the scope of "corporate governance problems" to somehow control and exclude these hard to monitor or verify business practices.

The problem lies in the minority shareholders who exhibited less than brilliant judgment in investing in a company with a trade-related controlling shareholder without any other safeguards such as mandatory buy-back clauses that would be normal for a minority position in a closely-held company in the West. That would be a foolish investment, and the World Bank Group should not broaden the "corporate governance" agenda to include "protecting" foolish investors.

Logic of exit versus the logic of voice, loyalty, and commitment

My remarks on the theme of investment climate promotion have focused on complicating the discourse by arguing that there are often tradeoffs between different types of investment. A better investment climate for one group may create a worse one for another group. There is also a theoretical structure common to most of the comments. Neoclassical economics focuses on markets, and (arms-length) markets are driven by the logic of exit. The areas where I argued that the focus on investment climate was one-sided were those areas where the Bank tends to adopt a "Wall Street" view of business. Then "investment" is taken as investment in securities. The logic of markets in general and securities markets in particular is the logic of exit, liquidity, mobility, and flexibility.

There is another logic of voice, loyalty, and commitment that comes more into play *within organizations* that is usually neglected by economists in general and in Bank policy-making in particular. The investment climate tradeoffs come from the cases where investment goes hand in hand with commitment and is *undercut* by the logic of exit, liquidity, mobility, and flexibility.

In the face of decline, there are always two different strategies for renewal: replacement or transformation:

- After a few years when the family car starts to emit strange clunking sounds, one has the choice of replacing it or trying to fix it (transformation).
- Many years ago, there was a cigarette ad about the loyal consumers who would "rather fight than switch" – the other option being "rather switch than fight."
- Albert Hirschman, in his 1970 classic, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, developed these two strategies as the logic of exit (replacement, the quintessential logic of the market) and the logic of loyalty, commitment, and voice (transformation, the quintessential logic of stable organizations).

When facing decline, a commitment-based strategy "fights" for renewal by fostering the transformation of the given people and structures. An exit-based strategy sees renewal as coming primarily and initially from the outside through "switching," the replacement of the existing people (or at least the top people) and structures by new ones. Transform the old into the new – or throw out the old (to create a *tabula rasa*) and then import the new; that is the question.

The pure logic of exit applies only to the ideal model of a perfectly competitive market imagined in economics textbooks. And there is no human organization with "No Exit." All real world situations of decline will call for appropriate combinations of transforming the home-grown old into the new (transformation strategy) and replacing the home-grown old with the imported new (replacement strategy).

Here are some of the ways that these two logics play out in different areas.

Area	**Logic of Exit ("Rather switch than fight")**	**Logic of Voice & Commitment ("Rather fight than switch")**
Change Strategy	Replace what you have with something better. Replacement.	Change what you have into something better. Transformation.
Response to decline concerning managers	Replace inside managers with new managers from outside to solve problems.	Develop inside managers to solve problems.
Efficiency	Allocative: moving resources to the use with the best return (high mobility)	X-efficiency: getting the best return from resources in the given uses. (low mobility)
Source of change	Exit (since innovation is exogenous, change takes place through entry and exit from the organization). Rather flee than fight. Error leads to replacement from outside. Exchange what you have for something better.	Voice (since innovation is endogenous, needed changes communicated within organization). Rather fight than flee. Error leads to learning. Change what you have into something better.

