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Development Models, Globalization and Economies

A Search for the Holy Grail?

Edited by

John B. Kidd and Frank-Jürgen Richter

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Also by John B. Kidd and Frank-Jürgen Richter

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Contents

List of Tables and Figures

Tables

Figures

Foreword

The six decades since the end of the Second World War have witnessed a vast transformation in the general economic welfare of the world. Not only have the devastated economies of Western Europe and East Asia recovered, countries such as Germany and Japan have become economic powerhouses of the world, together with the USA and the UK.

As the global economy liberalizes and the forces of globalization gain momentum, the socio-economic structures of the developed economies of the world are coming under increasing stress. What is the way forward for them? Should the developed Western economies follow the Anglo-Saxon models of liberal market economy with limited state intervention or should they drastically reform the state welfare-based system as in Continental Europe?

Even in Japan, known for its ability to combine economic prowess with a system of lifelong employment, there has been a need to review its socio-economic system as they can no longer ignore the twin challenges of increasing global economic competition and providing for an ageing population. Lifelong employment has broken down, and the proportion of atypical workers has risen sharply. The old polices are no longer sustainable in the longer term. The public mood has shifted towards support for reform.

At the same time, the opening up of China and India has uplifted hundreds of millions of their people out of poverty through the increasing employment opportunities afforded by their being the new manufacturers and service providers of the world. It is through this process that they are becoming the world's new consumers. They are now becoming the new engines of global growth and their economic development will have an impact on the world, for better or for worse. Can they sustain their economic growth in the longer term without introducing reforms to address the pressures from global competition?

However, there remain parts of the world that are economically underdeveloped and undeveloped, such as Latin America, Africa and large parts of Asia. The success or failure of the major economies to transform and restructure for the next stage of development will have implications for them.

The anti-globalization movement in the West, since the 1999 Seattle protests, is a reaction to the perceived excesses of global economic liberalization. Millions of workers' and farmers' traditional ways of living are being disrupted. While employers and companies have pushed ahead in their drive to be economically competitive, governments have either failed or lacked the political will to find alternative employment for displaced workers and farmers.

The concerns of the masses have to be addressed. If their concerns are not addressed, they will not support change which comes with great pain in the interim. Policy makers will find their attempts to transform their economies frustrated. Displaced workers and farmers cannot be left to fend for themselves, not even in countries with generous welfare benefits.

In the coming years, policy makers will have to find ways and means to ride the wave of globalization. Lessons amongst countries can be shared and the relevant experiences adopted to fit each country's own conditions. There is unlikely to be a model that is universally right for every country.

Lim Boon Heng
Secretary-General
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Notes on the Contributors

Laveesh Bhandari completed his PhD in economics from Boston University, USA in 1996. His PhD dissertation was on the success and failure of international alliances and received the Best Thesis in International Economics award by the EXIM Bank of India in 1996. Prior to that he received his MA in Economics specializing in finance and industrial organization from the same university. He was also awarded the Hite Fellowship for his work on International finance. Dr Bhandari began his career as a consultant for Manhattan (now Brookdale) Funds, New York and Boston, USA, where he was working on the valuation methodologies of derivative securities. He joined the National Council of Applied Economic Research (NCAER), New Delhi, as a Senior Economist in 1997. Since 2000 he has been leading Indicus Analytics – a socio-economics research firm based in New Delhi. He has taught economics at Boston University and the Indian Institute of Technology, Delhi. He was also the Managing Editor of the *Journal of Emerging Market Finance*.

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Hock-Beng Cheah researches and teaches at the School of Business, University College, the University of New South Wales. In economics, his research interests are focused on sustainable development and political economy in the Asia-Pacific region. In the management field his teaching and research interests include sustainable management, human resource management, organizational development, and entrepreneurship. He was a visiting Research Fellow at the Snider Entrepreneurial Centre, University of Pennsylvania, where he proposed a new perspective of the entrepreneurial process. He has also undertaken research at the Entrepreneurship Development Centre at Nanyang Technological University, Singapore; and the Economics Research Centre at Nagoya University, Japan. His work has been published in a variety of monographs and journals including *Creativity and Innovation Management*, *Journal of Business Venturing*, *Journal of Enterprising Culture* and *Labour and Industry*.

Chong Ju Choi received his bachelors degree in economics at Seoul National University, Korea; his masters in public administration at Harvard University, USA; his masters in business administration at INSEAD, France; and his M.Phil. and PhD in economics at Oxford University, UK. He has been a professor at Oxford University, UK; Cass City University Business School, UK; University of Bologna, Italy; Australian National University, Australia; Waseda University, Japan and Cambridge University, UK. He has published over 100 papers in international journals in the areas of international business, comparative business systems and knowledge management. His book on globalization, *Emergent Globalization* (with Carla Millar and Brian Hilton) was published by Palgrave Macmillan in 2004.

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Lim Boon Heng is Secretary General of the Singapore National Trades Union Congress, and Minister, Prime Minister's Office, Government of Singapore. He has been involved in the labour movement for more than two decades. Prior to joining the labour movement, he worked in the shipping industry. He has also been a member of Parliament of Singapore for more than two decades, and has served as Deputy Speaker, Chairman of National Productivity Board and National Productivity Council, Chairman of the Singapore Productivity and Standards Board, and Senior Minister of State for Trade and Industry. He was appointed as the Chairman of two tripartite Cost Review Committees to look into recommendations to moderate increases in the cost of living and ways to help lower-income workers. He holds a honours degree in naval architecture and has been conferred Honorary Doctor of Business by the Royal Melbourne Institute of Technology University and Honorary Doctor of Civil Law by the University of Newcastle upon Tyne, England.

François Houtart, born in Brussels in 1925, graduated in theology and became an ordained priest in 1949. He obtained a PhD from the Catholic University of Louvain, and conducted postgraduate studies in sociology at Chicago University. He is now a professor emeritus at the Catholic University, President of the Tricontinental Center (Louvain la Nence), and member of the International Council of the World Social Forum. He has been a visiting professor at the universities of Tilburg, Birmingham, Buenos Airies, Montreal, Sherbrook, Hanoi, Managua and Port-an-Prince; has an honorary doctorate from Notre Dame University (USA); and is an honorary member of the academies of sciences of Cuba and Vietnam. He has published above 50 books and many articles, which have been translated into more than 20 languages. Among the books published are: *Aspects sociologiques du Catholicisme Américain* (Paris: Éditions Ouvrières 1957); *Religion and Ideology in Sri Lanka* (Colombo: Hansa, 1974); *El Campesino como actor* (Managua: Nicaraguao, 1992); *The Other Davos* (London: Zed Books, 2001); *La Tirannia del mercado y sus Alternativas* (Madrid: Ed. Populus, 2003); *Déligitimer le Capitalisme – Créer I'espérance* (Brussels, Colophon, 2005).

John B. Kidd is a Research Fellow within the highly acclaimed Aston Business School which is a Faculty of Aston University, Birmingham, UK. He once specialized upon operational research, but moved towards knowledge management. In this focus he has concentrated upon the interactions due to cultural diversity within its core; however, he still retains an interest in project management and in logistics – but again acknowledging that the softer-side people-based components often have greater influence than the hard mathematics-based formulae. He has presented courses at MBA level within Europe and in the China Europe International Business School (CEIBS) Shanghai. Naturally, as a well-known scholar, he has made presentations in many other countries. He has worked closely with Frank-Jürgen Richter on a series of books, published mainly by Palgrave Press, but also by World Scientific – their topics often focused on Asian management practices and embracing human resources management in Asia; corporate governance; corruption; and, more recently, trust. A further book on *Infrastructure and Productivity in Asia* was published in January 2005.

Wolfgang Klenner holds a diploma and PhD in economics. He has been involved in projects in Africa, China and Japan; and undertook post-graduate research in East Asia. During 1979–84 he was Head of China Section at HWWA – Institute for Economic Research, Hamburg, and was consulted by China's National Planning Commission on the restructuring of China's economy (banking system, free trade zones, joint ventures, growth-cum-debt policy). Since 1984 he has been Professor of East Asian Economics at the Ruhr-Universität, Bochum, as well as Visiting Professor/Senior Research Fellow at the University of Tokyo, University of Nagoya, University of International Business and Economics, Beijing, University of California, and the National University of Singapore. He has undertaken projects on economics education in China (prepared for the World Bank), select issues on China's economic policy and reforms, China's financial system, Japan's industrial policy, Japan's industrial structure and organization, joint ventures in Asia, cooperation and competition in East and Southeast Asia, and the privatization of state-run firms.

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1

The Complex Competition for Relevance?

John B. Kidd and Frank-Jürgen Richter

We are all different on this planet – the flora, the fauna and ourselves – the humans. Observably we perceive different genders, our skin tones, and we find some of us are tall others short, chubby or slim: some wear spectacles, other use contact lenses. We speak many different languages, and are divided more or less naturally into different countries with individuals from each country exhibiting different habits and behaviours. Indeed the collective nature and attitudes of individuals in each country has prompted Hofstede (1991) to speak of 'the software of the mind' as determining the local culture, which in turn helps determine our local manners and ways of behaviour that makes them different from the others – our Welsh-ness, or German-ness and so on. From our early days of being hunter-gatherers we have looked to our leaders for guidance, and thus learn to work with their management models. Now we are globalized we observe there are both strong and weak economies. It is somewhat natural to aspire to be like the rich and powerful, and thus we might be inclined to take up their economic models – to be more like them, we hope. Yet, reverting to Hofstede's findings, we may find that our individual and collective attributes are unsuited to take-up another's economic model. The Americans proclaim a market-driven model, which was in total contradiction to the old Soviet-style planned economy. And while the Soviet model has been superseded today, the collectivist system still lives on in the models used in Asia, while Europe works within another paradigm – the social market economy. In Continental Europe, the unique aspects of the welfare system financed by contributions and backed by the state provided security for the individual. Indeed, as Munkhammar argues later, too many people still look to the State for support … since this system persists despite powerful forces for change.

With this book we do not want to add fuel to chauvinist sentiments. What the contributors of this book are writing about is not a battle between the states and their respective economic models but a comparison of systems of economic integration which, *per se*, are neither good nor bad. General – or even Universal – theories meant to explain similar economic processes across cultures are almost certain to mislead. Differing historical traditions will almost always intervene to make economic development unique in each nation.

It is the aim of this book to trigger a deep and fruitful discussion about the reality and practice of economic modelling. It is governments' and other stakeholders' primary task to steer economic development in an effective and sustainable way, and we hope that this book can contribute to these endeavours.

The work ethic?

Some of our learned behaviour also help determine our propensity to work – what some call the Protestant Work Ethic (mentioned in Chapters 2 and 3, for instance) – yet over time this aspect is changing with young people angering their parents by their flippant attitudes to work, or to not saving for old age and not looking carefully to the long term. Instead our European youth seem to be rushing to embrace a hedonistic lifestyle: 'burn it now, live it up' seems to be their slogan. And Japanese youth have two forms of 'idleness'. One set are called *freeter*[1] – and while they earn enough money for their lifestyle in temporary jobs they are a growing cause for concern: features upon them are written even in the popular press – note a reprint from the *Asahi Shimbun* in the *Asahi Evening News* (Tuesday, 4 January 2000: 5). Colin Joyce (2002) notes there are three types of *freeter* – (i) those who follow a dream (which may also be a hobby), (ii) those who can't yet decide on what career to follow, and (iii) those who simply fail to keep down a job. All nations have the third category, though they are not called *freeter*. But the growth, in Japan, of category (i) and (ii) is alarming. There are about 4 million *freeters* in total, although 70 per cent of these people assert they want to get a job, most are still supported by ageing parents, so they don't search hard for a job. But, worse, they too age day by day and become less attractive to a prospective firm: most do not pay into state pension schemes and most are not productive – they are sometimes called 'parasite singles'. They reduce Japan's falling birthrate by marrying late, or not at all (at least they are responsible in not having children they can't support) and soon, as their old parents die, they will become a 100 per cent burden on the state. The second form of 'idle person' is called *NEET* – 'not in education, not in employment, not in training'. They seem to be a growing problem, not only for Japan but for the UK too according to Peter Kingston, writing in the *Guardian* (Tuesday, 2 November 2004). He thinks that the UK has only about 161,000 children (that is about 9% of the 16–19 age group) in this category compared to 600,000 in Japan.

Not so long ago in the aftermath of the Chinese Cultural Revolution when all formal schooling broke down, the cult of 'Zero is Hero!' (白卷英雄) emerged, where a student gaining a zero per cent grade was lauded as the best of the anti-intellectual brigade. Times have changed – now Chinese parents are pressing their children to gain maximum grade-scores to get into the best of the Chinese (or indeed world-best) universities. Their model of success is to have their children so well-educated as to become global 'warriors', able to compete and work with the best, and to have high economic recompense for their effort. Furthermore, Asian children are very able in general terms, and some consider their abilities to be technically superior to Western children (Lynn and Vanhanen, 2005). Meanwhile these Chinese youngsters, like many others across the globe, wish to dress in jeans, listen to pop songs and download them to their iPods.

Problems of ethnocentricity

Business Schools were created in the USA in Harvard University … as their website proclaims, 'Founded in 1908, Harvard Business School is nearly as old as the concept of management education itself – and in less than a century, the School has produced leaders and ideas that have shaped the practice of management in vital organizations of every kind around the globe'. This is all well and good, yet, as the leaders of Harvard would be quick to point out, there are many alternative views on management held in high esteem in different parts of the globe. We know also that there are many pressures to accept modes of democracy, politics and commerce that are modelled on the American system, but which do not fit easily in the local environment. This comes about often through an overzealous zeal, or an ethnocentric belief in all things American being best.

Ethnocentricity arises partly from the difficulty of (a) creating a valid (local) model, and (b) maintaining a belief in its veracity. The distillation of local knowledge to create the model inevitably uncouples its wider connotation as it focuses tightly to the local issues and to local solutions.

This often leads to an oversimplification of broader issues through searching locally for a solution of an issue that may perhaps be a widescale problem. Take for instance the logistics learning of military graduates of West Point in the USA and Sandhurst in the UK when they were faced with resources provisioning during the Vietnam war. They refused to believe the enemy could build a substantial delivery system based on cycle power, asking, 'whoever heard of a modern army relying on guys with bikes?' Yet they were to rue their words, as the local terrain was undeveloped, supporting only a poor infrastructure and unsuitable for many ground-based transports, so they had to rely on noisy airborne transports that could not pass unnoticed through the jungle, as could bicycles. This was the result of a rigid mindset in teaching establishments who had seen the rising power of the combined air, sea and land forces in the wars of Europe and the Middle East, but who had not studied the alternatives needed in the very different terrain of tropical Asia.

Problems of control

Typically we are informed by the Project Management literature that we may control the variables of time, cost or quality in order to meet our desired goals. Most often we control a single attribute, usually 'time' as this makes management more simple, sometimes two variables are controlled (adding in cost management, for instance), but rarely can all three variables be controlled since the feasible solution space becomes severely constrained (Kidd, 1991). It is often also the mistaken thought of clients that they can control tightly the development of complex projects through the use of software, forgetting that these aids are simply *aids* to better interpersonal management. By and large, too many controls lead to failure through being in conflict with each other, while no control at all leads to havoc – we need to move to an understanding of what may be controlled and what should be allowed to be self-developing, though observed, so as to track and avoid oscillations that may later prove unwieldy.

We find the 'modern' project management tools and techniques grew up in the USA in the 1950s onwards: the techniques are arid, and do not accommodate human relations, but they have a logic that is generally good – begin at the bottom and add the walls and roof to these foundations in a controlled fashion. More broadly however, we find that interpersonal trust needs to be developed in all projects – a fact often forgotten in the West, and a fact which is certainly never mentioned in the western project management literature. This pressure to follow the

American way leads to many conflicts worldwide in project management unless the human touch is brought to bear. And we find the Asian mind has been there before and outlines ways forward that conjoins logic and ethics (Low, 2004: 151 pp).

Policy, governance and economic infrastructure

The development of an adequate economic policy, suitable for a local region, would seem akin to the Project Management task system. Yet while it would seem clear that the goals of these models will differ depending on the 'owners' and their political inclination, nevertheless the World Bank, the International Monetary Fund and other major donors of funds have in the past imposed a rigid model of financial management that stems from the American viewpoint. The results of these severe restrictions have been discussed at many meetings of the G8 world leaders – and in the 2005 meeting in Gleneagles there were strong policy changes proposed by the USA and the UK (effectively to alleviate the debts in most African countries, so allowing them to develop). We are seeing a move to allocate aid to infrastructure development rather than consumption (though hunger needs to be averted) and to promote trade as the mechanism of growth rather than allowing corrupt leaders to steal the incoming cash. Even so, within this new scenario there is the need to adhere to the local mechanisms although honest and trusting governance has to be developed. We must not impose methods that will not work in the locality.

It is the intention of this book through the words and analyses of the learned experts' chapters, to inform, to generate critique, and to allow one to form an opinion about the competition to provide the best models. We may then be able to decide if there might eventually be a unique and hence dominant economic model. But for the moment we think this is like the search for the Holy Grail.

Structure of the book

This book reviews different economic models proclaimed in the global marketplace today. The models are placed generally in the context of the political, economic and cultural background of a region that has sufficient strength and inertia to determine its general rules of operation and how it interfaces political actions against the economic models running in other regions. Yet, many would argue that cultural inertia is difficult to overcome, since many of today's actions are determined by decisions made in a long-ago past rather than by recent decision-making. The European Union for example, now encompassing 25 countries in Europe, has a discernable mode of operation based on its historical roots way back to the 1950s when several countries agreed a Common Programme developed by Robert Schuman. It was agreed that the six countries that signed the Treaty of Paris (1951), Belgium, France, Italy, Luxembourg, the Netherlands and West Germany, would pool their coal and steel resources.

Common policies have been agreed in many other regions – for instance, the North American Free Trade Agreement (NAFTA), the Southern American MERCOSUR, the emergent ASEAN agreement, and there is a Middle East Gulf States agreement on 'local' free trade and monetary union. These regions do not as yet have a discernable overall economic model, but their rationale is determined by underpinning local economic models: NAFTA has a strong US model, the EU has several strong historical models, and Asia too has its own rationales. Some of these macro-economic models are even used to simulate the effects of fiscal change. Sometimes we might joke that presidents or prime ministers might think they are really guiding their nations as they manipulate the parameters of their macro-economic models, forgetting that their model only simulates effects.

The major economic models have been derived by eminent economists in America, in Europe and elsewhere over a period of time, they have been tested and often proved to be reliable and have verisimilitude. Naturally discussions of these models form the basis of the initial chapters of this book. Of course, there are counter-arguments, and we offer insight to these too. Later in the book we look to how these models have influenced regional and global development, and finally we engage in discussions upon the way forward. The book has 13 chapters, divided into four parts. The first part considers the globalized development models, the next part critiques these models and considers alternatives; the third part looks to ways forward, while the short final part reviews the past and considers the future.

Part 1: models

In this chapter, '**The Complex Competition for Relevance**', John Kidd and Frank-Jürgen Richter introduce the notion that we cannot really expect to see and work with simple applications of leadership, across broad regions; that we cannot expect to apply a unique economic model that might fit all situations across the globe. The peoples of the world are all different and adhere to local values, hence local models work well in these regions. Even so, the authors question if new rules and procedures might not yield benefits, and that in order to create these new rules we must understand the major economic models, which are described in the following chapters of this section.

In Chapter 2, '**The Anglo-Saxon Model**', Nara Srinivasan describes how the 'neo-liberal' system of development, most associated with the United States and the United Kingdom, which has come to be commonly known as the Anglo-Saxon model of development, is a market-based model. Srinivasan looks closely at how this model has developed through the years and how it has influenced growth. He also looks at the various arguments of this model being the 'best or only' real model of economic development since it is influenced by the largest and most dominant groups globally throughout the history of development, that is the United States and the United Kingdom.

The model is rooted in the beginning of the industrial revolution (circa 1750s in the UK) and marks the beginnings of capitalism, since the established role of the Anglo-Saxon culture in the development of the Industrial Revolution is undoubted. It can be argued that in reality it was the birth of capitalism and it was the strengthened focus on the individual within economies that reflected the strength and involvement of the Anglo-Saxon culture in maturing the industrial revolution and capitalism. In simple terms, the guiding aspects of the Anglo-Saxon model are property rights, Protestantism (work ethic), and the 'Celebration of the individual'.

Srinivasan concludes that the Anglo-Saxon model propagates 'free trade' but in reality this does not include unregulated movement of labour through the markets. This limitation is caused by cultural and political factors rather than true economic argument. As such, the neo-liberal position of Anglo-Saxon theory of free trade that would result in free capital flows does not take into account the full picture, that is unregulated labour movement through the markets. Trade blocs try to address this issue, but it will take time to convince politicians that free trade in the real sense is workable.

Further, these economies have seen major collapses in business ethics due to market manipulation and serious frauds by senior management. While this is not restricted to the Anglo-Saxon economies, nevertheless the perception is that it is the companies and states that adapted the Anglo-American model of governance that have been largely affected by these failures. As a model of development, the Anglo-Saxon or Anglo-American model is facing its biggest challenge so far due to the growth in markets that did not adapt to their systems. In parallel the companies and states running with the Anglo-Saxon model are revising their statutes relating to financial probity, ethics and transparency – we will see by the end of this decade if these changes will erode the basic principles on which this system was based.

Chapter 3 is entitled '**Communitarian Capitalism and the Social Market Economy: An Application To China**', by Chong Ju Choi. The economic success of the United States in the mid-1990s created for several years the idea that the capitalism or business system of the United States was ideal, and that globalization was equal to Americanization. However, the stockmarket and technology crash of 2001, and the subsequent corporate scandals such as Enron, Andersen, WorldCom, Global Crossing and Tyco, all showed that no single business system is perfect in the twenty-first century. What was also underestimated in the 1990s was the phenomenal emergence of China, its global economic influence, as well as its business system. China has advocated a 'social market economy' as their business system, and one purpose of this chapter is to show that the Chinese social market economy has similarities to the communitarian capitalism and stakeholder business system that exists in continental Europe.

Although the term West is often used to describe both North America and Western Europe as a relatively homogenous grouping of countries in terms of economic and political systems, there is a significant difference between Anglo-Saxon countries such as the USA, Canada and the UK and those of continental Europe, which are often seen as closer to a 'social market economy'. The Communitarian business system includes the eastern and western European countries that are very different from the Anglo-Saxon countries in term of their domestic business systems that emphasize the role of the government in economic and social affairs. In these countries there are also close linkages between banking and industry, and the group orientation of the society and Communitarian values. In sum, their stakeholder systems are fundamentally different.

The suitability of the Anglo-Saxon model of capitalism for other regions of the world, such as South America or Africa, was especially questionable after the corporate scandals in the United States in the early twenty-first century. So Choi notes that in the year 2005 we are wiser in knowing that there is no one perfect business system. Both the Anglo-Saxon and Communitarian systems practised in continental Europe and the developed economies in Asia such as Japan, Korea, Singapore and Taiwan have all proven there is more than one way to approach a national business system and economic success in the twenty-first century. The more urgent question is what model or what combination of models is most appropriate for the emerging and developing economies of the world, especially in South America and Africa?

One of the views expressed by Haldor Byrkjeflot in Chapter 4, '**The Nordic Model of Economic Development and Management**', is that an inward-oriented and self-confident view of the Nordic system seems to have climaxed in the mid-1980s, before currently popular global management philosophies were well-known. Those were the days when management consultants and union representatives came to Scandinavia to learn from their experiences in a wide spectrum of areas such as management, user-friendly technology development, industrial democracy, group-work, welfare legislation and industrial relations. Many observers even came to Scandinavia to study the future. Sweden was perceived to be forming a vanguard in the inevitable march first towards a new industrial society, and later towards a post-industrial society.

The Nordic economic comeback, with its emphasis on electronics, mobile phones and the Internet, as well as the remodelling of the welfare states, has been an inspiration for those who want to display the model to the rest of the world. The Swedish industrial relations system in particular has been seriously restructured, and it is in this domain that defenders of the Nordic model have the most difficult time arguing for its 'essence' and continuity. The many predictions in the late 1980s and early 1990s about the coming collapse of the welfare state have failed to materialize, however. Currently there seems to be a positive attitude towards the architecture of the welfare state among Nordic intellectuals and politicians. There is a great deal of political controversy in the wake of the continuous advancement of the welfare state, however, particularly on the issue of privatization and the use of market mechanisms and individual rights in welfare provision. There are thus no signs that ideology has been reduced to irrelevance, as suggested in the 'end-of-ideology thesis'. The welfare state is still intact, its architecture is disputed, not its existence.