Labor mobility	High mobility so changes take place primarily by hiring workers embodying new knowledge.	Low mobility so changes take place primarily by knowledge workers learning new knowledge.
Model of supplier relationships	Competition between standardized producers with feedback through the market.	Cooperation with a small number of suppliers to continuously improve product through non-market feedback.
Relations to suppliers and customers	Auction market contracting based on assumption of mobility and exit leading to greater allocative efficiency	Relational contracting based on assumption of immobility and voice leading to greater X-efficiency
Contractual relationship	Arms-length	Relational
Stability of business ownership	Liquidity of stock market shareholders	Illiquidity of closely-held business
Stability in relationships.	Low trust relationships ⇒ highly explicit contracts with competitive arm's length exit-oriented relationships so no need to invest in building trust or loyalty ⇒ low trust relationships.	High trust relationships ⇒ incomplete relational contracts with voice-oriented relationships requiring investment in building trust and loyalty ⇒ high trust relationships.
Style of interpersonal relationships.	Standardized, professionalized behavior as a means of coordinating people. Low interpersonal knowledge associated with high turnover.	Familiarity, intimacy in long-term relationships as means of coordinating people. High interpersonal knowledge associated with low turnover.
Labor training	Responsibility of worker as it increases value on labor market.	Responsibility of company since immobility allows company to benefit.
Job definition	Extensively specified job definition to limit opportunism since there is little commitment.	Job flexibility and low monitoring based on worker commitment to company
Wage determination	Rate for job determined by market.	Rate determined by seniority and assessed merit.
Response to decline concerning workers.	Reduce employment and other direct costs to maintain profits.	Maintain employment, reduce hours, and retrain workers for new product lines.

Markets *and* organizations: not only markets

Consider the application of the logic of exit versus the logic of commitment in an organization. The exit logic looks at an individual as a market participant – even inside an organization.[6] The individual's actions within the organization are evaluated according to how the actions affect the person's market opportunities, e.g., in acquiring more marketable skills, increasing bargaining power, and the like.

In contrast, the logic of commitment looks at the individual as a member of an organization so that a different set of factors come into play such as trust, voice, firm-specific skills, cooperation, voice, and identification with the organization. It is this whole logic of commitment and the conception of an organization other than just a nexus of market contracts that is missing in the vision of conventional neoclassical economics. Thus all the investment climate reasoning concerned with building productive organizations tends to be ignored unless it can be reduced back to market behavior.

Herbert Simon's Vision of the Organizational Economy

One person who spanned the disciplines of economics and organizational theory and who spent a lifetime investigating both markets and organizations was Economics Nobel-laureate Herbert Simon. Economists tend to have a cognitive map of the world (like Saul Steinberg's famous *New Yorker* cover) where markets dominate the landscape except for small market failures (small "lumps in a pail of buttermilk") known as "organizations" off in the distance. Having studied both organizations and markets throughout his career, Simon found that the reality in the advanced economies was almost the opposite. Instead of thick markets connecting small organizational dots, Simon saw a world of organizations with thin markets connecting them. Indeed, he objected to the very phrase "market economy."

> The economies of modern industrialized society can more appropriately be labeled organizational economies than market economies. Thus, even market-driven capitalist economies need a theory of organizations as much as they need a theory of markets. The attempts of the new institutional economics to explain organizational behavior solely in terms of agency, asymmetric information, transaction costs, opportunism, and other concepts drawn from neo-classical economics ignore key organizational mechanisms like authority, identification, and coordination, and hence are seriously incomplete. (Simon 1991: 42)

The economic theory of contracts and agency imagines a world where causal chains are well-defined, where consequences can be imputed, at least probabilistically, to specific agents, where contracts can be clearly drafted, where performance criteria can be explicitly specified and they measure the right variables, and where fulfillment of the criteria or lack thereof can be objectively verified. It is a world where "complexity, uncertainty, instability, uniqueness, and value conflicts" (Schön 1983, 14) or, again, "uncertainty, complexity, and value conflict" (Hirschman and Lindblom 1962) can be somehow controlled or ignored. In such an imagined world, much of human activity could be carried out under performance-based contracts.

> But such [performance-based] reward systems are effective only to the extent that success can be attributed accurately to individual behaviors. If the indices used to measure outcomes are inappropriate, either because they do not measure the right variables, or because they do not properly identify individual contributions, then reward systems can be grossly inefficient or even counterproductive. (Simon 1991: 33)

Simon went on to note that these considerations are not nit-picking; they cut to the core of the rationale for organizations rather than markets.

> In general, the greater the interdependence among various members of the organization, the more difficult it is to measure separate contributions to the achievement

> of the organizational goals. But of course, intense interdependence is precisely what makes it advantageous to organize people [i.e., in organizations] instead of depending wholly on market transactions. The measurement difficulties associated with tying rewards to contributions are not superficial, but arise from the very nature and rationale of organization. (Simon 1991: 33)

The Periodic "(Re-)Discovery" of Performance-Based Contracts

One area where these issues are periodically played out is that of output-based or performance-based contracts. From time to time, private sector management "discovers" the idea of paying for performance (not just for time put in), of paying for outputs (not just inputs), and of management by objectives accomplished (not just intentions). It all sounds so obvious and so sensible that one must ask "Why didn't people think of this before?" The answer is that they did. And they discovered that it doesn't work too well – aside from fairly rude forms of labor. In areas of human effort where effort, commitment, and the application of intelligence are important, the carrots and sticks of external motivation are insufficient for sustained performance (see, for example, Chapter 11 on "Inducements" in Stone, 1997). Beyond simple and specific products, the determinants of quality are rarely susceptible to external monitoring.

One area where these issues periodically play out is in education. In the US today, parents and local politicians are "discovering" the idea of paying teachers for performance. One would hope that the substantive goal of school teachers is to awaken and foster a self-starting learning capacity in the students – but that goal is difficult for a third-party to objectively certify. Hence the measurable proxy goal of passing standard tests is used, and then teachers are pushed by educational administrators to fulfill the "performance-based" requirements by drilling students to pass the standard tests. In this way, the shoe-horning of education into the procrustean bed of performance-based contracts would probably do more harm than good to the original substantive goals of education.

What sort of activities can or cannot be farmed out to arms-length market-based private provisioners under performance-based contracts? Even in a country with highly developed markets such as the United States, there is considerable controversy about maximal private provisioning (e.g., public schools, public safety, social welfare services, public health services, prisons, and so forth). It is even more controversial in Europe. When this philosophy is mired in controversy in developed market economies, then it is very difficult to understand how private provisioning with output-based contracts could be done well in the developing countries with their much less developed markets.

Extrinsic and Intrinsic Motivation

But let us assume away the problems of identifying and measuring the relevant variables and let us heroically assume away the "uncertainty, complexity, and value conflict" that afflicts human activities. Could we *then* replace governmental and private organizations with virtual nexuses of performance-based contracts? This brings us to the question of motivation. The economic theory of agency contracts is based on "economic" motivation, the "carrots" of monetary compensation and the "sticks" of contractual penalties or termination of contracts. But this approach to motivation is based only the extrinsic motivation that can be used by the "principal" to control the behavior of the "agent." Yet it seems that extrinsic motivation works as a long-term motivator for only a rather narrow band of rudimentary activities ("ditch-digging" and piecework are classic examples). More often the intrinsic motivators of craftsmanship, workmanship, professionalism, pride, self-esteem, and a sense of vocation, calling, and organizational identification are prominent, and the extrinsic motivators of "carrots and sticks" – while still important–are more in the motivational background.

Piece rates and pay-for-performance schemes are examples of carrots in the foreground trying to get people's attention and guide their actions. An equitable salary more geared to experience and seniority would be an

example of keeping the carrot of pay in the motivational background so that other more intrinsic motives might emerge in the foreground to guide action. The tight coupling of pay with performance, as implied by agency theory, is beside the point when the pay is in the background.

These considerations are quite clear in the quality-based (e.g., "Japanese") management methods that take organization seriously. For instance, Edward Deming's "New Economics" recommends to "Abolish incentive pay and pay based on performance" (1994, 28), e.g., to pay salespeople by salary rather than by commission. Deming recommends replacing a system based on close monitoring and quality bonuses with a system using (for the most part) trust based on self-esteem and pride in the quality of one's work. This approach to quality relies not on cleverly constructed pay-for-performance schedules but on switching over to a quality system driven largely by intrinsic motivators such as self-esteem and pride in one's work – in short, quality as a calling.