Yet it is now difficult for industrial managers in the Nordic welfare democracies to achieve a position of power and legitimacy that matches their wealth. Increasing economic gains for the upper middle classes in the private sector represent a threat against the traditional regime, as such gains undermine the status of the historically more powerful political and organizational elite. The long tradition of 'functional socialism' and state paternalism implies that there is no strong support for the idea of unrestricted property rights or the suggestion that firms exist to maximize shareholder value. It is difficult to imagine a new Nordic compromise between a 'shareholder value' and a 'stakeholder' view of society. Nonetheless, it may be too early to wave goodbye to the Nordic model of compromise – the compromise between management and democracy and the compromise between extremes.

In Chapter 5, '**The Indian Reform "Model"** ', by Laveesh Bhandari, Bhandari notes that the Indian model of economic development is essentially a political economic model and not a purely economic model. And thus the political-economic model by default is more oriented to improving the processes of economic governance. Moreover, the speed with which economic policies change are determined by (i) the interplay between different pressure groups within its democratic polity, (ii) the different roles of the three tiers of its government (central, state and local), and (iii) the ever-changing macro-economic conditions acting upon the sub-continent.

One of the most important aspects of India that makes it somewhat different from many countries in the immediate vicinity is that India is a democracy with clearly demarcated powers of the various arms of government. Unless there is some sort of a consensus between different groups, any type of change is difficult. Given the fractured election results for the last 15 years demanding coalition parties be set up, the ruling party has had to defer to others on many issues, and reforms have also been slow; changes have occurred in spurts in some areas and leaps in others, but followed by slowdowns and sometimes even reverses a few years later.

A severe Balance of Payment crisis led to the post-1991 reforms which reversed many economic policies being pursued until the 1980s. Import-substitution industrialization and self-reliance were overthrown by reforms that preached deregulation and liberalization. Licences for domestic manufacturing were abolished, private-sector players were allowed to enter areas reserved for the public sector, import tariffs were reduced drastically, and the rupee was being devalued. The reforms were wide-ranging in the early years and many areas were thrown open to the private sector. The Stock Exchange Board of India (SEBI) was strengthened as a regulatory body for the stockmarket that brought in greater transparency and e-trading in stockmarkets.

Now, says Bhandari, there is a lack of clarity of the ultimate objective of reforms. Reforms have till now been 'sold' as the answer to India's economic problems. That is, those wanting to see greater reforms have been arguing that they will ensure greater growth and equity. Though data shows impressive gains, many do not believe these claims; it is difficult to make credible claims about improving equity when more than 250 million people continue to live below absolute poverty. Many continue to ask the basic question, 'has the bulk of the Indian population gained from reforms?' The answer is an unambiguous no. Most Indians have not experienced greater economic freedom.

In Chapter 6, '**The East Asian Development Model**', by Wolfgang Klenner commences by stating that the East Asian countries developed extraordinary economic dynamics, suffered from the Asian financial crisis, and are now again on an arguably more balanced growth path. This chapter, focusing mainly on Japan and China, looks into the question as to whether economic growth in the region may be partially explained by specific sets of 'intrinsic' institutional arrangements of the relations between state and firms, management and employees, and banks and firms, or whether it was generated just by sound economic policies.

In most East Asian countries, physical and human capital have been intelligently accumulated. Domestic investment has been financed by high savings rates, and considerable investment has been directed towards the education of the labour force which has contributed to a rapidly growing human capital. Most countries have been heavily trade-oriented and initially pursued import-substituting industrialization and later export-pushed trade strategies with declining protection rates. By integrating into world markets they were able to attract foreign capital, since the 1980s increasingly in the form of foreign direct investment, and in 2004 China became the world's largest recipient of foreign direct investment (of $65 billion dollars) and is also expected to be the world's third largest economy after the USA and Japan by 2008. No wonder we are looking to this 'new economic miracle'.

According to the widely held view of Western observers, East Asian governments are playing an active and extremely efficient role in their national development processes. Moreover, it is said that subordination of individuals to responsible and benevolent leadership is regarded as more efficient than the free play of individual interests, and that the betterment of groups or even the nation is considered more important than increases of individual wealth. These features, in connection with other socio-economic fundamentals, are usually regarded as the key elements of the Confucian ideal. This chapter will not dwell on Confucianism, but will consider the institutional issues concerning the relations between the state and the economy, between management and employees, and between banks and firms.

Klenner suggests that the idea 'that sound economic policy generates growth' would hardly come as a surprise for economists. But it would probably disappoint Asian experts who have developed considerable expertise to grasp East Asia's particular features. Herein he argues that the empirical evidence of a specific East Asian development model is rather weak. It would hardly encapsulate the regional and temporal diversities of East Asian countries. Yet he concludes that analyses which focus on institutional arrangements for tasks, countries and periods of time different from those examined in this chapter might lead to different conclusions. Examples which might be explained other than by economics are easy to find: according to empirical research, for instance, the profit–sales ratio of Japanese firms was 3.8 per cent in Japan and 5.1 per cent in other Asian countries, but this ratio fell to −0.2 per cent for affiliates in the USA. We must ask, therefore, why did these firms perform much better in Asia than outside Asia?

Part 2: critiques and alternative views

Capitalism in any country, says Tony Mitchell in Chapter 7, '**East Asian Capitalism: The View from the Tokyo, Seoul, Beijing Axis**', is a dialogue between the state, the market, entrepreneurs, professional managers, co-workers and providers of funds, banks and shareholders. Many of these actors have separate dialogues with one another and the shape of these dialogues is more frequently directed by the values which inform the society rather than issues related to profitable operation. However, in reference to East Asia, it is not necessary to argue about specific elements of Confucianism or to revisit Max Weber, since the argument is simply that entrepreneurs and managers in East Asia have grown up in nations which have developed through interpretations of each others' experience in a common cultural milieu. Also, it will be necessary in the future to define the differences within Michel Albert's 'Rhine model' between Japan and Germany, and here Confucian values emerge rapidly as posing a very different set of values informing the development of society and its socio-economics. In Germany, or better in the old Swedish model, there was a social compact between labour and capitalism, whereas in Japan the agreement flows not out of disputes of the period of industrialization but out of the continuity. The three major players of East Asia – Japan, South Korea and the PRC – are likely to coordinate more, and build their own common institutions. Their attitude towards their companies will be distinctly different from that of the Anglo-Saxon model. And while there are strong differences between Japanese, Korean, Chinese and overseas Chinese firms, including Singapore, Taiwan and Hong Kong, nevertheless they have some common elements.

This chapter argues that both the lost decade and 'the IMF crisis' taught Japanese and Korean companies many things about capitalism, notably that the actual structure of finance of their firms could not defy gravity just because the founder wanted it to be defied. Those who now run Japanese, Korean and Chinese firms are much more sophisticated in their risk management and use of capital than those who ran them 10–15 years ago. But as Nicholas Kristof shrewdly put it in 1998, adopting a Western diet or clothes does not make East Asians more American, just as 'Americans do not become more group-oriented or respectful of their parents when they put on a Sony Walkman'.

Mitchell continues, and observes, that a feature of the East Asian system is the need to persuade powerful government officials to let the company do its business in an uninterrupted manner, which in freer and less regulated markets would be unnecessary. Sometimes it was easier to get corrupt politicians to do the work for the company than persuade more public-spirited officials. Sometimes it was easier to have gangsters involved in shareholder meetings to ensure no embarrassing criticism. Was this an essential part of the old model and will it continue into the future? These and other questions must be answered, especially as there is strong pressure from Wall Street and venture capitalists to have firms work in the ways with which they are familiar – and the Sarbanes-Oxley Act (2002) does nothing to ease this pressure when US firms work in Asia.

Finally Mitchell notes that Korean, Chinese and Japanese companies when they act in their national interests might appear to act as politicians would like US companies to act – putting national issues, normally jobs, ahead of shareholders' interests in pure profit. In fact none of these companies have acted primarily to preserve jobs in their respective nations (though there is a spectrum of difference from Japanese to overseas Chinese firms). Rather they have acted in the belief that ownership of global markets and assets by national companies advances the interests of the nation itself – perhaps echoing Sloanism of prewar America. We even get this apparent convergence in the future; America will not discover the power of Confucian values since it is itself built on a legal and confrontational model rather than a consensus model. At the present time Japan and China seem far apart, and an East Asian community far from reality. As the consensus model begins to operate we may find an East Asian community on the doorsteps of America and Europe much faster than we can imagine.

In Chapter 8, ' **"Emerging Multinationals" in the Global Economy**', by Andrea Goldstein argues that understanding domestic entrepreneurship and the private sector is key to strengthening productive and trade capacity in emerging, developing and transition economies. In this context, it is not surprising that foreign direct investment (FDI) by multinational corporations (MNCs) based in such economies is playing an increasingly visible role on the world stage. Indeed, in a differing context the dissemination of humanitarian aid is now seen best to be targeted at increasing local trade and to the development of local infrastructures to support the trade, rather than directly at consumerism, though the amelioration of hunger and thirst is seen as very important. What are relatively new, in short, are the forms that FDI from non-industrial countries is taking, the motivations, and the effects.

These developments call for new research on the international expansion of such companies, bridging the gap between the existing literature on business in emerging economies. The former often portrays corporations as rent-seekers that flourish thanks to privileged access to political, financial and transactional resources. Scholars should now consider resources as the basis for corporate success. Factors such as protecting proprietary processes and competitive advantages, 'learning by competing' in high-income markets, following important customers, or the increasing global nature of managers (in terms of citizenship, education, recruitment and professional background) all combine to explain the decision to invest abroad. To advance this research agenda, scholars need to analyse the specific activities and capabilities of the firms involved, and the impact of FDI on the broader social and environmental context. In particular, research must come to terms with the concept of heterogeneity across firms as the best way to extend existing models to make them more realistic, but still theoretically precise.

Goldstein notes that for an emerging multinational corporation (EMNC) aspiring to become a profitable international player and recognized brand, acquisitions may improve its chances, but in international business the 'edge' of low labour costs – one of the emerging economies' advantages in competing with Western rivals – is less and less important. In countless industries, the big winners are mainly masters of an ultra-efficient logistics management: of suppliers, assembly and distribution. An important point emerging here is to note the heterogeneity of internationalization patterns and the consequent need to explore in great depth the linkages between the political and institutional environment, on the one hand, and corporate trajectories on the other. This point is certainly not novel. The 'varieties of capitalism' literature finds its origins in the analysis of OECD economies – and has even greater heuristic pertinence in the case of multinationals based in countries where, on account of weaker entrepreneurship, government institutions and policies have been so crucial in determining economic successes and failures.

In Chapter 9, '**Is Lean Production Sustainable? The Rise and Decline of Neo-Fordism**', Hock-Beng Cheah discusses another mantra almost as strong as the idea of a national development model, that is, the Japanese production model which many believe was the bedrock upon which its postwar economic success stood and towards which many industrialized nations aspired. Significant changes are underfoot that are transforming the mass production system that (in fact) dominated many economies for most of the twentieth century. However, Cheah suggests that these changes do not extend far enough, and they will need to incorporate greater concern for sustainability in the twenty-first century. These further changes will lead in the direction of what may be called a 'sustainable production system'.

Over time, relative to Fordist mass production, Japanese firms have been successful in developing superior forms of production management (such as just-in-time production systems, *kaizen* ('Continuous improvement'), and 'lean production') and employee management (involving long-term employment, extensive job-rotation and on-the-job training, strong teamwork, and keen employee motivation). Together, these constitute the lean production system. These, in combination with very effective corporate supporting structures (*keiretsu*), provided Japanese firms with very significant competitive advantages. The Toyota (Japanese) lean production system improved and effectively developed a more sophisticated and more flexible application of Ford's early ideas, and thus it may be labelled neo-Fordism to delineate both its genealogy as well as its constraints.

But the latest variation – the new sustainable production system (SPS) – will need to incorporate new dimensions of sustainability. At the micro level, the SPS will have to be integrated into the culture of the firm. At the macro level, conditions for the effective establishment and consolidation of the new SPS will depend on national and international efforts to recreate complementarity and flexibility to the global economy. However, what is required may be even more fundamental shifts in the focus of prevailing management and development processes. To achieve that outcome would require us to move beyond lean production to sustainable production, that is, producing goods and services in a manner that is sustainable for people and organizations, communities, nations and the world, based on the effective integration of economic, ecological, social and ethical imperatives. This gives rise to the concept of a sustainable organization; that is, an organization that is focused on the quadruple bottom line, to achieve long-term sustainability.

Part 3: ways forward

In Chapter 10, '**A New European Model**', Johnny Munkhammar discusses the European Social Model that is the focus of European public debate and policy-making. This has been the situation for years, but the debate has become even more intense. The main question is whether this model is a cause of many of Western Europe's serious economic problems or part of the solution. Clearly, there are problems. The average US citizen is about 40 per cent richer than the average Western European. The aim of the Lisbon Agenda of economic reforms, started in 2000, was to close that gap in ten years; but since then the gap has widened. Unemployment is high in most European countries; in Germany it is at its highest level in 75 years. Many people are dependent on the state throughout Europe; in Sweden, about 60 per cent of the adult population is dependant to some extent. In general, people wait for years to have treatment in public healthcare, and 'public' schools are performing more poorly every year. Yet, conversely, Spain is 'suffering' an economic boom.

Munkhammar states that the European Social Model should rather be called the Western European Social Model. There are differences which support this claim, but also central features. High taxes, regulated labour markets, large government transfers and public welfare services – schools, healthcare, child and elderly care – are the core parts of this model. Despite all the talk about keeping it, reforms to dismantle it are taking place. They have different names, such as Agenda 2010, but they have one direction in common: towards lower taxes, free competition in welfare services, higher employment. Throughout this chapter Munkhammer addresses the following questions: What are the main features of the European Social Model? When and why did it emerge? What are its main effects? Which are the challenges towards it? What reforms need to be done?

After the Second World War, Western Europe remained politically free. Economically, the main foundations for a market economy were still there, allowing fast and strong economic development during the first decades after the war, not least due to necessary reconstruction. But the foundations for the market economy were increasingly put aside and the state took possession of an ever larger part of society. High taxes and public monopolies steered and planned development. The so-called mixed economy was created – or, to give it another name – the European Social Model. Thus 'big' government began to be the major provider, even for those out of work, and over the years the model has become unsustainable.

Western Europe needs radical reforms, and basically knows what needs to be done. But of course it is not easy; most leading politicians have told the people for decades that this model is morally and economically superior; so doing the opposite quickly is a hard act. This also shows that introducing systems of benefits from government to people is the last thing you should do. It becomes almost impossible to take away. When a majority of the voters live off the system, they will hesitate before they vote to take them away. You know what you have, but not what you may get: there is a natural fear of the unknown.

Finally he says that it is clear what we have (the European Social Model) and therefore it is dear to many; but a big change is needed. And it has started, though strong forces will try to stop change. Large Western European countries will try to stop competition from the new EU members. They may shut their eyes to the world: but the elevator doesn't stop falling just because you close your eyes. Sooner or later things will change.

'**A View from Porto Alegre**', by François Houtart, is the subject of Chapter 11. Over the past few years the World Economic Forum has held an annual meeting, usually in Davos, a small Swiss town. There, invited guests and paying delegates mix to discuss issues affecting the globe and its peoples. But there are alternative views – at the same time as 'Davos' takes place, a meeting is held in Porto Alegre in southern Brazil, where invitees discuss alternative views, and proclaim ways to reach their targeted goals. Houtard leads us through many of these issues.

Capitalism can claim with some reason to be the most effective system for producing goods and services – as long as not too many questions are asked about the conditions of production and how the results are distributed. Ecological destruction and social exploitation, which have been continuing since the fifteenth century, are considered externalities and are not taken into account unless social movements or public authorities react. The widening chasm between rich and poor countries, as well as the rich and poor within them, indicates that if we define the economy as 'the activity to ensure the material basis needed for the physical and cultural life of all human beings', the capitalist economic system is the most ineffective in history. Never has so much wealth been produced and never have there been so many poor people. Let us quote a few examples: according to UNICEF, 640 million children do not have decent housing, 500 million have no access to sanitation, and 400 million have no access to drinking water; 270 million lack healthcare and 90 million are undernourished. In Latin America alone, in 2000, there were 210 million poor.

It is not only the financial and juridical mechanisms that reinforce the process of private wealth accumulation against the common good. Culture, too, is serving the purpose. In fact, the market's hold over education is becoming stronger and stronger. In the United States, the education business already takes up 82 million dollars worth of investment. The universities are gradually being reduced to advanced technical schools for the service of the market. Research is becoming privatized, university chairs are being sponsored by transnational corporations, scholarships are being replaced by loans. Universities are obliged to become centres of competitive excellence and whole sectors of the 'humanities' are disappearing from the taught curriculum. Everything must become commoditized, the only way of contributing to accumulation. The educational sector becomes one of its new frontiers and, in its wake, a source of new inequalities.

It is not that alternatives are lacking, but the lack of political will to apply them. The vision of Porto Alegre is that of the victims of the system, as well as those who identify with their cause. It reflects the views of those who have understood that the market is a social relationship and that the capitalist market creates unacceptable unequal relationships. The people meeting at the Social Forum demand the introduction of parameters ignored by capitalist logic into economic calculation: the so-called externalities. This is a first step to prevent the concentration of wealth in the hands of a minority, when majorities are victims of the system. They propose alternatives, essential for the survival and quality of life of all human beings. They constitute a globalization of resistances against the globalization of capital.

Chapter 12 is entitled '**Moral Capitalism**', by Stephen Young. In 1994 the Caux Round Table (CRT) network of experienced business leaders proposed a set of guidelines for decision-making in business. These are called the Principles for Business, and make express reference to the stakeholder relationships necessary for sustained profitability of enterprise. More fundamentally, the CRT Principles for Business attempt to articulate goals and objectives for enterprise based on the moral ideals of *Kyosei*. *Kyosei* is a Japanese standard of conduct that values mutuality and interdependence among living beings and their environments. The vision of *Kyosei* presumes that we live within a network of dependencies, and that we thrive as those relationships increasingly support us in return for our support of them. *Kyosei* commands that our ideal of justice provide for mutuality and respect for that on which we depend. More broadly, we find that Stewardship values are inherent in many religions, and indeed the tradition of responsible behaviour that devolved upon the authors of the Caux Round Table Principles for Business was Calvinist. Protestants in general and Calvinists in particular emphasize a theology that has individual humans responsible for the good use of the power and opportunities that God places in their hands. Enterprise capitalism first arose in the Calvinist Protestant societies of The Netherlands, England and Scotland in the sixteenth, seventeenth and eighteenth centuries.

Enterprise capitalism, therefore, needs a moral basis from which to reach wealth and profitability. What guides this structure of economic rationality is a moral capitalism. So therefore we should not be surprised to find that economic activity is embedded in culture and values. The behaviours of people seem tied to mental perceptions of value, beliefs and interests, which only subsequently are translated into market preferences and choices. We arrange our lives around intangible structures of meaning.

The first general principle of the seven Caux Round Table Principles for Business affirms that a business must maintain its own economic viability in order to continue creating value for society, but its 'survival is not a sufficient goal'. A business is seen from a moral perspective as a means of improving the lives of all its customers, employees and shareholders. In addition, suppliers and competitors should be treated honestly with fairness; and businesses must understand that they are responsible citizens of the local, national, regional and global communities in which they operate. The six additional Caux Round Table general principles affirm that business must contribute to the economic and social development of the community at large through effective and prudent use of resources, free and fair competition, and with emphasis on innovation; that they must go beyond the narrow requirements of the law to honour sincerity, candour, truthfulness and transparency; that they should recognize that some behaviour, though legal, may still have adverse consequences; that they should cooperate in the liberalization of global trade; that they should protect, and where possible improve, the environment; and, finally, that they must avoid corruption, bribery and every form of illicit transaction.

Finally Young concludes that as there is no formal need to identify capitalism with 'Brute Capitalism', or the extreme individualism and short-sightedness with high externalities for stakeholders sometimes found in the Anglo-Saxon model, intentional efforts can move business practices towards a more moral form of free markets and entrepreneurial wealth-creation. What should be sought is optimal wealth-creation for the global community, with fair distributive outcomes resulting from the allocation of private-sector capital investment coupled with minimal negative externalities for stakeholders, including the environment.

Part 4: endpiece

In Chapter 13, '**Futures – and Still More Complexity**', John Kidd & Frank-Jürgen Richter look at some of the issues raised by the authors in earlier chapters – the need for better accounting standards (both in terms of widespread application, and in terms of creating comparability and promoting transparency); the interaction with cultural norms (defining beliefs and behaviours that clash when crossing national borders); and the role of Business Schools (historically, and the need for them to alter their curricula in the future to address the *art* of management); and finally the need to address the dark side of business, the corruption and the production of fakes which seems to have reached, globally over US$ 500 billion in 2004. The fakes have various effects – items made of inferior materials do not last as long thereby annoying customers (but then they were cheap); some may however be life-threatening if they are drugs with no discernable pharmaceutical properties (again cheap to buy, but is life that cheap?); and all fakes in some way reduce the income accruing to the official manufacturer which will sooner or later cause them to exit their business as they can not afford the development costs (which are not recovered by their forecast sales).

From a brief consideration of outsourcing and offshoring and noting the sheer variety of human needs and the natural variety of their sociometrics, they determine that no single development model can 'fit all'. But with better learning taking place between peers it ought to be possible for manufacturers, traders and politicians to consider the other in a more open way, and think of the 'economic model' as an advisor. Equally, global financiers ought to consider more than the single bottom line and address sustainability in their balance books when offering international aid.

Note

1 *Freeter* is coined from two words – the English word *free*, and the German word *arbeiter* (labourer). The term '*freeter*' was said to be coined in 1987 by Yukio Okubo, general manager of the 'think-tank' of the employment agency Recruit.

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Part 1

Models

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2
The Anglo-Saxon Model

Nara Srinivasan

> 'Economic theory is, in essence, a collection of models: simplified representations of reality, which inevitably leave out some aspects to focus on others.' (Krugman, 1994)

Introduction

When discussing development models, the 'neo-liberal' system of development is most associated with the United States and the United Kingdom. This system has come to be commonly known as the Anglo-Saxon model of development and is a market-based model. Previous and recent writers argue that this model of development is a comprehensive product of the Anglo-Saxon culture (Newton, 1984; Taeusch, 1935; Schroeder, 2000).

In this chapter, we will look closely at how this model has developed through the years and how it has influenced growth. The chapter will also look at the various arguments of this model being the 'best or only' real model of economic development since it is influenced by the largest and most dominant groups globally throughout the history of development, i.e. the United States and the United Kingdom.

When one refers to the Anglo-Saxon economic models, this term is associated with both Americans and the British. The model is rooted in the beginning of the industrial revolution (circa 1750s in the UK) and marks the beginnings of capitalism. The established role of the Anglo-Saxon culture in the development of the Industrial Revolution is undoubted. It can be argued that in reality it was the birth of capitalism and it was the strengthened focus on the individual within the economies that reflected the strength and involvement of the Anglo-Saxon culture in maturing the industrial revolution and capitalism.

In simple terms, the guiding aspects of the Anglo-Saxon model are property rights, Protestantism (work ethic), and the 'Celebration of the individual' (Schaede, 2000). All of these are part and parcel of the Anglo-Saxon culture. It is really the work ethic coupled with the initial and later burgeoning economic environment and technology that has resulted in the Anglo-Saxon economic model as it exists today. One could argue that technology emphasizes similar principles, that is, individualism and effective working patterns. While it is true that technology holds an increasingly important place in the Anglo-Saxon model of economic development, through history, the maturing of this model has been based on political, religious, cultural and economic factors. Yet, two facts remained constant: the importance of the individual and the exploitation of the opportunity in the marketplace to increase profits (Schaede, 2000). In some aspects this is in direct conflict with the religious and cultural factors, but profitability became the overarching principle of this model and overrode any other considerations. In one analysis, it could be seen that this is not true if taken as a standalone principle, but the argument was that the marketplace decided what was important and in the marketplace, profits became the key guiding principle.

The model

History of Anglo-Saxon economics before the 1970s

The roots of the Anglo-Saxon economics show that it begins and ends with the growth and maturity of the marketplace (Jones, 1993). The eleventh-century fundamental changes that occurred in English society speared the growth of the market model due to the profitability that could be achieved during this period. The producers had greater demands placed on them and this in turn resulted in the growth of demand and in profits (Jones, 1991). The older system of bartering was replaced by this newer system of commodities being exchanged for money. Most importantly the price of these commodities was decided by demand and supply, and as such one could argue that the beginnings of the 'Anglo-Saxon' model of development started well before the 1970s as the marketplace had started dictating elements of this model at some stage in eleventh-century Britain. Indeed, there are similar aspects indicated in continental Europe at that time, where banking was beginning to be developed. In Italian city-states such as Rome, Venice and Genoa, and in the fairs of medieval France, the need to transfer sums of money for trading purposes led to the development of financial services including *bills of exchange*. Although it is possible that such bills had been used by the Arabs in the eighth century and by the Jews in the tenth, the first definite evidence was seen in a contract issued in Genoa in 1156 that enabled two brothers who had borrowed 115 Genoese pounds to reimburse the bank's agents in Constantinople by paying them 460 bezants 'one month after their arrival'. Partly to help trade, the Order of the Knights Templar was set up to protect pilgrims on their passage to the Holy Land; they also aided traders in their personal quests by providing *letters of credit* (Davies, 1996). The important 'individualism' factor seemed to have had its beginnings sometime during this period, but was seen in a different way to the 'individualism' that developed during the 1970s. This point made Britain ready to face the challenges of the industrial revolution well before other 'Anglo-Saxon' states.

During this time, the fairly low transaction costs when compared with what were the costs in the preexisting allocative system made the system of market economics popular. Indeed, the lower transaction costs can be attributed as the single most influential factor that encouraged the spread of the market economy in those times (Jones, 1993). The balance of trade system and what can be described as the wealth of 'mercantile London' based on the import and export in a market economy also fuelled the growth of this system (Jones, 1991).

One of the other factors that contributed to this change was the 'emergency conversion(s)', that is, cataclysmic events that force changes to society that make them trade in the marketplace (Jones, 1993). What this refers to is the changes that members of the society had to make in order to survive. The raids by the Vikings and the increasing of taxes forced the English to develop a market economy (as this was a way of maintaining financial balance) that was positive when compared with others in the Western world of that day. This is where the true force of individualism comes into play, where the individual has to adapt to changes that are happening in society or opt to be left behind. The strong relationship between the individual and the market is established when the individual is forced to make changes that are sometimes in conflict with the state.

Strategic principles of the Anglo-Saxon model

The Anglo-Saxon model is principled on the individual as the driving force. Strategically this is seen as a major benefit in advancing the economy, as the argument is that it is the individual who would want to benefit and as such it would result in overall benefits to the entire economy.

This could mean that there is no need for markets to be regulated or governed, as individuals would not do anything that would destroy the markets as this would directly affect their personal profits (Larsen, 2002). In reality this is not true as the model also emphasizes profitability and the conflict between the profitability for individual and the state comes into play. It is interesting to note how different economies use this conflict and deal with this conflict to showcase 'moral superiority'. The argument that the model which emphasizes the individual will encourage greed and thus needs greater regulation is put forward by economies that argue that they are not driven by individualism.

The conflict between the state and the individual is regulated through giving the state some powers and having the understanding that the individual wants to make profits and thus keep costs low. The state is also concerned about the amount of profits that can be shared with the state, that is the taxes that could be imposed on the profits. One way of looking at this is that the profits are shared between the state and the individual but this is not a true partnership as there are competing interests between the state and the individual. This is the biggest challenge facing the Anglo-Saxon model of development today and will be discussed in a later part of this chapter and throughout this book. The World Bank in an influential report stated that 'the state is central to economic and social development not as a direct provider of growth but as a partner, catalyst and facilitator' (World Bank, 1997). This thinking involves a governance model of economic development where the state plays a real partnership role in providing the right environment for economic growth. Market regulation is seen as just one role of the state. According to the early day Anglo-Saxon model, this approach is not too different as the state is not interfering with the profits or the capitalistic environment but rather supporting and so making the environment more fertile for capitalistic growth.

The central pillar to all this is the 'market', and this is determined by price uniformity within a particular area (Larsen, 2002). It is the demand and supply mechanism that dictates the movement and price of commodities in the Anglo-Saxon system, and the balance between the individual and the market can be summed up as the constant challenge facing the Anglo-Saxon model of development.

The determinant of the model is also liberalism 'allowing market forces to operate in giving policy makers few instruments to apply directly to private firms' (Katzenstien, 1977). This ties in well with the principle of state and individual being separate, that is the doctrine of separation of powers. The state can make some rules for the regulation of the markets, but 'liberalism' is what determines the individual independence that is part of this model.

In more recent times, the influence of Weberian and Protestant ideology has shaped the Anglo-Saxon model. Weberian capitalism consists of the 'calculated evaluation of anticipated periodic returns in the forms of dividends or interest' (Patrick 1997). This is further influenced by the idea of the Protestant work ethic, which is the 'spirit of capitalism'; this advocates hard work, thriftiness and a certain acquisitiveness (Lie, 1997). The idea that we also need to gain not only income but an increase on original investment is meshed in with all this, and it forms the basis of investments in the Anglo-Saxon world of today (Patrick, 1997). The influence of earlier writings affecting more recent writings in expanding the theory of capitalism to all areas of life creating neo-liberal economics cannot be underestimated (Becker, 1965). The influence of the Anglo-Saxon model being labelled as the Anglo-American model in recent years is also due to the influence of the United States as a powerful country that believes that capitalism is the most important element in modern economic development.

In the mid-1980s and later years, terms emerge such as 'strategic trade' which were developed by those who see the whole of the USA as a 'giant corporation'. These ideas impregnate the entire Anglo-Saxon world, that is, seeing the state as a 'giant corporation'. Whilst this seems to be in conflict with the earlier Anglo-Saxon principles of seeing the state as an independent entity, the reality is that it is no different from seeing the state as a separate entity to the business corporation. What 'strategic trade' pundits were pushing forward as economic models were actually the influence the state *should have* in assisting businesses to flourish. The key to this principle was seeing other countries as 'competitors', that is not competing with other businesses within the state, but competing with other trade blocs, in this instance non-Anglo-Saxon trade blocs.

You may argue that this is not true since countries such as Britain and the United States compete with each other and these are both Anglo-Saxon countries. In the longer-term, the trade blocs themselves have included 'Anglo-Saxon' countries against 'others' such as the recent trade liberalization debates. Trawling through history, from the eighteenth century, Britain proved the superiority of the free-market and free-trade policies by beating interventionist France, their main competitor (Chang, 2003).

It is fairly obvious that supporters of 'strategic trade' were opposed to the notion of free trade, but in later years when the Anglo-Saxon economies were losing out because of 'strategic trade' policies, these pundits cautiously embraced the ideas of free trade. In short, the Anglo-Saxon model of free markets went through a period when the 'pundits' decided that free markets may not be good when competition was rampant in an international environment. It looked like the Anglo-Saxon model might be changing shape to become more 'state'-based, that is more frequent and deeper regulatory approaches together with subsidies being given to businesses. Market forces would be 'manipulated' by the state through regulation and protectionism.

In the long term, especially after the events of 11 September 2001 (often noted as '9/11'), the Anglo-Saxon model is being shaped by more regulation by the state as a means of controlling activities that may be of 'national interest'. This was not a principle of Anglo-Saxon models of development pre 9/11, but has emerged as a means of controlling the business environment and providing renewed protectionism to certain industries under the 'national interest' label. Fairly obvious industries are defence and energy that are categorized under this banner, but using new laws and regulations: also, the United States and the United Kingdom have devised ways to label industries like pension funds under this category. Financial service industries are also being regulated through the 'financing of terrorism' category. The point here is that post-9/11, the free trade and free market principles of the Anglo-Saxon model are changing. The balance between free markets and state-owned businesses is somewhat muddied for the time being. In some aspects the immediate post-9/11 scenario looked like there would a series of state-owned enterprises springing up to manage services directly related to areas of 'national interest'. That scenario is operating in a watered down way today.

Applications of the Anglo-Saxon model in a 'real' environment

> 'Tony Blair, the current prime minister of Britain, professes to be an evangelist for the Anglo-Saxon style of economics.' (Schroeder, 2000)

As the above statement suggests politics seems to have taken a stronger role in economic policy development in recent years. The media and politically influenced economic advisors organize and control the development of economics and economic models as the politicians depend on them to win or lose elections. In such an environment, how do applications of the Anglo-Saxon model relate to the 'real' environment?

The political landscape

The term 'policy entrepreneurs' was coined by Krugman (1994) in the mid-1990s. He argues that these are professional people employed by politicians and the like to assist with the 'broader audience'. How is this related to the Anglo-Saxon model of development? In simplistic terms, these 'policy entrepreneurs' are a product of the Anglo-Saxon political environment and they have an immense influence on how economics is used in the 'real' environment to justify political means and goals. One could argue (as Krugman does) that these are the people who shape economic policies and development models in the Anglo-Saxon world of today.

Taking this further, if you are a political leader in a democracy, it would be paramount to your survival that the broader audience understood the economic messages that your party was propagating, since the key factor in a democratic economy is that the people who vote for you and your party make the decision based not only on their current standard of living but on the 'promised' future standard of living. To convince the public that your promises are achievable, you do not need academic economic papers with pages and pages of mathematical formulas and economic jargon. What you need is a strong and clear messenger with economic knowledge who can spread your message clearly with some understanding of what he or she is saying. This is where the 'policy entrepreneur' comes into the picture. They have *what it takes* to present simplistic economic theories that are understood by the masses and which in time become economic policies.

The 'policy entrepreneurs' of the 1980s convinced the American government and public that taxes and regulation were a major burden to business expansion, while the 'policy entrepreneurs' of today have convinced the world that terrorism is the major threat to everything that we do today. In both of the above cases, many economic policies and debates are centred on these notions. The point that is being made here is that these 'policy entrepreneurs' seem to be a major product of the Anglo-Saxon economies as their political systems allow them to flourish effectively.

It is also relevant to compare and contrast the policy instruments and objectives of the United States and the United Kingdom through the years (Table 2.1). When this is done, it is clear that the trade and economic policy instruments are very similar. The differences appear in instruments of foreign policy and this is evident today where these 'Anglo-Saxon' countries differ in their foreign policy objectives. These differences appear to mould some of the finite economic models that have been exported by the respective countries. As pointed out earlier, the United States being a more dominant power and having greater global presence today, has become the powerhouse that disseminates the Anglo-Saxon model of economic development. Whilst this is not accepted by many countries globally, they appear to have no choice but to accept this dominance as they are reliant on the capital and development funds from the 'Anglo-Saxon' countries.

The application of this model in the real world is far-reaching for the reasons pointed out above. There have been some key changes to the world economies that are a direct result of the application of the Anglo-American economics. The first and most influential change is to do with private enterprise in any economic system. As discussed above, this is being controlled in the USA post-9/11 but it has not stopped the USA propagating the important role of private enterprise globally. As an example, private enterprise is playing a bigger role in stimulating the domestic market in China. This is done through the application of 'scientific and efficient operating mechanisms that allows the private enterprise to adjust their production activities and structure according to demand' (Anonymous, 1999).

The Anglo-American model has also led to the development of several alternative approaches to dealing with deficits and maintaining company profits; one example is the introduction of pension fund capitalism. This

Table 2.1 Policy instruments and objectives of the USA and the UK

Objectives	*Britain*	*United States*
Trade	Export-oriented Liberalization of imports	Export-oriented Selective protection
BOP	Strongly defend parity, less after 1970	Defend parity, flexible post-1970
Foreign investment	Encourage capital export; encourage foreign investment	Encourage capital export; encourage foreign investment

Instruments of foreign policy

Britain	*United States*
Consensus ideology	Anti-communist ideology
Institutional innovation	Shift to institutional arena
Macroeconomic policy (both monetary and fiscal)	'Voluntary' bilateral agreements

Source: Based on Larsen (2002).

also reflected in the different ways governments have dealt with the pension funds. In effect, pension funds are a very important financial institutions in Anglo-American economics as they dominate the national and international securities markets (Clark, 1998). Clark also argues that pension fund capitalism is principally an Anglo-American phenomenon. In a more recent article, *The Economist* suggests that pension funds in the Anglo-Saxon world are instrumental in keeping the economy active and productive, especially in an environment where individuals' saving rates are dropping drastically (*The Economist*, 2005). The point here is that other countries such as China and Singapore have high savings and are developing large pension funds, mainly state-controlled. The models that are being adapted in these situations are variations of the Anglo-Saxon model of savings, but with higher success rates. One example of this is when during the early Thatcher years in the United Kingdom, unemployment slowed and demand went up. When analysed, one of the reasons was the low saving rates in Britain during those years. When Thatcher and her government realized that this was not sustainable in the long term and increased interest rates, the results of this debacle were there for all to see, leading to double-digit unemployment rates and partially responsible for Thatcher's fall.

Advantages and disadvantages of the Anglo-Saxon model

The best way of viewing the advantages and disadvantages of the Anglo-Saxon model is to compare it to different models to illustrate the faults and successes of the market-oriented system.

A system that challenges the core issues of the Anglo-Saxon system is the bank-oriented system, an example of which is that of Japan, and contrasting Japan's system against the market systems of the United Kingdom and the United States proves interesting. The essence of the difference lies with the bank-oriented system relying on high bank ownership, high equity holding by banks and close monitoring and corporate control (Patrick, 1997). This is compared to the style of management practised by UK and US companies where the company operates freely according to the wishes of the Board (Corfe, 1993). Interestingly, this notion has changed considerably since the collapse of major corporations such as Enron and WorldCom (Larsen, 2002). However, what has changed are the external controls imposed by the state to manage the (still) very independent boards of management. As such, the final independence of the board and in effect the companies remains the same.

The open approach of the Anglo-Saxon model has always been touted as the better model, with companies and investors seeing the bank-oriented system as reducing accountability and motivation (Schaede, 2000). Of course, in relation to governance, the Anglo-Saxon model has been refined after the collapses of major US and UK corporations that were primarily due to a collapse in their corporate governance architecture related to this system. It must be noted that since these changes have been imposed in the Anglo-Saxon economies, the other economies have also made changes to their governance systems, ranging from stricter controls in some of the Asian economies through to more government intervention in some European economies.

A major shortfall of the market system is the self-dependence of companies to produce profits and meet demands. While in the bank-oriented system banks are able to provide capital funding, in the market-oriented system this is not easily available; there is no 'unlimited borrowing' from the banks (Corfe, 1993). In the Anglo-Saxon environment there is constant postponement of reinvestment as this system relies on raising capital from the capital markets through various financing methodologies and competition for limited funds: it is a major factor that inhibits growth.

The question of whether there really exists a true market system in the Anglo-Saxon structure has already been addressed in this chapter and needs to be reemphasized. In a world that is filled with trade tariffs, interventionist government and government advisors, protectionism and economic ideologies that are politically based, there is really no true market-based system. This has been further eroded since 9/11 where in the Anglo-Saxon economies the state has taken a more active role in regulatory affairs. However, as we know it today the Anglo-American system is still the closest to a true market-based system and the figures available show that this system has several advantages over other systems. Between 1982 and 1999 the GDP growth rates of Anglo-Saxon companies have been greater than the rest; the US rising 66 per cent and the UK 54 per cent compared to Germany (43%) and France (40%) (Schroeder, 2000). In addition, the Anglo-Saxon system has provided faster economic growth, lower unemployment and higher employment rates since the mid-1980s (Schroeder, 2000).

Conclusion

The 'one size fits all' approach to models of development or governance is not one that should be accepted by economies today. The argument that one model is better than another is based on what is acceptable and/or what is workable in the current environment. A model that takes into account the different economic, social, political and cultural needs of the environment must be put in place since the 'one size fits all' approach that is being propagated by the dominant economies of today is not workable in the longer term.

The capital markets that have the power to supply much needed funds to developing countries across the globe only understand and accept the Anglo-Saxon model of governance and development. One argument that is used to support this is that if these capital markets are supplying the funds, they have the option to decide what type of system they will fund. This position starkly demands that the principles of the Anglo-Saxon model be adapted by countries that want to attract inflows of capital.

The Anglo-Saxon model also propagates 'free trade', but in reality this does not include unregulated movement of labour through the markets. This limitation is caused by cultural and political factors rather than a true economic argument. As such, the neo-liberal position of the Anglo-Saxon theory of free trade that would result in free capital flows does not take into account the full picture, that is of unregulated labour movement through the markets. This results in a partial adaptation of the Anglo-Saxon theory of development in the area of free trade – that is, unregulated and free markets with restrictions in labour flows. Trade blocs try and address this issue, but it will take time to convince politicians that free trade in the real sense is workable.

In recent times, Anglo-Saxon economies have seen a revival of Keynesian ideas, arguments for state intervention in the economy and business, free but controlled trade, and growth in governance principles. These economies have also seen major collapses in business ethics due to market manipulation and serious frauds by senior management. This, however, is not common only to the Anglo-Saxon economies, but the perception is that it is companies and states that adapted the Anglo-American model of governance that have been largely affected by these failures. As a model of development, the Anglo-Saxon or Anglo-American model is facing its biggest challenge due to the growth in markets that did not adapt to these systems. By the end of this decade, it will be seen if the changes that are being introduced by Anglo-American businesses will erode the basic principles on which this system was based.

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3

Communitarian Capitalism and the Social Market Economy: An Application to China

Chong Ju Choi

The 1990s saw a worldwide interest in comparative business systems and the different types of capitalism. The Asian financial crisis of 1997–99, the transition economies of Eastern Europe, as well as the emerging and developing economies in South America and Africa all raised issue of successful business systems in the twenty-first century. The economic success of the United States in the mid-1990s created for several years the idea that the capitalism or business system of the United States was ideal, and that globalization was equal to Americanization. However, the stockmarket and technology crash of 2001, and the subsequent corporate scandals such as Enron, Andersen, WorldCom, Global Crossing and Tyco, all showed that no single business system is perfect in the twenty-first century. What was also underestimated in the 1990s was the phenomenal emergence of China, its global economic influence, as well as it business system. In the twenty-first century, China's business and economic influence throughout the world has become self-evident for all countries. In 2004, China became the world's largest recipient of foreign direct investment of $65 billion dollars and this complements an economic growth rate approaching 10 per cent per year for the last 25 years. China has advocated a 'social market economy' as their business system.

Firstly, however, we will show that the social market economy has similarities to the communitarian capitalism and stakeholder business system that exists in continental Europe, since we believe that there are lessons to be drawn from China's phenomenal economic success for economic development and growth – and to be applied to other emerging and developing economies – and that, in turn, drawing from the European experience, may well bolster the Chinese enterprise.

The 1990s saw an increased global interest in different types of national business systems and the subtle differences in capitalism across various regions of the world. The Asian financial crisis, Eastern Europe's transition economies, and the continuing struggle for economic development in South America and Africa all emphasized the need to understand comparative business systems as an urgent agenda for businesses, government and society. The economic boom in the United States in the mid-1990s also defined globalization as based on an American business system, or the well-known 'Anglo-Saxon' stockmarket-driven system of capitalism. The stockmarket and technology crash of 2000, as well as the various global corporate scandals of giant firms such as Enron, Andersen, Tyco and Global Crossing in the United States, showed that no model of capitalism or business system is perfect. Furthermore, the suitability of the Anglo-Saxon model of capitalism for other regions of the world was especially questionable after those corporate scandals.

In the year 2005, we are wiser in knowing that there is no one perfect business system. Both the Anglo-Saxon and Communitarian system practised in continental Europe and also in the developed economies in Asia, such as Japan, Korea, Singapore and Taiwan, all have proven there is more than one way or approach to a national business system and economic success in the twenty-first century. The more urgent question is what model or what combination of models is most appropriate for the emerging and developing economies of the world, especially in South America and Africa. One factor that has astounded the world is the phenomenal economic and business emergence and growing influence of China. As the world's largest emerging market, China raises fundamental questions of what business system, or capitalism, has allowed China to grow for 25 years at nearly 10 per cent economic growth rates per year.

The greatest change in the global economy of the twenty-first century has been China's emergence as one of the world's largest economies. China is predicted to become the third largest economy in the world after the USA and Japan by 2008, and was the world's largest recipient of foreign direct investment in 2004 – $65 billion dollars (*Economist*, 2004). This ties in with its phenomenal 10 per cent per year economic growth over the last 25 years. China's new President, Hu Jintao, in his first visit to foreign countries, advocated that: 'China will continue its economic growth through its social market economy' (October 2003, Canberra, Australia). This raises fundamental questions about what is a social market economy, and whether it can be followed by other developing and emerging economies to replicate China's phenomenal economic success. Our premise is that the social market economy is the same concept as the more familiar 'Communitarian Capitalism' – a capitalism followed in most continental European countries (Albert, 1991) and in many developed Asian countries.

China's role as a major economy in today's global business environment, acting as a catalyst for structural economic changes and the blurring of national boundaries as well as various consequences on firm activities and performance, have led to an urgent need to reassess the traditional purely neoclassical, competition-driven frameworks such as Porter (1990) of international management research. We now need to incorporate other social-science based systems of exchange including sociology, anthropology and cultural studies (Biggart and Delbridge, 2003). These disciplines can better analyse the nature of a social market economy and, in turn, provide a better understanding of social entrepreneurship (Honig and Christie, 2003) in China.

Contrasting neoclassical economics-driven frameworks is the research on the role of business in society and models of corporate social performance; and the social control of business and stakeholders throughout the 1980s and 1990s (Freeman and Philips, 2002; Freeman, 1984; Aram, 1989; Jones, 1995; Donaldson and Preston, 1995). However, it is only in the twenty-first century, with the realities of corporate scandals that management researchers have begun to think in a more pluralistic way in terms of ethics as well as the diversity of business systems (Reed, 2002; Gonzalez, 2003; Kilduff and Dougherty, 2000; Glynn, Barr and Dacin, 2000).

Previous economics and social science research on China has tended to focus on narrow issues such as the *guanxi* or close personal relationship, in business transactions and *guanxi*'s potential negative connotations for business ethics (Dunfee, 2001; Fan, 2002; Chenting, Sirgy and Littlefield, 2002; Chan, Cheng and Szeto, 2003), or other general cross-cultural issues which are indeed important for managers. There has been relatively less research on the national business system of China, or the social market economy and the factors that are influencing the emergence of one of the world's largest economies. Economic entrepreneurship and economic development (Honig and Christie, 2003) could potentially become a major topic of research on China, given that China's foundations are based on communitarian capitalism (Albert, 1991) and upon a social market economy.

The purpose of this chapter is threefold. Firstly, we would like to analyse the meaning of a 'social market economy', which has been advocated as China's business system, and show that this is another term for communitarian capitalism. Secondly, we analyse the traditional shareholder and stakeholder (Freeman, 1984) debate in terms of business systems (McWilliams and Siegel, 2001; Felcher, 2001; Brief and Bazerman, 2003; Biggart and Delbridge, 2003), analysing the economy together with society; we show that China's social market economy has many similarities to the stakeholder business system of Continental Europe. Thirdly, we discuss the implications of the emergence of the Chinese economy and the Chinese business system (Child and Tse, 2001; Tan and Peng, 2003) in the context of potential contributions to economic entrepreneurship, business growth and economic development in the twenty-first century.

Comparative business systems

The revival of interest in comparative economics, political and social organization and institutions in academic research has focused on the issue of competing models of capitalism, or *business systems*, as the mechanism of the sustained success of the German and Japanese economies: this provided an alternative model of political economy often called alliance or communitarian capitalism (Reed, 2002; Gonzalez, 2003; Gerlach and Lincoln, 1992; Dunning, 1996). More recently this focused on the importance of pluralism (Kilduff and Dougherty, 2000) and comparative systems of exchange in business systems (Biggart and Delbridge, 2003; Griffiths and Zammuto, 2003). There has also been an intense debate on the reform of corporate governance systems coupled with various initiatives of corporate restructuring due to the above mentioned corporate scandals in the United States (Donaldson, 2003). In addition, there is a compelling need to develop an applicable model of business systems for the former Eastern bloc countries as well as other emerging market countries such as China, India and Brazil (Yin and Choi, 2003; Tam, 2002; Khanna and Palepu, 2000).

The Anglo-Saxon business system, or capitalism, has been economically dominant in the nineteenth and twentieth centuries. Although the term West is often used to describe both North America and Western Europe as a relatively homogenous grouping of countries in terms of economic and political systems, there is a significant difference between Anglo-Saxon countries such as the USA, Canada and the UK, and those of continental Europe which are often seen a closer to a social market economy (Albert, 1991). The communitarian business system includes the Eastern and Western European countries that are very different from the Anglo-Saxon countries in terms of their domestic business systems that emphasize therein the role of the government in economic and social affairs, the close linkages between banking and industry, and the group orientation of the society and communitarian values. In sum, their stakeholder systems are fundamentally different (Trompenaars, 1993).

China's business system will be a convergence and mixture of these two major business systems as China becomes the world's third-largest economy. However, given China's focus on a social market economy, it will be much closer to the Communitarian business system prevalent in continental Europe and some Asian countries such as Japan and Korea. The fact that China's $65 billion dollars of foreign direct investment in 2004 originates from companies from both systems will further accelerate a mixed system in China. China in turn needs to be distinguished from the traditional definition of a developing country or transition economy (White, 2000; Peng, 2003; Uhlenbruck and de Castro, 2000; Meyer and Estrin, 2001; Newman, 2000) because of its phenomenal economic growth and rapid development in various industries including electronics, telecoms and semiconductors.