Simon came to similar conclusions about organizations in general:

> Although economic rewards play an important part in securing adherence to organizational goals and management authority, they are limited in their effectiveness. Organizations would be far less effective systems than they actually are if such rewards were the only means, or even the principal means, of motivation available. In fact, observation of behavior in organizations reveals other powerful motivations that induce employees to accept organizational goals and authority as bases for their actions. (Simon 1991, 34)

Simon goes on to identify pride in work and organizational identification as some of the most important motivators. These intrinsic motivators are not controlled by the purse-strings of managers. Other influential management theorists make the same point:

> 'Intrinsic' rewards…are inherent in the activity itself; the reward is the achievement. They cannot be *directly* controlled externally, although characteristics of the

> environment can enhance or limit the individual's opportunities to obtain them. Thus, achievement of knowledge or skill, of autonomy, of self-respect, of solutions to problems are examples. (McGregor 1966, 203-4)

Paying someone to "identify" with the organization is like trying to "buy love." The motive corrupts and falsifies the action.

Conclusion

Much of the conventional western thinking about improving the investment climate is informed by a market-oriented exit-based vision of the markets-and-organizations system. This vision leaves out "half" the story and thus it yields rather one-sided policy recommendations. The market-oriented exit-based vision leads to policies that do not support and may even worsen the investment climate for the members of organizations to invest in building organizational and productive capacity.

We have also seen that in the face of decline, there are essentially two strategies for renewal: transform the old into the new (transformation strategy based on logic of commitment and voice), or throw out the old (to create a *tabula rasa*) and then import the new; that is the question (replacement strategy based on logic of exit).

If the local decision-makers are to stay in control of the country's own development, then enough of the home-grown old must be transformed into the new so that they do not "lose their footing" and become so estranged from the change process that his only response is to cling to the old. From that sound footing on the home-grown but transformed old, they can then take charge of throwing out part of the old and to appropriate and adapt the imported new to make it their own. The alternative is a process externally driven by replacement of the old with the imported new where people are "blown off their feet" and are being swept along without any real ownership of the new realities that were established outside of their control.

This analysis supplies a perspective on the current debate about globalization. Often that debate is posed in simplistic terms of whether or not a country should be "open" to globalization. This seems to be the wrong question. Of course, a country needs to be open to whatever is compatible with and will augment its independent development. Gandhi used a good metaphor for the openness that is compatible with one's autonomy. "I do not want my house to be walled in on all sides and my windows to be stuffed. I want the cultures of all lands to be blown about my house as freely as possible. But I refuse to be blown off my feet" (Quoted in Datta 1961: 120). By building on enough transformation of their old into the new, the local change-agents could remain "on their feet" and have the self-confidence to seek out, assimilate, adapt, and own the external knowledge, experience, and relationships available to them in a globalized world.

(This paper is based on my work in the World Bank as advisor and speechwriter for Joseph Stiglitz who was then the Chief Economist (1997-1999) of the Bank.)

Notes

1 The World Bank's advice to client countries is framed in terms of labor market policies rather than human resource management. But for the Bank's own staff there is a Human Resource Vice-Presidency rather than a "Labor Market" Vice Presidency.

2 Keynes, John Maynard (1936) *The General Theory of Employment, Interest, and Money*. New York: Harcourt, Brace & World (157). In the same vein, Hirschman is fond of mentioning "that long confrontation between man and a situation' (Camus) so fruitful for the achievement of genuine progress in problem-solving" (Hirschman 1973: 240).

3 After the WB sponsored and funded "pension reform" in Kazakhstan, more than a billion dollars has been taken by law out of workers' paychecks and fed into the "pension funds" controlled by the main financial/tribal groups in the country.

4 A private sector development team took a tour in the late 90's around Russia visiting companies to help prepare the new strategy for Russia. One of their striking observations was the number of bright young people who had recently come into manufacturing after originally being in "financial engineering" but then had to leave after the financial collapse in August

1998. Here again, it was the collapse of the Bank/Fund protect-the-ruble-corridor policies and the related financial schemes that help redirect the "best and brightest" human capital into the real sector.

5 One example of this strategy to thwart foreign direct investment was the flotation of the Croatian pharmaceutical company Pliva on both the London and Zagreb stock exchanges – when a large western drug company was in hot pursuit.

6 Recall the Bank having a "labor markets" sector but no human resources sector in work with client countries.

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