Institutions and strategic transparency

Researchers in management (at least since the 1980s) have discussed the importance of national institutions and capabilities: North (1990) on economic institutions; Kogut (1991) on technological capabilities and national systems of innovation; Huntington (1996) on social contingencies and elective affinities; Whitley (1990), Chang and Hong (2000), Filatochev, Buck and Zhukov (2000), Child and Tse (2001) on comparative forms of business organizations and management systems. These works, elaborating on the 'global standardization and local adaptation' debate, have helped to analyse the complex realities of institutional and organizational diversity that persist in today's increasingly converging business environment. I further suggest that the business system of a country or a group of countries consisting of various institutional and cultural factors is a crucial determinant in analysing the differential modes of organization and strategy as well as differential rates of performance in today's global competition.

Global competition can be seen from the viewpoint of what motivates and constrains firms' strategies and behaviour in today's global business environment. Such constraints include national culture, the legal and regulatory environment, business–government relationships, the role of financial institutions, and corporate governance systems in the home country as well as host countries of multinational firms. It is worthwhile to note that globalization and the competition between competition-driven countries do not mean that differences between the latter and the economics-driven countries do not exist. The importance of the national business environment in influencing the organizing principles and competitive strategies of firms has been analysed in Kogut (1991), Albert (1991) and Guillen (2000). According to their analysis, domestic institutions play as important a role in determining corporate behaviour as the pressures of globalization. For example, in many parts of Asia it is not the financial markets but various government ministries that monitor corporate performance and control financial allocation and which pressurize local managers in their international ventures.

In many continental European countries such as Germany and Switzerland, the banking sector as institutional shareholders monitors corporate performance and investment decisions (Schmidt, 1997). Firm behaviour and strategy, especially investment decisions such as new market entry, diversification and innovation and new product development, can be significantly constrained by the differences of home-market institutions while at the same time providing sources of competitive advantage that may or may not be transferred across national boundaries. These constraints in turn determine the scale and scope of collaborative activities across national boundaries. That is, in spite of the global nature of today's competition, the political, economic and socio-cultural effects of home-market institutions can have both positive and negative influence on firm capabilities and competitive advantages.

Implications for economic growth and development

As mentioned above, one of the major research topics in management in the 1990s and early twenty-first century is the issue of corporate governance, national business systems and accountability to shareholders versus stakeholders (Donaldson, 2003; Freeman, 1984; Hill and Jones, 1992; Donaldson and Preston, 1995; Jones, 1995); and Bowman and Useem (1995) suggest that the traditional model of corporate governance was underlined by economic and legal theories and advocated distinct roles among owners, directors and managers. The well-known Anglo-Saxon system contrasts with the communitarian system of continental Europe and several developed Asian economies. China's business system and the foundations of China's social entrepreneurship (Honig and Christie, 2003) will be a hybrid of both systems as shown in Figure 3.1.

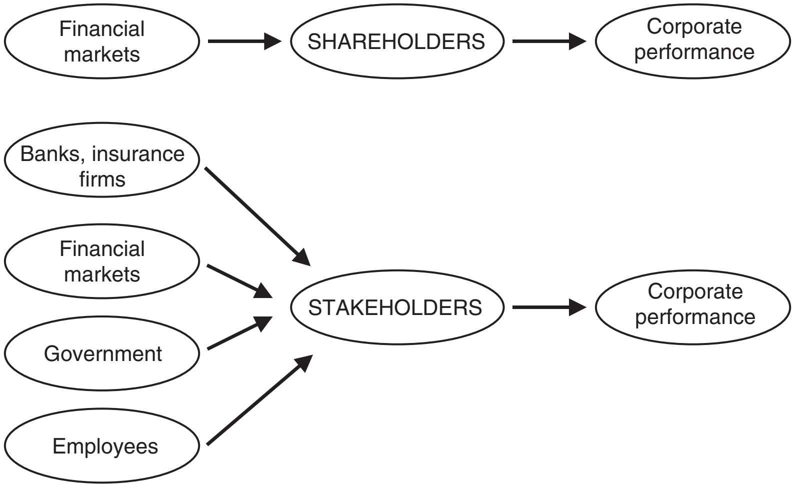

Figure 3.1 China: shareholder and stakeholder systems and a social market economy

The debate in the 1990s and the twenty-first century on corporate governance reform in the market-based economies such as the UK and the USA has focused on the issue of protecting stakeholders' interests at the expense of shareholders (Freeman and Reed, 1990). The debate was previously discussed from an economic point of view (Alchian and Demsetz, 1972), which argued that the nature of the firm recognizes capital suppliers and managerial efforts as the main factors of production. The recent research track is expanding the nature of the firm to include all the stakeholders (employees, managers, capital suppliers, community) who can influence, or be influenced by, the firm's decisions. The literature provides arguments on the effects of stakeholders on the agency relationships between a firm's shareholders and managers (Reed, 2002; Gonzalez, 2003; Chang and Hong, 2000; Demsetz and Lehn, 1985; Khanna and Palepu, 1999). As shareholders have always been the focus of the Anglo-Saxon market-based corporate governance system, it has resulted in the problem of short-termism of profitability in comparison to the long-termism of Germany and Japan that emphasizes the long-term relationships between strategic capital suppliers (Schmidt *et al.*, 1997).

China's business system is closer to communitarian capitalism (Albert, 1991) stakeholder-driven business systems (Freeman and Reed, 1990). In this system, there are many close linkages among government, firms, banks and employees. In turn, this more holistic business system should provide a fertile ground for social entrepreneurship. Along with this foundation, China's intention to continue the path of a social market economy (Hu, 2003) will further develop its contributions to global research on economic entrepreneurship and economic development. So we suggest that 'social market economy' is fundamentally the same type of capitalism as communitarian capitalism, widely practised in continental Europe and the developed Asian economies of Japan, Korea, Taiwan and Singapore.

China's communitarian capitalism system

Market liberalization in China has required firms to follow the International Accounting Standards (IAS) and the disclosure regulations of the leading international financial centres in the Anglo-Saxon business system such as the USA and the UK. Nevertheless, the relatively weak legal infrastructure did not permit adequate disclosure as many cases of fraudulent accounting and violations of disclosure rules were detected. The main areas of low or absent disclosure were asset valuation, disclosure of off-balance sheet items and transactions with parties related to controlling shareholders.

In the new Chinese corporate governance system, strategic transparency therefore requires bringing about structural change – for the following reasons. Economic integration will gradually lead the Chinese market to be more liberalized which requires more disclosure to outside investors. The present stage of economic transition in China requires low-cost long-term financing which cannot be guaranteed unless financiers are sure about the near and far future of the Chinese firms. In this regard, China is considered in a good position to have reduced transaction costs by utilizing their technological information advantage and so become more transparent to existing and potential investors and stakeholders (Reed, 2002; Tam, 2002; Gonzalez, 2003; Phan, 2001). Evidence in the field supports a positive relationship between firm disclosure, reducing costs of equity, costs of debt and performance in the product market (Botosan, 1997, 2000; Sengupta, 1998).

Economic integration requires Chinese financial institutions (securities markets, banks) to focus on long-run performance and to avoid the problems of short-termisim prevalent in the Anglo-Saxon market-based system. The role of China's banks, or even their subsidized debt, is not the only cause to blame for the economic downward trend witnessed at the region. In fact, to analyse the situation from a practical point of view, bank loans are considered in the literature of corporate finance as very viable sources of finance especially when certain types of investment do not appeal to the trends in the stockmarket. This active role of debt has been realized through the evolution of the Anglo-Saxon market-based system (Triantis and Daniels, 1995). The point of criticism has come from the relatively heavy reliance on stockmarket short-term financing which has led Anglo-Saxon firms to plan their financing and investment decisions to satisfy the short-term interests of their myopic shareholders (Laverty, 1996). For China's business system to focus on long-run performance, they must strengthen the legal infrastructure to enable a more active role of bank financing. According to the preceding discussion, it has been realized that China's banks cannot play the promised active role in corporate governance. In fact, the firms' low equity holdings in banks and institutions goes against the foundations of the relationship-based business system which is unique to the region.

Transparency will lead to better financing and investment decisions as the market-based mechanisms use price signals efficiently to allocate resources and monitor market returns. In this regard, I suggest a reform measure for China's corporate governance system that relies, *inter alia*, on the ratios of long-term and short-term financing to total financing. The higher the percentage of long-term financing, the more we can infer the extent of outside investors' confidence in the future of China's firms. The long-term perspective is crucial to a sustained competitive corporate governance system in China. In contrast we see the economics-driven business systems, and the associated Anglo-Saxon corporate governance systems, have resulted in short-termism in both financing and investment decisions which negatively affected the competitiveness of the Anglo-Saxon corporate governance. This shows the importance of including the logic and analysis of other social science disciplines such as sociology and anthropology, in addition to traditional neoclassical economics in the analysis of national business systems (Donaldson, 2001, 2003; Biggart and Delbridge, 2003).

The different modes of corporate governance and information disclosure can have an important influence on the strategic behaviour of firms and organizations as they undertake economic entrepreneurship (Honig and Christie, 2003). Table 3.1 shows the differences of the three business systems.

Table 3.1 The Anglo-Saxon system, communitarianism and China's social market economy

Types of business systems	*Type of social entrepreneurship*
Anglo-Saxon system	• Shareholders and the dynamics of financial markets • Domination by private entrepreneurship and the profit motive
Communitarian system	• Stakeholders: employees, suppliers, government and the community • Closer mix among social institutions, businesses and the community
China's business system	• Privatization of government ministries, state-owned enterprises • Social market economy • Mix of both shareholder and stakeholder systems

Conclusions and further research

In the 1990s, the world looked for a single type of ideal business system, or capitalism that could be followed by all countries to ensure economic and business success. The Asian financial crisis of 1997–99, developments in Eastern Europe, South America and Africa, all raised questions about comparative business systems. The Anglo-Saxon business system in the mid-1990s had appeared to be the ideal system that all countries needed to emulate in order to ensure economic and business success. However, visions of a single, ideal business system all changed by the beginning of the twenty-first century following the United States' stockmarket and technology crash of 2001, as well as the various global corporate scandals, showing that no model of capitalism or business system is perfect.

In the year 2005, we are wiser in knowing that there is no one perfect business system. Both the Anglo-Saxon and Communitarian system practised in continental Europe and the developed economies in Asia such as Japan, Korea, Singapore and Taiwan have all proven there is more than one way or approach to a national business system and economic success in the twenty-first century. The more urgent question is what model or what combination of models is most appropriate for the emerging and developing economies of the world, especially in South America and Africa. One factor that has astounded the world is the phenomenal economic and business emergence and growing influence of 'China'. This chapter has discussed communitarian capitalism and described how China's social market economy is fundamentally the same as communitarian capitalism (Albert, 1991) as followed in continental European countries, as well as in some developed Asian economies.

The emergence of China in the twenty-first century as a major economic power has repercussions for the OECD countries, as well as serving as a potential model for developing and emerging economies in South America and Africa. China has begun to adopt a wide range of corporate governance and economic reforms (Reed, 2002; Gonzalez, 2003; Tam, 2002) which have been moving on according to the pace of globalization – based on both shareholder and stakeholder business system factors (Freeman and Philips, 2002). In turn, these changes and the convergence of many business institutions is creating China's new social market economy, which has similarities to the capitalism of Continental Europe (Albert, 1991). In the twenty-first century, economic growth and development in China will take into account the foundations of its social market economy.

Further research may be developed in at least two ways. First would be a theoretical analysis and comparison within the different regions of China to understand better the strength and applicability of the social market economy or communitarian capitalism model and its stakeholder values. Second is the need for empirical work comparing China and other transition economies such as Eastern Europe, as well as developing and emerging economies in Africa and South America, in terms of economic growth and development in the twenty-first century. What is clear is that we are still at an early stage of understanding the nature of business systems, capitalism and how systems can be combined to ensure continuing business and economic success in the twenty-first century.

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4

The Nordic Model of Economic Development and Management

Haldor Byrkjeflot

The Nordic model of economic development and management, which existed primarily between 1945 and 1990, was an attempt to combine economic growth with democratic stability: a programme for increased equality and extensive democratization of society.[1] In this corporatist programme, management was a political task, an act of compromise, of finding the best solution to conflicts between workers and employers.

The Nordic solidarity pattern was based on a close identification with national centralized organizations of a collegial, constitutional type, and with a high degree of 'functional deference'.[2] Such organizations have played a significant role in social and political life, and they have, along with other collective actors such as 'the people' and 'the nation', been central points of identification.

To a certain extent, this solidarity pattern may be in contrast with more individualistic identifications, and the privileged position devoted to firms and top managers in the historical Anglo-Saxon self-portraits. The Nordic industrial elite was considered to be the 'junior partner' in its relations with the state – not the other way around, as exemplified in Chandler's account of the rise of corporate management as 'the visible hand'.[3]

One aim of this chapter is to discuss how management relates to models of economic development as displayed in accounts of how societies have developed historically. I argue that the Nordic social democratic version of history presents a different view of management – *constitutional management* – in contrast to the *paternalistic* and *professional* models of management that was more influential in Continental Europe and in the Anglo-Saxon countries. I will take my departure from the situation that existed more than fifty years ago, when the major concepts of management and democracy that are now challenged by neo-liberalism and the shareholder value movement were about to be constructed. All these constructions, which I exemplify by referring to the Nordic, Continental and Anglo-Saxon models of management, were linked to a particular phase of modernity – a phase referred to by sociologists and business historians as 'organized capitalism'. It is argued that these traditional models have been in a phase of transformation since the 1980s, due to the rise of global markets, the shareholder value movement, and the disorganization of national models.[4]

The contested position of the firm and business elites

The status of the firm and of business elites in society has been a highly contested issue in the Western world during the twentieth century, and this contest has been downplayed in many of the recent articles and books that pay uncritical tribute to corporate managers.[5] Eric Hobsbawm, on the other hand, does not revere managers, but focuses more on politics and conflicts, due to his insistence that the last century was an age of ideological extremes rather than an age of management.[6] Yet the current popularity of the idea of global markets and of corporate managers as agents of shareholders and investors is a recent phenomenon, particularly in the Nordic societies. The current situation is contrary to the predictions of intellectuals and politicians of the mid-1900s, when the common interpretation was that the epoch of '*homo oeconomicus*' and proprietary capitalism had come to an end.[7] It was presented as a task of utmost necessity for industrial leaders and politicians to develop alternatives to utilitarianism as a principle of legitimation. The idea of the professional manager as a trustee for the stakeholder and the community at large was then constructed as the solution to the ideological vacuum created by the disappearance of property rights and free markets as major principles of legitimation.

The construction of management

Peter Drucker was among the first scholars to see the significance of the large firm as a challenge to capitalism. The modern corporation is and has been an important political institution, he said, particularly because it represents a countervailing power to the state. The sheer size of industrial corporations and the power exercised by their managers was a problem that had not been accurately addressed:

> In the modern corporation the decisive power, that of the managers, is derived from no one but from the managers themselves, controlled

> by nobody and nothing and responsible to no one. Managerial power today is illegitimate power … It is in no way based upon a fundamental principle accepted by society as a legitimate basis of power.

What constituted 'legitimacy' was a question that could be answered only in terms of a given society and its given political beliefs.[8] A similar argument about management, based on the assumption of a future convergence towards socialism, was presented by Joseph Schumpeter. The Schumpeter view of management was a major inspiration behind a large-scale international research project funded by the Ford Foundation, in which the critical question addressed the type of management needed for the industrial society. They took it as a given that 'the general direction of management development in all advancing industrial societies is the same' (Kerr *et al.*, 1960: 121). The new system of industrial relations and the associated Human Relations discipline that developed in the USA provided a universal model for resolving the relationship between managers and the managed. Management was to have a guiding role, but within a corporatist order in which the industrial and occupational associations would be a permanent check on managerial power:

> as a consequence, dictatorial or paternalistic direction gives way to a kind of constitutional management in which the rules of employment are based upon laws, decisions of governments, collective contracts, or agreements. (Kerr *et al.*, 1960/1996)

In this 'industrial man' view of the society of the future, it was expected that the nation-state would play an even more important role in the regulation of management–labour relations, while economic development would depend more and more on the quality of management and the industrial corporation. Labour would take a central role in national industrial relations systems, and it was a key issue for societies to cultivate the right kinds of management expertise, thereby creating a 'society without ideology'.

I will now discuss the differences between the management concepts and models that were constructed in the USA, Continental Europe and the Nordic countries, and place the views and cases presented in the literature in a historical and cultural context. I need ideal types in order to compare these literatures and cases. These ideal types are categories derived from observation of practice, and not necessarily accurate reflections of such practices. Rather they are cognitive models that bring the observed logics to an extreme in order to make it possible to compare the logics of organizing and acting in different sectors or cultures. It is not possible to find practices that make a perfect fit with such ideal types, as such practices commonly represent mixtures or hybrids.

Ideal types of management

Management relates to the kind of polities and authority structures that have been developed historically, that is statist or corporatist from above on the European continent and more individualistic in the United States.[9] The Nordic polities were also of the corporatist kind, but with a stronger emphasis on mobilization from below:[10]

- *Paternalistic management* refers to the structure that was developed around the entrepreneur or a patron in a large or middle-sized firm, but also, historically, to the top civil servants in the state. The German and French had each developed their variation of paternalism. Managers were trusted because they knew their craft or discipline and because they relied on 'inner circles', such as family ties in business affairs or access to powerful people in the state administration. Paternalistic management was based on a view of management as tacit knowledge, for it could only be derived from other types of social functions and transferred and cultivated in closed groups, such as families, guilds or top management groups in firms and state administration.
- *Professional management* is based on the idea that it is possible to learn how to manage, either through experiences acquired in a career or by reading and discussing management texts in business schools or courses. The concept is linked to a particular kind of middle-class ideology centred on individualism and uplift, and a pragmatic and universal view of knowledge. Managers are the carriers, not of functional competencies or family responsibilities, but of knowledge about the ways to combine the various functional competencies needed to achieve particular goals.
- *Constitutional management* is based on the idea of managers as representatives of a community of associations, an ideal that places a strong demand on managers to seek compromise among conflicting interests. Management knowledge is also tacit in this model. It is cultivated in more open settings, such as associations and parties, but there is also here a strong tendency to downplay and mystify the role of leadership knowledge.

The Nordic nation-states were late developers in the field of management, and there was a great deal of imitation in the development of management as a professional role. One possible role that Nordic managers could take before the Second World War was a variation upon a German theme: the owner-entrepreneur (*Der Unternehmer*). Another possible professional model developed in the USA was the *General Manager*.

Contrasting normative literature with historical descriptions, I will demonstrate that management in the Nordic countries, particularly Denmark, comes closer to a mixture of the disciplinary and constitutional ideal type, and that the general manager emerged as a more important point of reference than did the owner-entrepreneur. Functional deference and the call to stay in one's vocation were important principles of organization and motivation in the Nordic countries as well, but the values of ownership and elitism were less important than in Germany. The German system of management moved toward the constitutional type after the Second World War, when co-determination became an important part of the law regulating corporate governance. The professional model had more limited impact in Germany during the era of organized capitalism, however, and then mainly as a negative model of reference. There was also a movement towards the constitutional model in US management, as apparent in the presentation of the *Industrial Man* view of management above, but this model has been in decline in the USA since the 1980s along with the rise of the shareholder value view of economic governance and management.

The US model: professional management

The professional model of management is linked to the idea of organizational society – society as a collection of social units similar to the US business firm.[11] It may be useful to place such a view of management in a historical and intellectual context.

The US political tradition was founded in opposition to British supremacy and the Conservative tradition of the old European regimes. It is partly for this reason that no strong conservative or socialist tradition has ever been established in the USA.[12] The last decades of the nineteenth century in the United States is commonly referred to as the gilded age or the age of the Robber Barons, due to the great increase in economic inequality that took place then. This change arguably led to a crisis of confidence among those who believed that the US experience was exceptional (American exceptionalism). The progressive period provided a new basis, a legitimization for the roles of professionals, and later for professional managers.[13] Since then, managers in the United States have been keen to legitimatize their actions by arguing that they relied on science, in contrast to the traditional managers who based their legitimacy on religious values or on their personal integrity.

The Taylorists argued that the class struggles and ideological conflicts of the European type were unnecessary in USA, where science and expertise had been developed to a higher level. It was on the basis of such an argument that the concepts of *general management* and the associated model of the multidivisional firm were constructed by innovative business practitioners such as Alfred Sloan and Chester Barnard.[14]

The German model: disciplinary management

Germany has been considered the archetype of organized capitalism, while Sweden is another major example of a society where capital, state and the labour movements institutionalized a high level of economic organization and state planning. The difference between Germany and Sweden was that in Germany capital and the state were doing the organizing in a rather one-sided manner. The state and the industrialists were developing a protectionist economic policy and social legislation was also initiated from above. State paternalism was the justification for the large firms and associated corporate organizations in Germany, at least to a much greater extent than in the USA and the Nordic countries. The owner-entrepreneurs (*Unternehmer*) in Germany had an uncontested position as the 'masters of the house' (*Herr-im-Hause*).[15]

The social and political institutions of traditional Germany fostered the notion of an elite responsive to the presumed needs of the populace, but not directly responsible to it.[16] This view of leadership may be illustrated by Max Weber's insistence that leaders should be chosen on the basis of personal qualities rather than adherence to definite programmes, and that during their tenure of office leaders should act entirely according to their own judgment.

There was clearly a much more positive attitude toward property rights in the German social market economy than in the Nordic social democracies. One difference between the US and German views of property rights was that Germany attached social responsibilities and duties to the control of property, even to the extent of mentioning it in the constitution. German law treats the firm as a constitutional construction for structuring a process of ongoing negotiation among different groups within the firm.[17] Particularly in large firms and in the postwar era, there has been recognition of labour's role in the principle of codetermination (*Mitbestimmung*), or joint decision-making.

Stockmarkets were less well-developed than in the United States, and it was less apparent that transfer of control from owners to managers had occurred in Germany to the same extent as in the USA.[18] The increasing power of US managers was a consequence of the rise of a diffuse collection of small shareholders. In Germany, by contrast, ownership was more concentrated, through personal ownership in small firms or in a small number of banks and financial institutions in larger firms. Labour had also more influence in the German system of corporate governance; it was a contested terrain, in contrast with the US system of one-sided management control.[19]

In his comparison of German and US management in the 1950s, Heinz Hartmann claimed that *Führung* (leadership) was the core idea for understanding the role of the German version of entrepreneur: the *Unternehmer*.[20] *Führung* is acquired by commitment rather than learning; it demands belief rather than rational examinations; it follows values rather than technical functions. In the modern world such beliefs had to be justified by knowledge, however, and the *Unternehmer* presented themselves as experts in such technical fields as law or purchasing rather than as management specialists. This owner-entrepreneurial tradition has continued to be an important focus in German management. Thus the division of labour places strong emphasis on leadership from the top; whereas those lower in the hierarchy ought to act in accordance with the norms of administration rather than leadership. Hartmann found that German managers still depended to a large extent on 'absolute values' such as property and on the calling and the elite ideology. These three widely accepted sets of values endowed German managers with a greater 'zone of indifference' among workers than US managers enjoyed, because they did not constantly have to demonstrate their abilities in the specific function of managing.[21] German managers identified with a particular scientific field (*Wissenschaft*) or practical discipline (*Fach*) and also with a specific owner-entrepreneur and firm. Class identity and identification with the nation-state may not have been as strong as in the Nordic countries.

The Nordic model: constitutional management

In the USA, the *general manager* was a professional middle-class person – a person competent, not in a specific functional field, but in the art of managing. In Germany, the entrepreneur-managers relied on ownership and functional competence. But another role model emerged, most distinctly in the Nordic countries as a consequence of the democratic mobilization against elites: the constitutional manager – the manager who was trusted for arriving at a position or cultivating a skill related to an agreement between particular groups in society. Such groups saw themselves as being in conflict, but had arrived at a 'constitution' or an agreement at a given point in history.

Social democracy was one example of such a managerial constitution. Nordic social democracy was a model of *Politics against Markets*, a system in which a regime of industrial planning and welfare redistribution kept abreast of market forces.[22] The vision was to establish hegemony for a policy of social planning and redistribution, and thereby to initiate the process of market abandonment as the central principle of economic governance, as Schumpeter had predicted. At some point in their history the Nordic social democratic parties all relied on the Marxist argument that capital owners exploited the working classes and that it was necessary to abolish property rights for the major capitalists and to socialize the means of production in order to develop a socialist society. This position was gradually abandoned, and the idea of 'functional socialism' was launched in its place: the position that it is not necessary to nationalize private property, but that ways should be developed in which private property is rendered functional to the community at large.[23] It was the working people rather than the markets and the capitalists who now would set the terms for the development of the future society.

The struggle to cultivate markets and to develop the industrial society of the future would trigger three transformations. The first transformation had already occurred when working class and farmer alliances brought Social Democrats into government; the second was the development of the social welfare state; and the third was industrial democracy, of which the growth of public welfare reducing worker dependence on the firm was a precondition:

> 'Political citizenship' must precede 'social citizenship', and these are in turn indispensable for the third stage 'economic citizenship'. Workers must be emancipated from social insecurity before they can partake effectively in economic democracy.[24]

In this narrative, the underlying force for change was working-class mobilization, and particularly mobilization of control over economic resources. The welfare state was not an end in itself, but a means of altering the balance of class power to the advantage of social democracy. It was mainly in periods of radicalization such as the early postwar era and the 1970s that demands for industrial democracy were placed on the agenda, but such programmes ended in the 1980s and early 1990s. Since then, the centre of attention has moved away from politics at work toward other issues, mainly related to the spheres of culture and welfare.

The welfare state has now become an end in itself, not just a means to alter the power balance in society. The differentiation that prevails in other countries between social security rights for manual workers, white-collar workers, and the self-employed, has been abandoned in Scandinavia to a large extent. Individualism in family relations is combined with group consciousness in the workplace and also active engagement in national and social affairs. Thus the Nordic countries are among the most collectivistic in public affairs and the most individualistic in family affairs. Accordingly, Swedish managers have been found to be among the most individualistic in their views on family affairs, but the most collectivistic in their societal perspective.[25] Trägård has argued that the Nordic pattern of solidarity may be viewed as 'statist individualism'.[26]

The Nordic model meets other models

The inclination among the people of 'Norden' is to borrow ideas, import technologies, and create new hybrids: as noted by Thorstein Veblen,[27] who saw the northern European countries as 'late developers' and as masters of adaptation. Stråth argues that the foreign experiences of many central industrial leaders in Sweden influenced their political views, and partly accounted for their support of the democratic transition in Sweden between 1917 and 1920. One should also remember that political leaders acquired experiences abroad as part of their early travels, work experiences and political careers. The most influential event in the life of Martin Tranmael, the informal but real leader of the Norwegian Labour Party before the Second World War, is reported to have been his experience with the US syndicalist trade unions. US work experience influenced the political views of other central leaders of the Norwegian social democratic movement, and the influence on their organizational practices may have been even stronger.

These events occurred long before the idea of a 'third way', and yet a US journalist described Sweden and Denmark in the 1930s as a 'middle way' in a best-selling book with this title.[28] It was after the publication of this book, partly as a consequence of the rise of the Nazi regime, and later in the climate of the Cold War, that the Nordic models of management and democracy were created as part of a continuous engagement with alternative models, serving as both positive and negative points of reference.

An inward-oriented and self-confident view of the Nordic system seems to have climaxed in the mid-1980s, before currently popular global management philosophies were well-known. Those were the days when management consultants and union representatives came to Scandinavia to learn from their experiences in such a wide spectrum of areas as management, user-friendly technology development, industrial democracy, group-work, welfare legislation and industrial relations. Many observers even came to Scandinavia to study the future. Sweden and Scandinavia were perceived to be forming a vanguard in the inevitable march first towards a new industrial society, and later a post-industrial society.[29]

The renewal of the model: still Nordic?

The rise and the fall of the Swedish model is a theme that was featured prominently in political commentary and in the social sciences in the late 1980s and early 1990s. In one version of the story, the downfall began in 1976 when the trade unions in Sweden demanded the establishment of a *wage-earner fund* in order to absorb rank-and-file criticism for wage restraint in the name of solidarity. Because this campaign for wage-earner funds, along with increased union influence over private profits, received worldwide attention, the stakes for the Swedish model were high. Its cancellation came as a consequence of an employers' offensive and a discursive shift away from the 'politics-against-markets' framework of Swedish politics towards a shareholder value framework. The economic problems, the employers' withdrawal from corporate cooperation, and the subsequent electoral setback for the Social Democrats in 1991 spelled trouble for those who looked to Sweden for guidance. Unlike its predecessors, the Swedish non-socialist government that held office between 1991and 1994 repeatedly rejected the Swedish model, provoking media people and political activists, and since the early 1990s there has been continuous reporting about and calls for necessary repair work and remodelling.

The Nordic economic comeback, with emphasis on electronics, mobile phones and the Internet, as well as the remodelling of the welfare states, has been an inspiration for those who want to display the model to the rest of the world. The Swedish industrial relations system in particular has been seriously restructured, and it is in this domain that defenders of the Nordic model have the most difficult time arguing for its 'essence' and continuity. The many predictions in the late 1980s and early 1990s about the coming collapse of the welfare state have failed to materialize, however. Currently there seems to be a positive attitude toward the architecture of the welfare state among Nordic intellectuals and politicians.[30] There is a great deal of political controversy in the wake of the continuous advancement of the welfare state, however, particularly on the issue of privatization and the use of market mechanisms and individual rights in welfare provision. There is thus no signs that ideology has been reduced to irrelevance, as suggested in the 'end-of-ideology thesis'. The welfare state is still intact, it's architecture is disputed, not its existence.[31]

Because the other Nordic countries used the same rhetoric as Sweden did, they experienced a problem in 1992 when Sweden's conservative government changed its rhetoric to that of a European identity.[32] Also, the move toward a shareholder value orientation and the preoccupation with business managers as heroes and villains may undermine the idea of a Nordic 'third way'.[33] One wonders to what extent the return to a belief in a market society and the growth in finance markets since the 1980s will undermine the efforts to maintain a Nordic identity.

The Nordic constitutional model of management, which emerged as part of a corporatist mobilization for nation-building, welfare, and industrial democracy, has been challenged. The example of Scandinavian management – a movement among Nordic managers and academics in the 1980s and 1990s – may be used to illustrate the increasing impact of professional and 'visionary' management models and the gradual movement away from functional socialism and constitutional management.

The communicative turn in Scandinavian management

The 'Scandinavian management' concept, which was particularly popular in the 1980s, may be seen as part of a movement toward the development of a more charismatic and communicative model of leadership. Pehr Gyllenhammar of Volvo and Jan Carlzon of Scandinavian Airlines (SAS) are representatives of such leadership models.

Pehr Gyllenhammar, CEO at Volvo between 1971 and 1993, was oriented towards national and international political affairs and linked to experiments with autonomous groups at the Volvo manufacturing plants. His management philosophy came to be associated with the typical Scandinavian pattern of compromise and negotiation and with a management philosophy of the democratic-participative kind. Gyllenhammar was playing by the rules established in *Folkhemmet*, and was therefore allowed to play the role of a major public figure.

Jan Carlzon, CEO of SAS from 1980 to 1993, later became the personification of 'Scandinavian management'. The success of SAS was, to a large extent, attributed to the management practices of Jan Carlzon, who was also associated with the even more influential 'Service Management' trend, a management fashion with distinctive Scandinavian roots.[34] Carlzon's model was simultaneously customer-oriented and anti-hierarchical, a harbinger of things to come.

Volvo was placed at the core of the industrial sphere, whereas SAS was in the communication and service business. Gyllenhammar and Carlzon both emphasized the power of communication, however, and they also positioned themselves as a third option, between American capitalism and Soviet communism. They published books in English, and were followed closely by management gurus and representatives of the international media.[35] It may not be accidental that the concept of 'Scandinavian management' was already losing power and attraction to others – beyond the Scandinavians themselves – as the careers of these charismatic managers came to an end in 1993. The Scandinavian management concept continued to be used primarily by management scholars interested in the relationship between culture and management, the implication being that Scandinavian managers behave more democratically due to the strong emphasis on equality and informality in the Nordic culture.[36]

Communicative management is both a response to the change in the conceptualization of democracy and the shift towards New Public Management in the way the public sector is organized. Neither the aims nor the means of politics are any longer taken as a given, and together with increased immigration and globalization this situation leads to a greater emphasis on a pluralistic and dialogical way of understanding democracy. The focus has shifted to the organization of communication processes and service delivery, and the necessity of including several viewpoints and response from users of services in decision processes and public debates. There has been a shift also in the Nordic region towards a neo-liberal agenda for public governance. Market mechanisms have been introduced also in the core public sector of health and welfare, exemplified by free choice of hospitals, purchaser–provider arrangements and contracting-out of welfare services. Furthermore, there has been a great deal of creativity in state administration towards new kinds of intermediate forms between state public administration and private enterprises.

There has been, accordingly, a decline in the power and legitimacy of political parties and the political elite relative to the new managerial, economic, media and cultural elites. The expanding business press has led to increased transparency in business affairs, by displaying internal problems of individual companies, individual managers and conflicts among such stakeholders as unions and customers. The traditional industrial elite has been accustomed to operating in a political environment with a negative view of markets, and these elites are not necessarily the group best equipped to face the challenge from the more active media and financial environment. The increased professionalism of the business media has been paralleled by an increased focus on media management in organizations and in consulting, however.[37] The turbulent position for financial and industrial managers is not only a consequence of globalization, but also a change in the rules of the game away from 'inner circles' and towards 'weak ties'.[38] The rise of stockmarkets and the business press and the associated strengthening of a public relations and consulting profession have combined to change the rules of the business game. The disappearance of the model of 'industrial society', which in the Nordic area took the shape of functional socialism, and the development of a much stronger and more self-conscious industrial elite has altered the balance between management and democracy. There is now a stronger emphasis on customer-oriented and visionary management as opposed to representative and constitutional management.

The Nordic model of welfare and industrial relations is still an important precondition to management in the Nordic countries. It is likely that new variations on old themes of corporatist bargaining and stakeholder trusteeship will be developed, as well as new variations on the theme of Scandinavian management. There are limits to the lengths to which an industrial manager can go to become a communicator of a vision – not only for the firm, but also for society. The lessons of the last decades of the twentieth century was that there was a large potential for industrial managers in Sweden and Finland to become national heroes. Initially the public skepticism against such leaders seemed to be a more constant feature in Norway and Denmark, but the rise of the Norwegian capitalist Kjell Inge Røkke is an example of the possibility for industrialists to arrive at such a heroic status also in Norway. Fellman argues that the supportive milieu for individual leadership and new ideas in Finnish firms may partially explain the success of Nokia. The paternalistic tradition has been stronger in Finland than in Norway and Denmark, and economic growth has always been accorded the highest place on the agenda, in contrast to Sweden in the 1970s, where a movement for democratization of the economy and the workplace overshadowed the emphasis on economic growth for a brief moment.[39]

The status of industrial managers is in constant flux, however, perhaps as a natural response to the constant infighting and organizational changes in today's business life. One reason for the increased attention to such affairs is the rapidly increasing economic gains for business people in comparison with people in politics or the public sector.

One should also not underestimate the importance of import of new management concepts and the rise of the business schools and business academics as the favoured advisors of governments. One such business scholar with a rising influence in policy-making is Torgeir Reve, former president of both the major business schools in Norway. In the Scandinavian tradition, Reve pointed out in 1994, the firm has been an institution like any other in a national community; more specifically it has been understood as a stakeholder alliance between internal and external actors, with an equally legitimate claim on the activities of the firms.[40] This tradition has to come to an end, he argued, because it leads to an internal focus and is overly preoccupied with fair distribution. Scandinavian management cannot work in a modern era with a more global business environment where there is a constant demand for change and active leadership. A more ownership-driven, market-oriented model of management is now required.[41]

This cry for a reorientation of management practices in Scandinavian firms was part of a general movement in this direction among large Scandinavian companies. The top managers in new global conglomerates like ABB could not build on any single regional style or philosophy, as it was feared that managers with such a regional and culture-specific orientation would not be loyal to the whole firm.

The emerging model and its Nordic variations

The alleged crisis of the Swedish welfare state in the early 1990s did bring renewed attention to a particular feature of the Swedish model: the strength of the industrial bourgeoisie. It has been argued that Sweden was the country in the whole OECD most dominated by large corporations, and that it ranked among those countries with the most concentrated ownership structure.[42] The industrial elite in Sweden may have been exceptional in the extent to which they were able to maintain a powerful position during the era of 'functional socialism'. The industrial bourgeoisie has survived Social Democratic rule in all cases. Finland and Sweden conform more to the model of 'organized capitalism', with Denmark and Norway displaying characteristics less easily classified into this category. The stronger historical influence of guilds and middle classes and civil society institutions in the cultural and religious sphere may account for the more disorganized and 'liberal' pattern in Denmark. The elites are always on trial in Norway, due to the lack of entrenched power structures and strong populist movements linked to the conflict between periphery and centre. The distinction between the public and private spheres of life is less clearly drawn, and the Norwegians as well as the Danes are less formalistic and adjust less easily to hierarchical structures. The historical influence of aristocracy is more notable in Sweden (and perhaps Finland), and has been used to account for the more finely grained status hierarchies developed in this society. This stereotype has received new support in recent research on immigrant experiences from the Scandinavian countries.[43]

Partly due to the lack of any strong aristocratic tradition and an overlap between national and democratic mobilization, Norway was the first country to become a formal democracy. Denmark was the second nation to make this transition, but its process was more abrupt, due to the entrenched absolutist forces. Finland and Sweden did not have a broad suffrage until the first decade of the twentieth century, when it was instituted abruptly, in the continental manner. Sweden's more gradual transition to a democratic system in 1921, when all men and women received the right to vote, was due to the long-term influence of representative institutions.[44]

The relationship between economic development and management also depends on political circumstances, for example involvement in the EU, and established authority relations in each society. Sweden's state culture has been described as paternalistic corporatism, in contrast to Denmark's liberal welfare state.[45] In Sweden and Finland the prime-movers were the nobility and the peasants, in Denmark the bourgeoisie and the nobility, in Norway and Iceland the bourgeoisie and the peasantry.[46] It has been argued that that the image of Norden as a culture-free formula for success has been closer to the Swedish self-interpretation than to that of the other Nordic countries.[47] There has been a stronger inclination among Swedes to believe that Sweden (and Norden) could be a relatively culture-free area of social experimentation. It was as if they wanted to show the world that the success of Swedish industry and society was due to a universal formula. The Danes have reacted differently to attempts to import foreign models, as they have been more keen to emphasize their own cultural heritage.[48]

The 'Nordic management style' argument has also been used by those who are interested in the consequences of political structures for the development of authority patterns. Management styles are supposedly more participative and democratic in these countries because of the strong democratic traditions and the smallness and openness of the political economies.[49] Scholars with backgrounds in economic history or business history may argue that management strategies are merely reflections of industrial structures, and therefore represent comparable advantages in natural resources. Sweden's historical emphasis on large firms and its relative strength in electronics and the steel industry, should, according to this argument, give rise to different management styles than in Norway, where smaller companies, shipping and service industries have been more important. Neither perspective is sufficient when confronted with the puzzling differences between organization structures and management styles in the Nordic countries. Management is part and parcel of an authority structure in a society. It is, therefore, critical to approach the idea of a Nordic model of management and democracy from a broad perspective, identifying the major organizational entities and conceptual constructs in these societies in various periods, and employing a 'feedback effect' – the impact of the prevailing view of the Nordic model in other countries.

The transition from the social democratic model of management towards something that looks like a combination of the shareholder value model and the professional model of management is linked to the rise of the more individualistic middle classes, as well as the development of a managerial knowledge community: universities and business schools, consultants, and the business press. An important challenge to the Nordic tradition is the Anglo-Saxon idea that the enterprise is the central unit of society, along with the emergence of a movement based on the idea that shareholder value increases customer value. There is now, in all Nordic societies, a relatively large group that earns its living by talking about management and providing advice to management; and this group relies on the ebb and flow of such concepts and movements. Ownership has not in itself been highly valued in the Nordic countries, due to their long tradition of functional socialism – the idea that it is not necessary to nationalize private property. Rather, they have found it possible to achieve the same means by regulating the markets to such an extent that property owners lose their power anyway, creating socialization by other means. These strategies of Nordic governments differ from those of Germany, where the idea of property was institutionalized in the role model of the owner-entrepreneur, and of the USA, where professional managers increased their power *vis-à-vis* fragmented shareholders. The idea that shareholders ought to exert greater influence is promoted by a small but growing middle-class movement. There is an increased focus on the role of management, often justified by referring to the individual's rights to choose, to human and social rights, and to the need of organizations to serve the consumer. Thus the traditional US model of management is becoming less realistic, built as it was on the idea of management as a profession, which implies a stakeholder view of the firm and the idea that a managerial career is a life project. Modern business life and social affairs relies on powers of communication and the ability to create temporary identifications and visions. Networking and trusting have become critical skills, due to a stronger emphasis on contracts, projects, and life-long competence shifts – a movement away from all the traditional management models associated with organized capitalism and towards a model of communicative management associated with an era of global capitalism.

Conclusion

The social democratic model of 'Norden' was an attempt to find a middle way between capitalism and state socialism. This formula lost some of its attraction with the downfall of Soviet communism and the rise of global capitalism. Corporatism and stakeholder management formed a model that provided guidance for western industrial and political managers during the epoch of organized capitalism. The German and US versions of this model have been particularly influential in the Nordic countries. It was a natural consequence of the Second World War that the German model lost its attractiveness, followed by a distinct shift toward the US model. The Nordic model that crystallized after the Second World War was sustained by the idea that it *was* a 'middle way', that management was a political task, but also an act of compromize, in order to avoid the extremes. Sweden, in particular, became a bellwether nation for some people.

This interest in the Swedish and Nordic third way gave Nordic managers and politicians confidence to initiate experiments for work reform and capital control, and also to invent new concepts like 'service management' and 'Scandinavian management'. A more self-critical attitude has emerged since the alleged 'fall' of the Swedish model in the early 1990s.

It is difficult for industrial managers in the Nordic welfare democracies to achieve a position of power and legitimacy that matches their wealth. Increasing economic gains for the upper-middle classes in the private sector represent a threat to the traditional regime, as such gains undermine the status of the historically more powerful political and organizational elite. The long tradition of 'functional socialism' and state paternalism implies that there is no strong support for the idea of unrestricted property rights or the suggestion that firms exist to maximize shareholder value. It is difficult to imagine a new Nordic compromise between a 'shareholder value' and a 'stakeholder' view of society. Nonetheless, it may be too early to wave goodbye to the Nordic model of compromise – the compromise between management and democracy and the compromise between extremes.

Notes

1 The exact period of the existence of the model is not the issue here – the important point, rather, is that the idea ceased to exist sometime between 1978 and 1990, and that it had its beginnings in the first half of the twentieth century.
2 Eckstein (1966): 147; Olson (1990).
3 Chandler (1977).
4 Lash and Urry (1985).
5 See, for example, Fagerfjäll (1999).
6 Hobsbawm (1995).
7 Drucker (1942/1995); Schumpeter (1942/1962).
8 Drucker (1942/1956): 64, 75, 34.
9 Meyer (1994; 2001).
10 Stråth (1996).
11 Boulding (1953); Drucker (1992); Perrow (2002).
12 Hartz (1953); Lipset and Marks (2000).
13 Shenhav (1999).
14 Barnard (1938/1968); Sloan (1963).
15 Stråth (1996: 33–4).
16 Struve (1973).
17 Ziegler (2000): 196.
18 Berle and Means (1932).
19 O'Sullivan (2000).
20 Hartmann (1959): 172.
21 Hartmann (1959): 6. The notion of a zone of indifference was launched by Chester Barnard (1938/1968): 168.
22 Esping-Andersen (1985).
23 For an elaboration of the idea of functional socialism, see Adler-Karlsson (1967).
24 Esping-Andersen (1985): 22.
25 Holmberg and Åkerblom (1998).
26 Trägård (1997): 262.
27 Veblen (1917): 22 ff.
28 Childs (1936).
29 Albrechts and Zemke (1985); Zemke (1988); Inglehart and Baker (2000).
30 Kuhnle (2000).
31 Sandkull (1986); Meyerson (1991); de Geer (1992); Mouritzen (1995): 14; Olsen (1996); Rothstein and Bergstrøm (1999).
32 Mouritzen (1995).
33 Tainio (2001).
34 Carlzon (1985/1989); Normann (1984); Grönroos and Gummeson (1985); Albrecht and Zemke (1985).

35 Maccoby (1981); Maccoby (1991): 40; Lindquist (1996): 13; Fagerfjäll (1999): 165.
36 Hofstede (1982); Sjøborg (1985); Lindkvist (1988); Lindell (1994); Jönsson (1996); Schramm-Nielsen, Lawrence and Sivesind (2004).
37 Kjær and Langer (2000).
38 Stenlås (2001).
39 Fellman (2001): 201.
40 Reve (1994).
41 Reve (1994): 572.
42 Henrekson and Jakobsson (2001).
43 Frank Meyer (2001).
44 It should be added that women did not receive the right to vote in Finland, Norway and Denmark until 1906, 1913 and 1915, respectively.
45 Knudsen and Rothstein (1994).
46 Beyme (1992): 192.
47 Ekwall and Karlsson (1999); Arnstberg (1989).
48 Musial (1998).
49 Kalleberg (1993); Katzenstein (1985).

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5
The Indian Reform 'Model'

Laveesh Bhandari

The Indian model of economic development is essentially a political-economic model and not a purely economic model. The political-economic model by default is more oriented to improving the processes of economic governance. Moreover, the speed with which economic policies change are determined by (1) the interplay between different pressure groups within its democratic polity, (2) different roles of the three tiers of its government (central, state and local), and (3) the ever-changing macro-economic conditions.

One of the most important aspects of India that makes it somewhat different from many countries in the immediate vicinity is that India is a democracy with clearly demarcated powers of the various arms of the government. Unless there is some sort of a consensus between different groups, any type of change is difficult. Given fractured election results for the last 15 years, reforms have also been slow, changes have occurred in spurts in some areas and leaps in others, with slowdowns and even reverses a few years later. However, on the whole the direction has been towards a greater and greater role of the private sector, greater economic freedom, and lower interference of the government in the economy.

To put this in different words, the Indian model is not outcome-oriented but is rather process-oriented. The post-1991 reform years have seen changes in the general processes of macro and micro-economic management, and because of political forces some processes have been easier to change than others. For instance IT, telecoms and financial services have seen significant changes as various lobbies are in consonance, whereas manufacturing, infrastructure, land, labour and related issues have seen slower/fewer changes due to greater disagreement between the different pressure groups. Sunrise sectors where entrenched forces are less powerful see greater openness and liberalization, but mature sectors are more difficult to change.

The three tiers of governance also make it difficult for a single entity to coordinate activities. The central (or federal) government has certain powers, the state governments have certain powers, and increasingly many powers are being decentralized to local governments due to constitutional reform in the early 1990s. As a consequence, reform-oriented governments tend to improve the processes within their own ambit. Many reforms therefore do not have an immediate impact as some other important issues are still constraining economic activity. However, over a longer period the impact is felt as other arms/tiers of governments also change the laws, rules, regulations or procedures.

Lastly, macro-economic forces create or ease certain pressures that in turn affect micro-economic activity as well as reforms. For instance the need to check inflation (among other things) required high interest rates which in turn affected domestic investment. Thus manufacturing investment was low through much of the late 1990s and early 2000s. With easing of inflationary pressures interest rates were reduced and we observe a resurgence of the manufacturing sector since the early 2000s. Similarly, the high foreign exchange reserves have enabled the Indian government to ease controls and we observe greater international investment by Indian companies.

What is the Indian model supposed to be?

An examination of the policy developments reveals an interesting picture of what the Indian model of economic reforms has been intended to be. The reform process has been the process of transition from a government-controlled economy to a market economy in India. Policy documents since the beginning of the reform period have all called for greater ease of entry and exit, a lowering of government intervention in unnecessary areas, and a simplification of the government–-private sector interaction. But before understanding the model, one first has to understand what the conditions were. The government-controlled economy in India was one where the government in one way or another determined most of the important decisions taken. The government decided how much could be produced, at what prices it could be sold, who could produce what, and also where it could be produced. The government has also had a strong role to play in how production took place, by controlling the amount of capital or the kind of technology that any producer could use. Moreover, by attempting to control the various economic activities, the government traditionally imposed significant hurdles on Indian entrepreneurship and talent.

Because of the overbearing nature of controls, the government routinely rewarded sloth and inefficiency at the expense of industry, innovation and competitiveness. This is because the government has been suppressing markets in the past. If a formal market is suppressed, illegal markets spring up to enable mutually beneficial exchange. Even the most thorough government cannot suppress markets as long as people can gain through exchange. Corruption, 'side payments', favouritism, all are unintended consequences of such control.[1]

The nature of the reforms

The 1980s saw a major generational shift among policy-makers as well as corporate India. The first generation of those who had grown up after Independence was taking over many important policy-making positions. With them came fresh views, and a relatively more economically liberal attitude. Thus the first efforts towards deregulation and liberalization had started in the 1980s. However, these were minor in nature and important macro-economic as well as micro-policy shifts were being talked about but could not be pushed through parliament.

A severe balance of payment crisis led to the initialization of the post-1991 reforms. There were fears that India would have to default on its international dues, but timely action on many different fronts including devaluation, reduction in controls on investment, as well as borrowing from international institutions gave the government enough breathing space to carry out further reforms. More importantly, the poor economic conditions enabled the government to ignore opposing voices and lobbies.

The post-1991 reforms reversed many economic policies pursued upto the 1980s. Import-substitution industrialization and self-reliance were overthrown by reforms that preached deregulation and liberalization. Licences for domestic manufacturing were abolished, the private sector was allowed to enter areas reserved for the public sector, import tariffs were reduced drastically, while the rupee was devalued. The reforms were wide-ranging in the early years. Simplification and rationalization of the excise tax structure occurred, though many loopholes remained; interest rates are now determined by market forces. Many areas were thrown open to the private sector, and the Stock Exchange Board of India (SEBI) was strengthened as a regulatory body for the stockmarket that introduced transparency and e-trading in the stockmarkets.

Table 5.1 India's economy and reforms

	The manufacturing sector				
	Entry	*Operations*	*Finances*	*Trade*	*Exit*
Key characteristics pre-1991	Limited through a complex licensing system; some sectors altogether not open for the private sector	Controls on how much can be produced; govt. specified which technology, the scale as well as location of production; limits on growth	Controls on where credit could be accessed from; subsidized rates in many cases	Difficulties in inter-state trade; imports and exports suffered from high tariffs and quantity restrictions etc.; overvalued exchange rate	Extremely difficult to exit due to combination of insolvency and labour laws
Beneficiaries	Incumbents as well as established large business houses who could obtain licences	Incumbents, established large firms; side payments benefited many public officials	Established firms and incumbents	Side payments benefited many public officials; established inefficient incumbents	Improved negotiating power of large labour lobbies
Post-1991 reforms	Largely done away with – little opposition faced	Largely done away with – little opposition faced	Largely done away with – little opposition faced	Sustained reform despite significant opposition	Little change, politically powerful labour lobbies highly antagonistic to change

Continued

Table 5.1 Continued

	The agriculture sector				
	Entry	*Operations*	*Finances*	*Trade*	*Misc.*
Key characteristics pre-1991	Land records maintained poorly; as a result land transactions are difficult and with high transactions costs; international entities not allowed to purchase agriculture land	Little explicit control of the government; however significant control through governments' large purchases for the public distribution system as well as minimum prices for some commodities	Difficult for farmers to access finance due to small land holdings and poor land records	Many commodities not allowed to be traded domestically; many more also cannot be exported from time to time (if fear of domestic price increase is strong)	Poor infrastructure imposes many constraints on production; availability of inputs (water), transport, trade, etc.
Post-1990s reforms	Same as before	Same as before	Same as before though some easing of credit availability for the small farmer	Some loosening of controls, but situation improved only slightly	Some ongoing improvements in roads, rural infrastructure remains low priority

	Infrastructure				
	Entry	*Operations*	*Finances*	*Consumer orientation*	*Misc.*
Key characteristics pre-1991	Almost wholly government-owned and controlled; many firms – but in public sector; private-sector activity explicitly discouraged	Command and control system – government subsidized; little need to recover user charges; little incentive to provide services and therefore little desire to pay	All through government; limited fund availability hindered infrastructure development and as a result growth in many parts of the country	Missing consumer orientation – focus on government 'providing' or 'granting' to the consumer	Little private-sector interest because of inability to recover taxes from consumers: as in power distribution
Post-1990s reforms	Greater private-sector entry 'allowed' – but regulatory and legal changes still required	Increasingly recognized that it is essential to recover user charges – however political lobbies asking for free power for agriculture	Easier to access finance; however inability to recover charges from some types of consumers is also affecting financing into the sector	Public-sector providers still not service-oriented; more towards infrastructure creation	Some ongoing improvements in roads; rural infrastructure remains low priority

Continued

Table 5.1 Continued

	Finance			
	Entry	*Securities markets*	*Other financial transactions*	*Prices*
Key characteristics pre-1991	Almost wholly government-owned and controlled; many firms – but in public sector; private-sector activity explicitly discouraged	Active but quite thin stock market; government-owned institutions were the largest players; many allegations of price-rigging, Debt market not as developed	Many permissions required for large firms; international portfolio investment not allowed, and direct investment discouraged	High government control over interest rates that were kept low – this aided the larger business houses
Post-1990s reforms	Greater private-sector role; market is less thin now due to entry of many more private players (both Indian and foreign) in all sub-sectors of the financial sector	Has become much more 'deep'; better use of technology such as electronic trading, greater and more effective regulations on unfair practices	Few controls left apart from those related to capital account convertibility	Little explicit control on interest rates; however Reserve Bank of India manages short-term interest rates within a narrow band

	The services sector			
	Entry	*Operations*	*Contributory infrastructure*	*Misc.*
Key characteristics pre-1991	Free entry for domestic firms; however entry from international professional services firms not encouraged; strict controls on foreign nationals working in India	Little control on domestic firms; little regulation either; services such as legal/medical/accounting regulated by concerned associations	Limited spread of IT infrastructure; power outages common; lack of satellite connectivity; extremely poor communications infrastructure	A few high-quality educational institutions (largely run by the government) led to creation of a well-trained human capital
Post-1991 reforms	Some easing of controls	Same as before	Great improvements in communications and IT infrastructure	Services benefited from little government intervention, and improvements in communication infrastructure

While many drastic changes were brought about, controls were not dropped completely; these are being eased slowly. Privatization though spoken about by many governments has essentially not picked up, and as a result successive governments are selling part equity in public-sector firms. Though since the mid-1990s, three different governments have been at the centre, reforms have continued, but have slowed down. The rapid reforms of the early 1990s have given way to debate and arguments over what the benefits of each additional reform would be. Table 5.1 illustrates the nature of the economy as well as the direction of the reforms. Broadly, we find that reforms have occurred where there was insignificant political opposition: for example in the financial sector, where markets were at such a nascent stage that groups that would have lost from an absence of reforms – as in the case of mobile communications; and where historical developments had weakened the traditionally strong lobbies – as in the case of established manufacturing business houses.

The reforms that have not occurred have primarily been those where established lobbies have been able to prevent changes. These include reservations for small industry (where SSI (supplemental security income) lobbies have been able to stall any significant reforms), labour rationalization (established labour lobbies have been against most reforms), privatization (perks and many invisible benefits enjoyed by politicians who control such units), limits to domestic trade (agriculture traders gain from arbitrage opportunities), etc.

Reforms: a timeline and impact in brief

The major stages of reforms and their impact may be summarized as follows:

- **1980s**
  - efforts towards deregulation and liberalization had started in the 1980s;
  - reforms got jump started by the crises in the middle of 1991;
  - there were fears that India would default on its international dues;
  - or else would default for want of critical imports.
- **1991 – from crises to reforms**
  - balance of payments crises led to the initialization of the 1991 reforms;
  - the 1991 reforms completely reversed those being pursued up to the 1980s;
  - import-substitution industrialization and self-reliance were overthrown by reforms that preached deregulation and liberalization.

- **1991 reforms**
  - licences for domestic manufacturing were abolished;
  - private sector allowed to enter reserved public-sector areas;
  - import tariffs were reduced drastically;
  - the rupee was devalued.
- **The 1990s saw …**
  - simplification and rationalization of the excise tax structure;
  - market determination of interest rates;
  - public-sector banks gave way to the entry of private banks;
  - Stock Exchange Board of India was strengthened as the regulatory body for the stockmarket;
  - transparency and e-trading introduced in stockmarkets.
- **Phasing out of controls**
  - while many drastic changes were brought about, controls were not dropped completely;
  - conditions/qualifications apply to many reforms that are being eased out slowly;
  - subsidies are being restrained but not very successfully;
  - privatization of the public-sector enterprises did not keep up its initial pace.

Then why have the reforms slowed?

First it should be said that lobbies are not the only culprits, there is also the fact that reforms have been poorly sold. Politically there is some sort of a consensus towards greater reforms. Most politicians, bureaucrats and economists now appear to agree that India must be reformed. It is also agreed that reforming India requires us to reform the economy. There is that much agreement. Beyond that there seems to be chaos. In the past during many important occasions democracy served India well, difficult decisions had to be taken where there were many losers and gainers and were taken. Why then are reforms somehow not catching the fancy of the masses and as a result their representatives – the politicians?

To some extent there is a lack of clarity of the ultimate objective of reforms. Reforms have till now been 'sold' as the answer to India's economic problems. That is, those wanting to see greater reforms have been arguing that they will ensure greater growth and equity. Though data shows impressive gains, many do not believe these claims; it is difficult to make credible claims about improving equity when more than 250 million people continue to live below absolute poverty (Dubey and Crooke, 2001). But that is not the only opposition. Many continue to ask the simple question. Has the bulk of the Indian population gained from reforms? The answer is an unambiguous no. Most Indians have not experienced greater economic freedom. A few large corporations have, some upper-middle-class households may have greater freedom in their purchase decisions, but avenues for greater employment opportunities, and greater income-generating opportunities for the poor illiterate masses have not occurred to the desired extent. It is therefore not surprising that the reforms are seen to be by, and for, the elite. And it is also therefore not surprising that there is little public support for further changes. The credibility is just not there.

The reformers have always known that the full impact of reforms for the masses will take many years to percolate through. And even when it does, it may not be seen directly as a result of the reforms. That is precisely what has happened. High economic growth has not translated into the kind of employment growth that is required. Indeed it will be many years if not decades before the real effects of reforms percolate down to the poorest sections.

The need for greater economic freedom

If one studies the various policy documents, most of the changes that have occurred have been backed by arguments over reduction of government interventions in the economy. That is, the changes have occurred to increase the freedom to buy and sell without going through the government. In other words, the reforms are about freedom from permissions, inspectors, long lines, corruption, *hafta* (side payments) and so on. For large masses of people who have suffered on account of government meddling in their economic affairs this would itself have been a strong enough argument for reforms.

It is well-known that the chief wage-earner in almost half of all Indian households is self-employed. (Of the other half between 30 to 40 per cent are on a daily/casual wage, and the rest in long-term salaried/wage employment; Sundaram, 2001.) The self-employed have enough understanding of the advantages of economic freedom to have formed the core supporters of economic freedom. However, that has not been the case. The reforms have been sold as actions that will generate benefits for all. As a consequence they are being judged on criteria that even the most die-hard supporters will admit will take many years to show up. Many who have supported reforms continue to point to improvements in economic growth, greater value creation, low inflation, balance of payments, investment and so on. However for political acceptability in India it *does not matter* what the 'economic' fundamentals show.

What would generate greater support for the reforms is if they are seen to aid individual initiative and abilities. The whole planning process, and many policy initiatives, are based on the assumption that a few 'smart' people can do a better job than individual initiative of the 'common man'. This, it is now generally agreed, has been quite harmful for the economy. The two most internationally competitive Indian industries for instance are software and jewelry. And each of these has been built purely on individual initiative with no government intervention and support in the initial period. The hands-off policy was the best for competitive forces to emerge. The same kinds of forces need to be unleashed in other sectors and this why reforms are important. This should be the argument for further reforms.

Reform indications for the next 10 to 20 years

There are two broad routes that the Indian reforms will take. The first might be termed 'business as usual', and the second would occur if the government is able to take a more proactive route towards enabling economic freedom.

The business as usual scenario

Slowly but steadily the remaining constraints on foreign investment will be eliminated in all sectors barring defence. Currently sectors such as information, media and broadcasting, highly polluting industries, distribution and trade, civil aviation, and other transport areas, do have significant controls over who can invest. However, they will in all likelihood be done away with over the next one or two decades. The reason is that these sectors would require great investments, and the cash-starved government will be forced to utilize any means at its disposal to ensure that infrastructure-creation keeps pace with requirements.

Public-sector firms will progressively have lower government equity but remain under government control. This would develop through equity in those firms being part sold to financial institutions or the public. Many firms would have a majority share in public hands, but as long as the government controls greater than 26 per cent equity in any firm it has the ability to veto any decisions. This is according to Indian corporate law. The veto power provides a large say to the government in any of its part-privatized companies.

The financial sector will become almost fully 'marketized'. However, the government's role would not be absent; the government would continue to control about half of the financial institutions (by size). In other words, large public-sector companies such as the Life Insurance Corporation (LIC), Unit Trust of India (UTI – mutual funds), State Bank of India (SBI – commercial banking) will continue to dominate the market despite private entities chipping away at their market shares. Apart from control of large Financial Institutions (FIs), the government would continue to regulate the sector through formal and informal means acting through the Reserve Bank of India and the SEBI.

Internal trade will be greatly liberalized and controls on inter-state trade done away with. This will ensure access to large markets domestically by the smaller Indian firms and traders and would therefore be of great benefit to them. Moreover, large areas of the hinterland would be opened up due to increases in road-creation across the country.

International trade being governed by international agreements will also become much freer and there will therefore be a negative impact on prices and a positive impact on quality in the medium term. However, the largest markets for Indian products are potentially in its vicinity – China, Pakistan, Bangladesh and Indonesia together have a population of around two billion, double that of India. If current movement in international relations is any indication, these markets would remain 'farther away' than those of the West, since many physical and non-tariff barriers will remain that will prevent the free flow of goods.

Reforms related to agriculture will not occur to any great depth; the established lobbies will only get stronger. As a consequence, reforms related to charging for water and power, less subsidies for fertilizers, tariff-free import of fertilizers and agro-chemicals, genetically engineered seeds, and so on, are not likely to occur. Land-related laws and those related to contract farming will not be changed to a great extent, though there will be some changes. The latter two reforms would be in the interest of the larger land-owner farmers and therefore the agriculture lobbies (generally controlled by the larger farmers) will not oppose them.

The government's fiscal situation is likely to remain poor, and in fact whatever reforms happen will be because of the driving forces that the fiscal conditions will create. For instance, the need to set up air and sea port facilities, improve connectivity through roads and rail, the need to set up an IT 'highway', and so on, will all require great amounts of funds. The government's funds are all locked up in wage, pension and interest payments, so the need to attract the private sector is therefore natural, and since private funds are limited domestically the government will be much more open to attracting international funds.

To sum up, in this scenario the country will continue to reform albeit slowly. Reforms will continue to be lobby-driven; however, they will be in the right direction.

A proactive reform process

A proactive group of political leaders could accelerate the reform process, ensure greater levels of economic freedom across all sectors, and as a consequence accelerate economic growth to double-digit levels.

How might this be possible? First we have to recognize that in India economic reforms will continue to be political in nature. Lobbies have to be played against each other, forces have to be balanced, negotiations and bargaining need to be conducted between players who are all interested in maintaining and expanding their own political base. However, all lobbies are interested in one aspect that will go hand in hand with the reform process – and that is the creation of infrastructure. Broadly, four types of infrastructure are going to be created in the next two decades on an unprecedented scale and will remain largely in the public domain. All lobbies will benefit and few are going to oppose any measures that will enable the government to gather funds (through taxation or borrowings) for this purpose. These four broad categories of infrastructure are:

- transport, especially road infrastructure;
- rural infrastructure;
- water supply and sanitation; and
- health and education.

If infrastructure could be built up rapidly, the potential gains for each section of society will weaken many if not all of the anti-reform lobbies. For instance, if greater taxation in rural areas were to be translated into better rural road systems and irrigation infrastructure then the forces opposing greater rural taxation would be weakened. Similarly, if better basic education and health facilities are linked to fund availability from selling-off non-performing public-sector firms, then the leftist lobbies who tend to oppose every reform measure would be hard-pressed to oppose privatization. Such examples abound.

But the problem with the creation of infrastructure is not so much the lack of funds, but the inability of governments rapidly to promote such large projects. Every year many billion rupees allocated for infrastructure are never used, due to the slow progress of infrastructure projects. Some examples are mentioned below.

The first large national infrastructure project, the Golden Quadrilateral, that will connect the whole country into a common road system is one instance. It is already behind schedule by more than a year and will be further delayed. The railways have resisted reforms quite successfully, and are run today almost exactly in the same manner as they were run in colonial times. Rail charges are rarely increased for passengers and frequently increased for freight. Surpluses generated are used to subsidize passengers. Track length has not increased, nor has track quality improved; trains regularly fall off bridges and jump off the tracks. Succeeding ministers try to outdo each other by announcing more passenger trains at the cost of improving infrastructure and quality.

The PURA scheme of creating rural infrastructure across the length and breadth of the country (Providing Urban Amenities in Rural Areas) has been on the drawing board for the last three years despite receiving wholehearted support from all sections of the polity. Similarly, numerous water supply and sanitation projects are delayed for one reason or the other. In some cases the land required for infrastructure is stuck in litigation, in some others some interested stakeholder has obtained a stay order from a court of law or water has not been released in adequate quantities for processing and supply. About half of all processed water leaks away, and water-starved consumers are forced to purchase water from private suppliers. Both individuals and commercial suppliers have responded to this by constructing illegal tubewells/borewells that extract sub-surface water. There is a similar scenario for irrigation, and consequently overdrawing of sub-surface water is common across the country. Water levels are falling in just about every part of India.

All the government needs to do is ensure a well-functioning water supply and sanitation services for domestic requirements. For irrigation requirements it needs to ensure that traditional ponds, lakes and tanks are well-maintained, and that canals connecting rivers and storage areas for farms are built. These are not difficult tasks, and the required skill-set exists both within and outside the government.

Note

1 Cement and steel markets in the 1970s and 1980s are classic examples. The government had control over production and prices of these commodities, and as a result there was not enough supply in many places, which in turn led to the creation of a large black market.

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6
The East Asian Development Model

Wolfgang Klenner

Introduction and overview

East Asian countries developed extraordinary economic dynamics, suffered from the Asian financial crisis, and are now again on an arguably more balanced growth path. In this chapter, focusing mainly on Japan and China, we look into the question of whether economic growth in the region could be partially explained by specific sets of 'intrinsic' institutional arrangements of the relations between state and firms, management and employees, and banks and firms or whether it was generated just by sound economic policies.

Economic success, even economic miracles but also economic failures of economies in East Asia are usually explained by Western observers by referring to the East Asian Development Model. Economists of the East Asian region, however, are not so sure about such a common approach of their countries. Even East Asia as a term has sometimes not much more than geographic significance, though it became the economically most dynamic area in the world.

A few political agreements aiming at integrating 'East Asia' have been concluded. In 1990, for instance, Malaysia promoted the 'East Asian Caucus'; since 1997, Japan, China and South Korea participate with ASEAN at the ASEAN +3 Summit; and in 2002, Japan introduced the concept of an 'East Asian Community' (Nakanishi, 2005). At the ASEAN +3 Summit in 2004 in Vientiane the establishment of an East Asian Summit was agreed on, but regional cooperation did not really move away from mere rhetoric to something more concrete. Quite a few more substantial cooperation projects failed to materialize. Japan's idea of an Asian Monetary Fund put forward during the Asian financial crisis, for instance, was not welcomed by China, though after the Chiang Mai initiative (May 2000) a certain cooperation in the fields of currency and finance is taking place. Problems within the Asian region are likely to escalate. Threats to the security of the region are posed by tensions relating to the Taiwan Strait and North Korea: and also in the South China Sea concerning ownership of the Spratly Islands. Other historically already sensitive relations are marred by opposing views on territorial issues.

Obviously, the East Asian region is quite heterogeneous. But does this observation exclude the existence of a common set of development features? Certainly not necessarily, at least not as far as basic economic strategies are concerned. But there is some room for doubt concerning the more 'intrinsic' features.

In most East Asian countries physical and human capital have been intelligently accumulated. Domestic investment has been financed by a high saving rate, and considerable investment has been directed towards the education of the labour force which contributed to rapidly growing human capital. Most countries have been heavily trade-oriented and initially pursued an import-substituting industrialization and later export-pushed trade strategies with declining protection rates (World Bank, 1993). By consequently integrating into world markets they were able to attract foreign capital, since the 1980s increasingly in the form of foreign direct investment.

In this connection Japan and later the East Asian newly industrialized economies played a particular role in regard to their economically less-developed 'periphery'. Different from, for instance, countries in Western Europe which encouraged capital mobility together with labour mobility, Japan and other East Asian countries primarily promoted the free flow of capital. In Western Europe, labour inflows from Europe's poorer 'South' were encouraged with the result that firms, without having to move abroad, could raise production, however not necessarily productivity. But Europe's periphery, because of a lack of foreign investment and outflows of the more dynamic workers, probably did not develop as fast as it might have with foreign direct investment (Klenner, 1999). In East Asian countries, however, labour mobility has been extremely limited. So capital had to move, mostly in the form of foreign direct investment. Capital was initially transferred from Japan to South Korea and Taiwan in order to establish labour-intensive industries, which in Japan were no longer profitable because of increasing wages. Later, after having reached a higher stage of development, South Korea and Taiwan exported capital as well to less-developed economies such as China, Indonesia and Vietnam – thereby following the so-called 'flying geese' pattern (Ezaki, 1995). Foreign direct investment was not just a means of introducing external funds for economic development. Unlike portfolio investment and foreign credits, foreign direct investment was also a method for transferring management resources and benefiting from the determination of the foreign partner's crew to be successful, and from linkages with intra-corporate networks which gave access to world markets.

For many East Asian countries, economic dynamics came to an end in the second half of the 1990s with the financial crisis. At that time it turned out that they not only had strong points but also weaknesses in common, such as inadequacy of financial regulation, a wrong sequence of financial liberalization, an excessive degree of debt maturity and currency mismatch, and problems of corporate governance due to less professional control exercised by family owners and financial institutions which very often were an integral part of the corporate group. These features were soon labelled 'crony capitalism' (Ito, 2001).

By now East Asian countries have recovered and again constitute a hub of economic growth. Business and trade have increased dramatically with countries outside and within the region. In 2004, for instance, the percentage of intra-regional trade was almost 46 per cent. This was higher than the percentage under NAFTA of 42 per cent, though lower than that of the EU which amounted to 62 per cent (*Asahi Shimbun*, 9 Dec. 2004). Foreign exchange reserves of East Asian central banks increased tremendously: in 2005 they amounted to US$ 3,800 billion (*Financial Times*, 23 Feb. 2005).

But apart from those common basic economic strategies and weaknesses, are there any similarities in what could be called the more 'intrinsic' features? In order to look into this question, I list a few elements which, according to the prevailing Western opinion, distinguish the East Asian development model from its Western counterparts, and we will ask whether institutional approaches within the East Asian region are a reflection of those elements, or whether the Western perception of East Asia is misleading.

According to the widely held view of Western observers, East Asian governments are playing an active and extremely efficient role in the development process. Moreover, it is said that subordination of individuals to responsible and benevolent leadership is regarded as more efficient than the free play of individual interests, and that the betterment of groups or even the nation is considered more important than increases of individual wealth. These features in connection with other socio-economic fundamentals are usually regarded as key elements of the Confucian ideal. The institutional issues which will be examined are specific approaches concerning the relations between the state and the economy, between management and employees, and between banks and firms. The focus will be mostly on Japan and China.

As far as the investigated period is concerned, a historical approach would certainly provide valuable insights into the socio-economic roots of production and innovation. It could be investigated for instance, how economic growth was initiated and promoted in Japan by the *daimyos* (Norman, 1973); and in China by local and foreign businessmen, sometimes in cooperation with, but usually against, its gentry and bureaucrats (Moore, 1969). But I shall confine ourselves to the period after the Second World War when economic dynamics increased and resulted in the so-called East Asian miracle, followed by the Asian financial crisis – and after that by an arguably more balanced economic growth, at least in a few countries of the region.

Changes are in the offing. The long economic stagnation in Japan and the ever-increasing foreign engagement in China will probably lead to revisions in their development approaches and perhaps bring to an end the East Asian Development Model, should it ever have existed. In this context extensive discussions are taking place (see, for instance, Allen, 2000); possible future developments, however, will not be discussed here, and much of what will be said below might already belong to East Asia's 'modern' history.

Relations between the state and the economy

Government–firm relations in Japan have usually been characterized by the term 'administrative guidance'. This concept was based on the extensive use of committees and councils in which representatives of the government, big industrial corporations, trade unions, financial institutions and academics participated. They expressed their interests, exchanged information and finally reached a consensus on the economic goals which became part of the five-year plans for the development of the economy (Komiya, 1980: 277).

In order to realize these goals the government intervened in resource allocation by providing financial assistance such as low-interest loans, subsidy payments, preferential taxes and by issuing licences and permits. As a principle, funds were allocated by providing incentives, not by decrees. Firms which did not comply did not necessarily face economic difficulties: but they knew that by not being aligned with the government they might miss their chance of strengthening their competitive position (Aoki, 1997: 398). The state usually relied on market mechanisms, but discretionary governmental intervention was utilized as well.

A more direct way of influencing capital allocation, called 'window-guidance', was used in the 1950s and 1960s by Japan's central bank. At that time, money was not supplied freely to any bank that was willing to acquire it at the interest rate offered by the central bank, but rather was allocated in specific amounts to selected banks. These banks were usually chosen by the central bank who offered credits to those clients willing to invest in accordance with the goals stipulated in the plan (Suzuki, 1980: 166; Nakamura, 1995: 113). Moreover, the government operated a unique financing system, called the 'Fiscal Investment and Loan Programme' for achieving policy objectives. It was said that this programme, frequently referred to as 'the second budget', provided the government with a powerful policy tool (Ogura, 1984: 105). Japan's administrative guidance was based on responsible leadership and the placing of national development above individual interests: it carries the essential features of the East Asian Development Model mentioned above, and Japan in this connection has been called a 'developmental state' (Johnson, 1982: 26).

Most Japanese economists would argue that this approach was quite helpful as long as Japan lagged behind the industrialized nations in order to catch up with the Western economies (Aoki, 1997: 233). Immediately after the Second World War, when Japan had just transformed into a market economy, its economy was faced with serious market coordination failures because of insufficient economies of scale, backward and forward linkages of its corporations, and lack of precise information (Okazaki 1997: 74). These were the conditions under which the Japanese government might have played an active, useful role in development by designing and developing an institutional environment conducive to economic growth and productivity increases.

A few economists point out that the government has even been able to stimulate and nurture creativity after Japan's economy had completed the catch-up process. By fostering for instance public–private joint research, the government is said to have contributed to Japan's technological development in several ways. The enormous risks were spread among a greater number of firms and the government; technological knowledge was created for industry at large and the transfer of technology among several firms was accelerated (Sumita and Namiki, 1997: 33). It is also believed that this relation-based approach contributed to Japan's welfare at a time when Japan had reached the level of its Western competitors.

Other authors, however, absolutely disagree with both views. Ryutaro Komiya (1984), for instance, insists that administrative guidance was almost never effective. He differs with the opinion that Japan, different from all other industrialized countries, should have discovered the holy grail of fusing individual with so-called collective interests and markets with planning mechanisms. He, and other critics, do not deny that there were a few cases in which the Japanese government embarked on initially useful projects; but pressure groups of other industries neglected by the state coffers very soon claimed their share as well, and as a result benefits were spread to all those who had voiced their interests. The outcome was usually more or less indiscriminate incentive-granting without clear objectives.

Another critical economist, Yoshiro Miwa, looked into Japan's policies for small and medium-sized firms which are generally regarded as the most important and successful policy measures of Japan's administrative guidance. He found, however, that these policies have not been effective at all, and his conclusion is that much of what is said about Japanese industrial policy is simply wrong (Miwa, 1995: 399). To put the opposing view in a nutshell, the extensive government involvement in Japan might not have been as harmful as in some other countries, but it was never an example of a successful symbiosis of government and firms (Kosai and Okino 1980: 246).

Nowadays, administrative interventions no longer play a significant role in Japan. This can be inferred for instance from complaints of those who are in favour of such an industrial policy as they blame the government for not having intervened into the economy some 15 years ago, when economic speculation led to the 'bubble' economy. It is remarkable that they point at the USA as an example for good industrial policy (Klenner, 2002: 48), and praise the US department of defence and the national institute of health for having funded research. Their results constituted the initial impetus to the growth of electronics and biotech industries (in the USA) which was promoted by private venture capital (Yusuf, 2001: 19). It is said that at the same time Japan's bureaucracy has 'put its hands in its lap' while watching the many disastrous speculative actions of Japan's crazy investors. In the view of Japan's conservative economists, did the USA inadvertently become the country with the better industrial policy?

Given these different assessments and perceptions of the relations between the state and the economy in Japan, an outright assignment of Japan's government–firm relations to the so-called East Asian model might be questionable. Less controversial are views of the relations between the state and the economy in China. During the first three decades after the founding of the People's Republic, tight central control clearly dominated – with the central government taking all relevant decisions on economic development. However, twice in that period, during the Great Leap Forward at the end of the 1950s, and the Cultural Revolution beginning in the middle of the 1960s, central planning was virtually abandoned (Klenner, 1979).

Central planners lost their power, and local activists from factories and villages took economic decisions. These decisions were not the result of the free play of individual interests, and they did not aim at increasing individual wealth. Contrarily, they were driven by the desire to contribute to the economic and 'socialist' development of China (Xie, 1960: 47). Central planning with its concrete instructions to individual factories was replaced by general guidelines for economic development and labelled as the 'thoughts of Mao Zedong'. Mao Zedong was perceived as the benevolent leader whose rather vague economic ideas were to be implemented by the 'revolutionary masses' (Shanghai shi geming weiyuanhui: Liang zhong sixiang …:33).

All these approaches – central planning and, maybe to a greater extent, the economically unfortunately disastrous episodes – align clearly with the features of the East Asian development model described above. The situation changed when China embarked on economic reforms at the end of the 1970s and substituted step-by-step market mechanisms for planning mechanisms. The result, up to now, is some kind of mixed economic system with an important foreign-funded sector, a large non-state sector, and a state-owned sector with roughly 110,000 state firms, among them some 1,000 large state-run enterprises which are still under the control of the central government.

These large state firms are instrumental for accomplishing the leadership's goals. Although they account for only 10 to 15 per cent of industrial output (Perkins, 2001: 257), being of strategic importance their real influence on the economy is much larger than this percentage suggests. The non-state sector comprises not only private firms but also the roughly 350,000 collectives – the so-called 'township and village enterprises'. The collective firms account for 30 per cent of the gross value of industrial output of all incorporated enterprises. They are essentially community-government-controlled enterprises, which are expected to do nothing but business and focus on profits, different to state-run firms which are confronted with multiple goals set by planning authorities (Qian, 2001: 306). As a matter of fact, local governments behave like small business conglomerates and promote their enterprises – they control their own activities and receive the benefits.

There may nevertheless exist a few features which go together with the East Asian economic development model and used by the local communities taking advantage of the collective nature of their firms. This can be concluded from the comparison of cities with a collective ownership structure against cities with mostly private enterprises. The city of Wuxi in Jiangsu province, for instance, belongs to the first category whereas the city of Wenzhou in Zhejiang province has mostly private firms. Both cities have been mentioned quite often in the Chinese press. In Wuxi, where the government relies on sources of collective enterprises, the bridges, power stations, field terracing and other collective functions are said to be in an extremely good shape. In contrast, in Wenzhou the basic facilities and public works are rather backward. Individual farmers are building high houses with kitchens and bathrooms, but their kitchen slops are running openly along the streets because of a lack of sewers (Song and Du, 1990).

So far not only China's state sector but to a certain extent also the collective sector provide some leeway for elements of the East Asian model. Yet, after almost three decades of reform it is difficult to assess the influence of the government on industrial development. Compared with government–firm relations in many other Asian countries, the influence of the Chinese government is certainly quite substantial, stronger than for instance in Singapore, where the state still holds shares of the biggest enterprises (Wong and Ng, 1997: 124). But compared with Vietnam and maybe even with South Korea, where the President can negotiate economic issues with leaders of a small number of the huge *chaebols* that constitute the major share of Korea's industry (Perkins, 2001: 258), the Chinese government's influence might not be so outstanding.

Relations between management and employees

In contrast to controversies about Japan's administrative guidance, the characteristics of Japan's relations between management and employees are less disputed. Japanese firms have relied heavily on permanent employees which are closely connected to the well-being of the firm. It is estimated that roughly 30 per cent of Japan's labour force belong to this category. Much has been said about the mechanisms which serve as incentives for permanent employees such as the seniority wage system, the internal promotion system, the practice of regular pay hikes, retirement allowances, and corporate pensions which are paid when employees leave the companies. The Japanese wage system is generally linked to the long-term performance of their lifelong employees. As a consequence, the amount of pay is increased in accordance with achievement evaluated on a long-term basis. Individuals are interested in providing great effort for the firm with the expectation that they will be promoted one day and kept on the firm's payroll – even if the firm gets into economic trouble.

This employment system, characterized by deferred wage payments, the specific internal promotion system, and 'community-like' features (Suzuki, 2005: 82) corresponds with elements of the East Asia model such as benevolent leadership (at the enterprise level) and the principle that the betterment of the firm is more important than increases of individual income. However, this is rarely the result of specific 'welfare' considerations of the firm, but rational adoption of the firm to prevailing conditions in order to maximize the well-being of the firm in the long run.

Changes in external and internal conditions within the last decade increasingly trigger reforms of corporate governance and have a direct impact on employment relations. Among the internal changes are changes of bank–firm relations and the unwinding of cross-share holdings. The results are a stronger orientation towards the short-run performance of the firm, an increasing tendency to offer employees a larger amount of pay in conjunction with their recent achievements, and even lay-offs of permanent employees (Osano and Kobayashi, 2005: 58). However, impacts on Japan's labour force in general may be limited. Roughly 70 per cent of the total labour force never enjoyed the privileges connected with the mechanisms described. They either run their own business or worked more or less on a hire-and-fire basis, which made it difficult to be concerned with matters other than one's own economic situation.

China's traditional state sector offered lifelong employment and on top of this social networks and benefits for the whole family of the individual workers. It seems that unlike in Japan where income was connected to the performance of the firm, labour relations in China were more one-sided. State firms had considerable obligations towards their employees, irrespective of their short-term and long-term performance. But the staff took benefits provided by enterprises for granted and hardly felt obliged to be fully engaged on the job.

Only during the two episodes described above, especially during the Cultural Revolution, were things different. At that time, an interesting but chaotic experiment could be observed. Local activists felt uneasy with tight central planning combined with the organizational approach of the Stalinist version of the one-man management system, though it had gone together with a rapid rise in industrial output. They were opposed that only one individual should be responsible over each production unit and at every level of the planning bureaucracy: thus because of their authoritarian and technocratic character, a shift towards a more democratic, collective system was requested (Klenner, 1979).

As a result of fierce political struggles, the 'one-man' leaderships were replaced by so-called revolutionary committees. A large number of workers moved into management positions and even into planning bureaus. Because of the influx of workers into the organs of local government the very same concept of 'local government' involved more people directly in factory work. The linkages between the factory and the planning and coordination apparatus changed substantially. Efficiency of the firm was now interpreted as encompassing social benefits, local development needs, and educational side-effects (Andors, 1977: 213).

The reality might have been quite different from what was reported at that time. But the message was quite clear – 'people should accept responsibility for others' well-being'. Willingness to improve should be generated by worker participation. Worker-initiated innovation and grassroots creativity should be substituted for material incentives. Individual interests were clearly put behind the betterment of groups and the nation.

With the market-reforms, all this changed dramatically. One-man management and the revolutionary committees were abolished – though not always in the minds of the people. Corporate government in the foreign-funded sector became heavily influenced by the various business cultures of foreign investors from the EU, Japan, the USA, Hong Kong and elsewhere. Newly-founded private Chinese firms based on relationships, but probably quite different from Japan's 'community-like' enterprises, began to thrive.

A few elements of the East Asian model might still exist in China's decreasing state sector which by now contributes less than 30 per cent to total industrial output. State-firm employees still enjoy certain benefits of the traditional system, but they are aware that as the status of state-run firms will change very soon, so will their status. As far as the fast-growing collective sector is concerned, the term 'collective' suggests that township and village enterprises are still close to China's traditional economy. But this might be misleading. Many collective firms employ migrant workers on a hire-and-fire basis close to Manchester-like capitalism [… from 1780 to 1850, Manchester was one focus of the

Industrial Revolution and the very first industrial city, where what is known as 'Manchester' capitalism had its origins: eds]. Herein the relationships with employees from the same town or village do not differ much from those to migrant workers.

Bank–enterprise relations

Different from the Anglo-Saxon model of securities-based or capital-market finance, Japan had a bank-based system of relationship finance; loans were the predominant form of corporate finance (Aoki *et al.*, 1994: 3). The financial system is said to have been characterized by the mainbank system. The mainbank is defined as the bank with the largest loan share of a particular firm. The close bank–firm relations are usually solidified by the bank's stable equity holding in the firm to enhance control, though the bank's holding is limited to 5 per cent of the stock. It is assumed that the mainbank seldom sells its shares in the market unless it abandons its mainbank position, and it supports financially depressed firms in order to preserve the bank–client relation and the firm-specific human assets accumulated in the framework of the lifetime employment system. In so far it could be argued that the mainbank, by assisting firms in periods of economic problems, plays the role of a benevolent lender and sometimes even of a benevolent leader.

However, views on Japan's economic system differ not only in regard to administrative guidance, but also to its financial system. A small number of Japanese economists refute the outlined perception on the basis of detailed empirical studies. Yoshiro Miwa insists that the described mainbank–firm relation and inter-firm networks with a mainbank as centre constituting corporate structures called *kigyo keiretsu*, are nothing but a 'fable'. In reality, firms diversified their borrowing broadly and borrowed from the *keiretsu* bank only a small minority of the loans they needed (Miwa and Ramseyer, 2001: 5). Japan's financial system provides no empirical evidence which would justify the assumption that the large city banks exercise a mainbank function for their group companies and that *keiretsu* firms have stronger ties to that bank than non-*keiretsu* firms. He comes to the conclusion that *keiretsu* tell nothing about a firm's ties to certain banks. In his view most of what is said about Japan's corporate structure is based on the concept of committed Marxists who want to document culture-specific group behaviour in Japan or to define some kind of 'socially embedded' commercial transactions (Miwa and Ramsayer, 2001: 28).

Against these different assessments, observers of Japan's corporate structure remain puzzled. They are not sure whether the relations between banks and firms in the past can be described within the East Asia development model. By now, almost all Japanese economists, including those who in the past used to put Japan's banks into the mainbank-category, would agree that Japan's financial system has changed dramatically. Since the process of deregulation for bond flotation and the corporate bond market was completed in the 1990s, banks as provider of credits lost importance. Large firms request fewer bank loans and banks have been weakened in that they suffer from a large amount of non-performing loans accumulated during Japan's speculative bubble. On top of this, the unwinding of cross-share holdings leads to the undermining of their pivotal role in business (Osano and Kobayashi, 2005: 58).

Do the relations between banks and firms in China reflect some of those 'intrinsic' features described above? In the past, when central planning dominated, this might contrarily to expectation have not been the case. At that time it was definitely the government which acted as 'benevolent' leader, not the banks. Banks were not much more than cashiers managed by the Ministry of Finance. This situation changed during the Great Leap Forward and the Cultural Revolution. During those episodes banks rarely had to wait for payment orders from above but theoretically could decide on their own. However their role was not more important economically than before, since they were expected to finance all those projects conceived by local activists as 'revolutionary endeavours'.

There is a possibility of some kind of mainbank-like relation would have evolved after the reforms in the 1980s, when credits were substituted for dotations (a form of 'free grant'), and banks were expected to act like financial institutions in market economies. With only a small role for equity finance and financing by bonds, banks were supposed to provide most of the capital required by firms which would have been one of the prerequisites for a mainbank system.

But China's banks are still subject to frequent government interventions and, hence, basically not yet market-oriented. This can be inferred from the dramatic increase of nonperforming loans as a percentage of the GDP as a result of state interventions into the capital allocation in favour of loss-making state-run firms. In recent years, drastic measures such as capital injections, debt–equity swaps, and restructuring of enterprises have been taken in order to 'normalize' bank–firm relations. But at the end of 2004, the ratio of nonperforming loans, according to official statistics, still amounted to roughly 16 per cent of China's GDP (Jiang 2004: 8). Western estimates put this ratio much higher. Thus, after the abolition of central planning, some kind of 'relationship-banking' evolved with features familiar to the East Asian development model. But given their experiences with the financial crisis, the Chinese government is aware that this kind of relation might easily turn into 'crony-socialism'. As a consequence measures have been taken to establish capital markets and provide firms with an alternative to credits.

Conclusion

A few institutional arrangements have been found which would match the East Asian model, but some of them are heavily disputed, only a few can be found within limited segments of the economy, and some have even been substituted by other 'normal' arrangements during the development process. Thus the empirical evidence of a specific East Asian development model is rather weak. It would hardly encapsulate the regional and temporal diversities of East Asian countries.

The idea that sound economic policy generates growth would hardly come as a surprise for economists. But it would probably disappoint Asian experts who have developed considerable expertise to grasp East Asia's particular features. In fact, an analysis which focuses on institutional arrangements for tasks, countries and periods of time different from those examined in this chapter might lead to different conclusions. Examples which might be explained other than by economics are easily to find. According to empirical research, for instance, the profit–sales ratio of Japanese firms was 3.8 per cent in Japan and 5.1 per cent in other Asian countries, but this ration fell to –0.2 per cent for affiliates in the USA (Urata, 1998: 49). We must ask (but not here) why did these firms perform much better in Asia than outside Asia?

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Part 2

Critiques and Alternative Views

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7

East Asian Capitalism: The View from the Tokyo, Seoul, Beijing Axis

*Tony Mitchell**

Dialogue between government and business

Capitalism in any country is a dialogue between the state, the market, entrepreneurs, professional managers, co-workers and providers of funds, the banks and shareholders. Many of these actors have separate dialogues with one another and the shape of these dialogues is more frequently directed by the values which inform the society rather than issues related to profitable operation. The Sarbanes–Oxley Act (2002) is clearly values-driven rather than profit-driven. There are correspondences between the company as 'community' model observed in both Japan and Germany, and the company as the property of the shareholders model; but as important are the differences between different 'community' models.[1] The German model is a different dialogue from the East Asian model: the former is a dialogue between partners, which can be illustrated by the role of the unions in Germany within the dialogue compared with the duty of the employer in the East Asian model to take care of his employees. The values in East Asia are fundamentally the rule of men rather than the rule of law in Germany. The dialogue in Europe takes place on the streets and in the media and in East Asia between friends over a drink.

East Asia shares a common set of values which are broadly Confucian. Although each country historically interpreted Confucianism with

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* I am indebted to James C. Abegglen for sharing with me material from his recent publications. As I finished this chapter I became aware of a book by Marco Orru, Nicole Woolsey Biggart and Gary Hamilton, *The Economic Organization of East Asian Capitalism*, Sage 2005.

different twists, the core values are:

- The duty of the ruler to protect and foster the people.
- The duty of the people to be loyal to the ruler.
- Strong family loyalties – extended into familyism – the preference for group rather than individual actions.
- A preference for the firm to take care of all staff.
- The notion that society is the rule of men rather than the rule of law.

There is now a considerable literature on the role of Confucianism in promoting capitalism, with views ranging from the dissenting Sang-in Jun, who in 'No (Logical) Place for Asian Values in East Asia's Economic Development', argues that East Asia is a '(wishfully) imagined community' through to those who have seen Confucianism or Post-Confucianism as a capitalist life-force as strong as the Protestant ethic, like MacFarquar and Berger. It is not necessary to argue about specific elements on Confucianism or to revisit Max Weber in this essay, since the argument is simply that entrepreneurs and managers in East Asia have grown up in nations which have developed through interpretations of each others' experience in a common cultural milieu.[2] It will be necessary in the future to define the differences within Michel Albert's Rhine model between Japan and Germany, and here Confucian values emerge rapidly as posing a very different set of values informing the development of society and its socio-economics.[3] In Germany, or better in the old Swedish model, there was a social compact between labour and capitalism, whereas in Japan the agreement flows not out of disputes of the period of industrialization but out of the continuity.

Most clear of all is agreement that the state has a developmental responsibility, and that companies/entrepreneurs have a trust to sponsor national development while getting rich at the same time. Ironically this is probably weakest in contemporary China, where many entrepreneurs have risen out of diverting state enterprises or loans from the government, and where the government is only just reasserting its role in the process. There remains ambiguity as to whether all wealth really belongs to the state or can be truly individually owned. This continues a historic tradition of ambiguity dating back to antiquity.[4] These values foster both a strong concept of the state and a sense of national duty amongst business leaders. The values tend to promote the importance of the founding family and to diminish the rights of non-related shareholders other than to get on and off the ride!

The growing economic power of East Asian countries means that their voices will grow on international bodies which loosely shape/police the global economy. The three major players of East Asia – Japan, South Korea and the People's Republic of China (PRC) – are likely to coordinate more, and build their own common institutions. Their attitude towards their companies will be distinctly different from that of the Anglo-Saxon model. There are strong differences between Japanese, Korean, Chinese and overseas Chinese firms, including Singapore, Taiwan and Hong Kong, but they have some common elements, and the key similarities can be summarized as follows:

1. The size of the founder's family stake in the company is irrelevant – he is still the founder and his will rules the operation (where the founder has disappeared, whether in Japan or Korea, the company belongs to the senior officers of the company who act in the same way).
2. The company will form a group or cluster of interests, which will support one another and interact.
3. Ultimately the company owes loyalty to the state and must play a good citizen role regardless of profit, but being a good citizen is not a full-time occupation.
4. Shareholders are passengers whose main right is to get on and off the ride at will.
5. The state will come to the rescue of companies and (less certainly) small shareholders.

As the East Asian voice grows louder, there will be an impact on the rules of the WTO, the OECD and the IMF, and on national/regional bodies notably the EU and the jurisdiction of the SEC. It cannot be assumed that the East Asian voice will not begin a roll-back of the Anglo-Saxon values as the exclusive global values as East Asian-based companies become more important globally. However, before this can happen the East Asian governments, particularly Japan and Korea, are going to have to revise their policies as they face criticisms from their respective businesses that they have misunderstood Anglo-Saxon capitalism itself as being purely 'Wall Street capitalism'. As a recent Korean critic put it 'While Wall Street's shareholder capitalism aims only at protecting the profits of shareholders, the U.S. administration aims at facilitating investment funds to companies through protecting minority shareholders for economic growth'.[5]

Indeed before restating the East Asian model it is necessary to dispose of some arguments which have hovered over the region since Japan entered its lost decade, and S. Korea its 'IMF crisis'. Until 1997 it was possible to argue that there was an East Asian Miracle.[6] Between 1997 and 2002, however, the world hurried to deny any such thing. This chapter argues that both the lost decade and 'the IMF crisis' taught Japanese and Korean companies many things about capitalism, notably that the actual structure of finance of firms could not defy gravity just because the founder wanted it to be defied. Those who now run Japanese, Korean and Chinese firms are much more sophisticated in their risk management and use of capital than those who ran them 10–15 years ago. But as Nicholas Kristof shrewdly put it in 1998, adopting a Western diet or clothes does not make East Asians more American, just as 'Americans do not become more group-oriented or respectful of their parents when they put on a Sony Walkman'.[7]

East Asian business has become much more adept at using the tools of capitalism, but this may merely strengthen the similarities beween capitalists of different countries in the region. Governments have tended to *kow tow* more to American capitalism, and it may be argued that America abroad speaks with more of a Wall Street accent than with a Washington accent when prescribing reforms which are more neoliberal than those practised in the USA.[8] Korean business argues that the way that their government has adopted US rules means that the owners and managers of companies are diverted from growing their businesses by having to defend their businesses against foreign shareholders.[9]

The model

Globalization has many facets and processes. To the end of the 1990s it has been a US-led process with follow-up/back-up from the EU, the OECD and the WTO organizations shaped by Anglo-Saxon values. There are significant contradictions in the process. The USA has been leader of globalization and pursuer of its own interests. Since it can be argued (especially from an East Asian perspective) that US interests have reached their height in most economic areas and the shaping of the world as the USA wants it may be coming to an end, the USA will be increasingly forced onto the defensive, and this will force the USA out of its neoliberalism to become more aggressive in taking self-interested actions like steel tariffs and Kyoto treaty (2005) non-ratification. As the

USA responds to these challenges it is likely to see increased value in collective actions which will challenge the notions of anti-trust, and investigations such as those of Spitzer in the New York insurance industry will look increasingly destructive.[10]

In the Doha Round, the USA has already been challenged by both emerging markets and the Cairns group on various nationalist policies, while the East Asians have been relatively quiet. At an international level the East Asian voice may not be coherently expressed until East Asia has more regional bodies which speak for East Asia alone. However, the model predicts increasing intervention and modification of the international system in the following ways:

1 Dismantling those areas of the OECD and the WTO rules which prevent the state from intervening to rebuild its own economy or firms when they have trouble.
2 Resistance to Federal Trades Commission or Monopoly Commission rulings from Europe and the USA over mergers and collusions.
3 Support the founders of companies (we may call this entrepreneurial rights) against shareholder rights.
4 A preference for courses of actions which both promote national development and profitability over profitability alone.
5 A feudal rather than Anglo-Saxon attitude to law – the rule of men rather than of law in Confucian terms.[11]

In the latter case this would include preventing class or other actions when the state has ordered a company to take irrational action in the interests of the community rather than shareholders.

East Asian capitalism defines itself

In what has been described above is the dialogue from government to business, what is different about how East Asian business views itself and acts? East Asian capitalism is driven by a dedication to a business and to a founder. Where the founder is removed, as in Japan, the dedication is to the idea of the company.[12] In this concept of capitalism, the entity is much more important than the shareholders, and even the share price is less a symbol of success than a way that the founder can manipulate his influence in the company. There is a negligible concept of core competence in Confucian companies – there is no business that a company or an affiliate might not attempt.[13]

Thus a Hong Kong ‘hong’ can move, as the Li fleet of enterprises has done, from trading and property development to satellite TV and then to telecoms via life insurance. The Samsung empire can start in sugar, paper and trading and move to life-insurance and finance, electronics, heavy industry via textiles, and construction, hotels, theme parks and retailing. A characteristic of this empire is that after the death of the founder, Lee Byung-chul, it split into five components led by different members of his family, which have pursued different fortunes, only one retaining the Samsung name. The Shilla hotel group, Shinsaegae group, CJ group and Hansol group are also amongst the top 30 *chaebol* of Korea. When necessary the five groups pool resources and activities although pursuing separate destinies.[14]

To simplify is to falsify, but in essence East Asia’s unique contributions to global capitalism and globalization are:

1. New first, and second-generation multinationals.
2. Growth rates which are off the scale in Anglo-Saxon and Continental experience.
3. A collective mentality, strongest in Japan and weakest perhaps in China.
4. A clustering preference – creating conglomerates or families of companies.
5. Funding based on bank rather than equity finance.
6. Technocracy/bureaucracy in high regard.
7. Built round Asian market dominance.
8. Ferocious adoption of new technology, manufacturing processes and can do R&D.
9. An ambiguous attitude to extra national property rights.
10. Life-time employment or a continuing loyalty between employer (company) and employee.
11. A tendency towards what the West sees as corruption, and certainly to collusion.

A feature of the East Asian system is the need to persuade powerful government officials to let the company do its business in an uninterrupted manner, which in freer and less-regulated markets would be unnecessary. Sometimes it has been easier to get corrupt politicians to do the work for the company, than persuade more public-spirited officials. Sometimes it has been easier to have gangsters involved in shareholder meetings to ensure no embarrassing criticism. Was this an essential part of the old model and will it continue into the future? First, during the period of high growth there has been no division between government officials and company executives who usually attended the same schools and continued to socialize. The values which encouraged group culture meant it was difficult for there to be a division between government and companies, and the values of society said that both were aimed at the same result – growth. But there was endless conflict about means, since generally officials did not understand the workings of the market. In Korea, the Ministry of Labour was more interested in lifetime employment than companies were. Korean companies saw alternatives like encouraging staff to move outside the company to supplier companies, or to start companies which would be dependent on the mother company.

Will the tendency towards corruption continue? The answer is yes. The purity of the OECD ethics outlawing the bribery of government officials is much less clear on a case by case basis in the East Asian model. All countries in East Asia are very clear that bribery is wrong, but the placing of the borderline on what is bribery and what is relationship or relationship-building is very hard to place in the Asian model and varies from generation by generation. Transparency in both Japan and Korea has increased (and will shortly do so in China) for a simple reason, it is a survival skill for the heads of large East Asian corporations. Under the pre-crisis accounting systems, the CEO did not know the actual cashflow situation of the company and the use of company money by private managers and employees was not considered an important issue. Intra-firm transparency is now at a high premium, but this does not ensure that conflicts between regulators and companies will not be settled 'by men' rather than 'by law'.

It is proposed in this chapter that South Korean capitalism is taken as closest to the mean for East Asian evolution for the following reasons. Japanese capitalism was decapitated in 1945 as part of the MacArthur democratization of Japan, and Japanese capitalism matured under a partial Anglo-Saxon rule-set.[15] No matter that this interpretation was very Japanese, and that the removal of owners in the largest companies reinforced rather than weakened the lifelong employment culture. Chinese mainland capitalism, and state response, is still too young to have a clear shape. It may be supposed that in the future we will find a mixture of companies that look like Korean *chaebol* and Korean ex-state owned companies like POSCO. Overseas Chinese (including Taiwan and Hong Kong) lack the state as a parent dimension, although their corporate form is very like the Korean *chaebol*, while Singapore has the state as founder and shareholder and looks more like POSCO. South Korean

Table 7.1 Key parameters of East Asian capitalism

	Japan	*S. Korea*	*PRC*	*Taiwan*	*Hong Kong*	*Overseas*
Following state goals	X	X	X	?	?	
Rights of founder	To 1945	X	X	X	X	X
Loyal bureaucracy	X	X	?	?	?	?
Bank funding	X	To 1997	X	X	?	?
Clustering model	X	X	X	X	X	X

capitalism, despite the problems of the Asian financial crisis of 1997, represents probably the most pure existing form, even though South Korean capitalism has been distorted by state legislation, most notably policies forcing major companies to go public at an early date, and the prevention of holding companies and rational shareholding forms.[16]

Table 7.1 summarizes some of the comparative characteristics of East Asian capitalism.

It is not surprising in this model that some of the clearest statements of a new form of capitalism come from South Korea. To give two examples in 2005, a new wave of East Asian confidence with an explicit attack on the Anglo-Saxon model came from Samsung Economic Research Institute:

> The most significant factor that has led to Korean economic growth lies not in the Western-style management structure of shareholder capitalism but a corporate governance that could actively invest in the future industries. Thus we should not be adherent to considering shareholder capitalism as a global standard.[17]

In the second case, in March 2005 Korean financial authorities shocked foreign investors by demanding the disclosure of the principal shareholders behind various funds and trusts holding more than 5 per cent of Korean companies. This came in response to the sale by Newbridge of its shares in Korea First Bank to Standard Chartered Bank for a profit of US$1 billion. In newspaper comment, a Western lawyer in Seoul explained that the outcry was a consequence of the fact that 'in Korea pure profit is immoral'.[18]

Prognosis

It is important to understand that East Asian capitalism has changed significantly since 1997, whether fast in Korea, slowly as in Japan, by trial and error in China or by living in a freer market as in Hong Kong and Taiwan. The essence of the change is that much closer attention must be paid to accounting and especially free cash flow. The old East Asian group lived without regard to its free cash flow, and thought that as long as it was building factories or acquiring assets, it must prosper. Since the Asian crisis, the capitalist tool of proper management accounting has been added. This in turn requires some adjustment of business. As James Abegglen puts it 'it is fascinating to see that the major changes in *kaisha* have been in the finance area, the least personal, the least "human" part of the total complex'.[19] A shift from bank finance to direct finance whether bonds or equity does not change the nature of East Asian capitalism. To focus more on profit, and less on boundless diversification is rational too. It does not involve human values either. For Korean companies the principle of good management post-IMF crisis is 'spread of the "Choose and Concentrate" strategy across the corporate world'.[20] As Hamlin puts it, 'what the crisis meant for Asian corporations was a heightened strategic sense of the importance of resources. Not so much in their availability but, as Porter, Hamel and Prahalad argue, in the resourcefulness of their application.' For Hamlin, the shift to strategy was a question of 'focus on growth in profitability rather than growth merely in revenue and market share. The focus on profitability required that corporations ask themselves, "Given these new conditions, what will be our sources of profit?".'[21] Hence Japan experienced a decade of what Abegglen calls 'company redesign'. For companies that were slow to 'get it', like Sony, compared with Samsung, the results could be traumatic.[22] There are plenty of examples of companies or groups that were 'too good' to learn the lessons in the crisis, whether the collapse of asset values in Japan or the collapse of credit in Korea in 1997. SK Group learned the hard way when the old accounting methods (and remember SK partnered with Enron) failed and a gap of US$2 billion appeared in SK Global which was the Chairman's personal bank. Near takeover by Sovereign Group brought a new dedication to profit in the group in order to prove to other investors that SK could make a profit like any other company.[23] For many Chinese companies these lessons are still to come although there are signs as stock prices collapsed in Chinese-listed securities from a boom market in early 2005.

The market force is a tough master. Japanese and Korean, and presently Chinese companies, believed that they could defy the laws of the market, building assets ahead of marketing based on will-power and ambition alone, and so they could, as long as they could accelerate out of danger in high-growth situations. But as their respective economies slowed or will slow, the less human and least Asian features of East Asian capitalism – finance and strategic focus – must adapt. This does not mean that the other values change.[24]

It is to be expected that given this pattern of development to date, if the Asian model evolves we will see the evolution of more strident statements of the philosophy of this new form of capitalism. In particular as it finds its place in the world, Asian firms will argue that they more efficiently combine the ingredients of twenty-first century success in being able to stick to a vision of expansion and evolution without Western 'short-termism'. There are clearly ambiguities in this development. Samsung Electronics may be taken as an example of this problem. Samsung Electronics in 2004 was one of the nine most profitable companies in the world, and a global leader in the electronics industry. In what ways can we say that East Asian capitalism has shaped this company?

Prima facie, we cannot say that the East Asian capitalist model has damaged the profitability of this company. If we look for evidence on the issues related to the model we need to look into the balance sheet and ownership issues. Samsung Electronics owns substantial interests which have nothing to do with its main business, notably Samsung Capital whose card subsidiary required a bailout in 2003–04. In the past Samsung Electronics invested heavily in the later bankrupted Samsung Motors unit. In short, although Samsung Electronics is highly profitable, it could have been more profitable had it followed an Anglo-Saxon model.

Secondly the shareholdings of Samsung Electronics have been subject to manipulation in which the company's shares owned by other group companies have been traded round to give the Chairman of the Group's son and companies under his control, notably Everland, an increasing shareholding in the company without purchasing on the open market. A similar process can be observed in other *chaebol* companies. Clearly this is a practice which would lead to allegations of fraud in Western compliance countries, since shareholder value (rather than internal revenue values) was cheated.

In terms of pressures to change capitalism in other parts of the world, James Abegglen pointed to a discrepancy with considerable implications for Anglo-Saxon capitalism. This relates to the rules on networks and groupings and intra-group transactions. Abegglen suggested that it might be that both in the USA and the UK the restrictions placed by law on insider deals might be out of step and that 'the Americans rather than Asians are out of step with the world in this regard. And it might follow from this that the Americans need to reexamine their practices and laws to improve competitiveness.'[25] In his most recent work, he argues further that the core of East Asian capitalism in its Japanese form is defence of the stakeholder system. For the Japanese, 'the shareholder is entitled to a fair return on investment, but has no further claim. Further benefits should accrue instead to employees and such other stakeholders as customers and suppliers.'[26] For Korean companies, the shareholder's right is to come along for the ride and get off fairly. The stakeholders must turn off the lights or share the longevity of the company.

Is there a Confucian inside our own societies?

Korean, Chinese and Japanese companies when they act in the national interests might appear to act as politicians would like US companies to act – putting national issues, normally jobs, ahead of shareholders' interests in pure profit. In fact none of these companies have acted primarily to preserve jobs in their respective nations (though there is a spectrum of difference from Japanese to overseas Chinese firms). Rather they have acted in the belief that ownership of global markets and assets by national companies advances the interests of the nation itself – perhaps echoing Sloanism of prewar America. Even if we get this apparent convergence in the future, America will not discover the power of Confucian values since it is built on a legal and confrontational model rather than a consensus model. At the present time Japan and China seem far apart and an East Asian community further from reality. As the consensus model begins to operate we may find an East Asian community on the doorsteps of America and Europe much faster than we can imagine.

Notes

1 Arie de Geus, *The Living Company*, Boston: Harvard Business School Press, 1997, pp. 101–2; Michel Albert, *Capitalism vs Capitalism*, London: Whurr Publishers, 1993. I am indebted to James C. Abegglen for these references.
2 Sang-in Jun, 'No (Logical) Place for Asian Values in East Asia's Economic Development', 1995, www.unesco.or.kr/ethics; Roderick MacFarquar, 'The Post-Confucian Challenge', *The Economist*, 9 Feb. 1980; Peter Berger, 'An East Asian Development Model', in Peter Berger and Hsin-huong Michael Hsaio (eds), *In Search of the East Asian Development Model*, New York: Transaction Books, 1988, pp. 3–11.
3 Michel Albert, *Capitalism vs Capitalism*, New York: Four Walls Eight Windows, 1993, p. 18.
4 Tony Mitchell, *Preindustrial Economics* (forthcoming).
5 *Korea Times*, 27 October 2004.
6 World Bank, *The East Asian Miracle*, Baltimore, MD: Johns Hopkins University Press, 1996, passim.
7 N. Kristof, *New York Times*, 17 January 1998.
8 *Ibid.*

9 *Korea Times*, 27 October 2004.
10 Spitzer represents the pure voice of anti-trust see www.oag.state.ny.us/bio
11 The nature of feudal law is that it is personal, customary and penalties are highly flexible from rebuke to fine to confiscation.
12 Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925–1975,* Stanford, Ca: Stanford University Press, pp. 204–6. An account of how Mitsui companies instituted regular meetings after dissolution. There is a contrast between *zaibatsu* and later companies not affected by the MacArthur reforms such as Sony or the old Matsushita. See also James C. Abegglen and William V. Rapp, 'Japanese Managerial Behaviour and Excessive Competition', *The Developing Economies*, 8 (Dec. 1970): 427–44.
13 Euro-Asian Business Consultancy (EABC), *The Chaebol Report*, 2001, p. 200.
14 *Ibid.*, pp. 85–90; and 2002, pp. 50–65.
15 J.W. Dower, *Empire and Aftermath, Oshida Shigeru and the Japanese Experience, 1878–1954*, Cambridge, MA: Harvard University Press, 1988, passim.
16 EABC, *The Chaebol Report*, 2001, p. 200.
17 *Korea Times*, 27 October 2001.
18 Brendan Carr of Aurora Legal Services, quoted in *Korea Times*, 24 March 2005.
19 James C. Abegglen, *Redesigning the Kaisha: New Systems, Lasting Values*, Petersfield, Hants.: CLSA, 2005, p. 17.
20 Kim Kyeong-won, *Post Crisis Tranformation of the Korean Economy*, Samsung Economic Research Institute, 2004, pp. 215–24.
21 Michael Alan Hamlin, *The New Asian Corporation*, San Francisco, CA: Jossey-Bass, p. 160.
22 Tony Mitchell, *Building Global Pre-eminence by Willpower Alone*, Samsung Electronics Corporation (forthcoming).
23 EABC, *The Chaebol Report*, 2002, pp. 50–65.
24 James C. Abegglen in *Redesigning the Kaisha*, CLSA, 2005 argues most convincingly for the continuity of culture. It would be interesting to compare the different interpretations of Confucianism in national capitalist forms, for in Korea the culture is less stakeholder-based and more family-based, even if the company is family-based. Tony Mitchell, 'Generational Change in a Post-Confucian Culture', 1987, *Transactions of the Royal Asiatic Society*, Seoul.
25 James C. Abegglen, *Seachange, Pacific Asia as the New World Industrial Center*, New York: Free Press, 1994, p. 206.
26 James C. Abegglen, *Redesigning the Kaisha*, 2005, p. 21.

8

'Emerging Multinationals' in the Global Economy

*Andrea Goldstein**

Introduction

Understanding domestic entrepreneurship and the private sector is key to strengthening productive and trade capacity in emerging, developing and transition economies. Although recent thinking on this subject has put great emphasis on the informal economy, on the development of small- and medium-sized enterprises, and on the participation in global production networks, it is doubtful that sustainable and high growth can be achieved without a flourishing domestic 'big business'. It is through this typology of firms that organizational and managerial knowledge is acquired, new products and processes are developed, and promising market opportunities are pursued.

In this context, it is not surprising that foreign direct investment (FDI) by multinational corporations (MNCs) based in emerging, developing and transition economies is playing an increasingly visible role on the world stage. The rise of emerging MNCs (EMNCs) in the early part of the twenty-first century is a qualitatively new phenomenon that bears relatively few commonalities with its earlier manifestation since the early 1970s. In the past, firms based in the Third World chose to invest in branches, joint ventures and wholly-owned subsidiaries overseas, rather than simply export goods or enter into licensing arrangements abroad, to maximize their ability to adapt existing process and product technologies (including second-hand equipment), 'descale' them, and produce at low costs with small production runs and inexpensive labour

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* The usual caveats apply to this chapter: one in particular, the opinions expressed and arguments employed are my sole responsibility and do not necessarily reflect those of the OECD, the OECD Development Centre, and their members.

(Lall, 1983; Oman, 1986; Wells, 1983). The general belief was that companies from non-industrial economies could hardly ever rise to become formidable global competitors.

Following the wide, albeit incomplete and at times flawed process of economic reform and liberalization that the 'South' has gone through since the late 1980s, EMNCs have learned to play the tricks of the global economy. Alliances, takeovers, acquisitions of competitors in crisis, and the establishment of research and development laboratories in Europe and North America have become the staple of EMNCs' expansion. The ability to fund considerable financial arrangements in sophisticated markets or to build distinctive and highly competitive corporate characteristics and resources are not anymore the confines of 'Northern' firms. The outcome is in the form of path-breaking deals such the acquisition of the IBM personal computer business by Lenovo of China, or the takeover of International Steel Group by Mittal to create an Indian-owned steelmaker that is the world's largest.

What are relatively new, in short, are the forms that FDI from non-industrial countries is taking, the motivations, and the effects. These developments call for new research on the international expansion of such companies, bridging the gap between the existing literature on business in emerging economies – that often portrays corporations as rent-seekers that flourish thanks to privileged access to political, financial and transactional resources – and the increasing attention that scholars devote to resources as the basis for corporate success. Factors such as protecting proprietary processes and competitive advantages, 'learning by competing' in high-income markets, following important customers, or the increasing global nature of managers (in terms of citizenship, education, recruitment and professional background) all combine to explain the decision to invest abroad. To advance this research agenda, scholars need to analyse the specific activities and capabilities of the firms involved, and the impact of FDI on the broader social and environmental context. In particular, research must come to terms with the concept of heterogeneity across firms as the best way to extend existing models to make them more realistic, but still theoretically precise.

Trends in 'southern' outward FDI

Table 8.1 provides a snapshot of FDI outflows from the top-21 developing countries for the last decade. The raise in the absolute value is certainly impressive – from less than US$40 billion in 1991–96 to more than US$100 billion in 2000. Global FDI flows over this period, however, rose much faster, and as a result developing countries' weight has

Table 8.1 FDI outflows from emerging and transition economies[a] (in US$ millions, countries ranked by cumulated 1992–2003 figures)[b]

	1992–97	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*
World	**328,248**	**687,240**	**1,092,279**	**1,186,838**	**721,501**	**596,487**	**612,201**
Developed economies	275,716	631,478	1,014,331	1,083,885	658,094	547,603	569,577
Developing economies	51,351	53,438	75,488	98,929	59,861	44,009	35,591
Hong Kong	20,557	16,985	19,358	59,375	11,345	17,463	3,769
Singapore	5,419	2,996	7,517	5,298	17,063	3,699	5,536
Taiwan	3,215	3,836	4,420	6,701	5,480	4,886	5,679
Korea	2,939	4,740	4,198	4,999	2,420	2,617	3,429
China	2,846	2,634	1,775	916	6,884	2,518	1,800
Russia	1,027	1,270	2,208	3,177	2,533	3,533	4,133
Malaysia	2,073	863	1,422	2,026	267	1,904	1,370
Chile	848	1,483	2,558	3,987	1,610	294	1,395
Argentina	1,606	2,325	1,730	901	161	−627	774
Mexico	413	1,363	1,475	984	4,404	930	1,390
South Africa	1,561	1,779	1,580	271	−3,180	−399	720
Brazil	510	2,854	1,690	2,282	−2,258	2,482	249
Venezuela	426	1,043	872	521	204	1,020	1,143
Iran	19	10	738	348	2,812	1,299	1,486
Colombia	285	796	116	325	16	857	926
India	96	47	80	509	1,397	1,107	913
United Arab Emirates	51	−30	115	2,094	441	442	992
Hungary	96	319	250	620	368	275	1,581
Turkey	100	367	645	870	497	175	499
Azerbaijan	0	137	336	0	158	326	933
Czech Republic	74	125	90	43	165	206	232
Top-21 total	44,161	45,942	53,173	96,247	52,787	45,007	38,949

Notes: [a] Excluding tax havens, see text; [b] South Africa included on account of its high pre-2000 ranking, see text.

Source: UNCTAD (various years), *World Investment Report*.

almost halved from 14.8 per cent in 1991–97 to 7.9 per cent in 2000–02. This trend does not diminish the importance of EMNCs, as much as it underlines the fact that the 1990s have seen stronger investment integration, led by M&As among OECD economies.

Asian developing economies remain by far the largest source. The so-called Tigers – Korea, Hong Kong, Singapore and Taiwan[1] – accounted for almost 62 per cent of the top-21 total in 1992–2003 and 67 per cent in 2000–03. Adding China, the five largest economies, all in Asia, accounted for almost three-quarter of the top-21 total in the early part of the twenty-first century. Conversely, Singaporean firms allocated 36.3 per cent of their total 2001–03 investment to foreign markets; Hong Kong channelled 28.2 per cent; and Taiwan 10.5 per cent. For the two latter countries, a large chunk of FDI outflows went to Mainland China and, of course, one has to be careful with Chinese data. A large percentage of investments pouring into China emanates from Taiwan, Hong Kong and Singapore – a significant part of which is round-tripping from China's mainland. FDI enjoys favourable treatment compared to domestic investment, resulting in an incentive to label projects as foreign.

The Russian Federation is another major source of Southern FDI, with a heavy concentration in the natural resources and transportation sectors of the countries of the Former Soviet Union (UNCTAD, 2003). In this case, the Cypriot offshore sector has developed into a landing place for Russian capital, to the extent that Cyprus is currently the biggest direct investor in Russia. Also, the investment flow from (or via) Cyprus to other Eastern European countries is relatively big and a significant share of these 'Cypriot' investments is considered to be of Russian origin (Vahtra and Liuhto, 2004).

On the other hand, Latin American investors such as Argentinean companies, which set up cross-border production as early as in the early part of the twentieth century, now account for a much smaller share. Since 1992, the six large Latin American economies – led by Chile, which has the smallest population among the six – have held a constant share of around 10 per cent. Finally, South African data reflects the decision of many of the country's traditional groups and mining houses to transfer their primary listing from Johannesburg to London, as well as the reverse takeover of De Beers by Anglo-American (15 February 2001).

Even in the age of globalization, FDI flows still show a high degree of geographical proximity. Many of the world's largest firms are not globally but regionally based, in terms of breadth and depth of market coverage. Data on the activities of the 500 largest MNCs reveal that very few are successful globally: for 320 of the 380 firms for which geographic sales data are available, an average of 80.3 per cent of total sales are in their home region of the triad (Rugman and Verbeke, 2004). The expectations in the case of emerging and transition economies are not clear. On the one hand, EMNCs may have an even stronger 'local bias' than their more sophisticated competitors that have had the time to develop the managerial and logistical skills to control a complex web of multi-country subsidiaries. Instead of entering into direct competition with Northern majors, EMNCs may try to replicate on neighbouring countries their own transformation on the home market. On the other hand, to the extent that EMNCs use foreign acquisitions to gain market access and knowledge, they are likely to do this in distant countries that they

Table 8.2 Geographical destinations of FDI from selected emerging and transition economies

	Same region	*EU 15 & EFTA*	*Japan & Oceania*	*Canada & USA*	*Rest of the world*
Brazil	10.42	10.09	0.13	4.49	74.87
China	20.69	–	8.00	20.78	50.53
India	25.43	32.72	1.41	23.26	17.18
Korea	40.30	20.70	1.90	32.00	5.00
Russia	37.02	24.74	–	23.11	15.12
S. Africa	7.02	75.11	5.64	11.32	0.91
Thailand	58.75	6.74	1.78	15.17	17.56
Turkey	32.01	57.70	0	2.79	7.51

Note: Data from, lightly different time periods and different sources, so strict comparability is limited.

Sources: Banco Central do Brasil (2004), *Capitais Brasileiros no Exterior*; Lee (2004); Hazine İstatistikleri – Treasury Statistics (2004); Pananond (2004); Pradhan (2003); Singapore Statistics (2004), *Survey of Singapore's Investment Abroad*; South African Reserve Bank (2004), *Quarterly Bulletin* no. 232; Vahtra and Liuhto (2004).

cannot otherwise conquer. To add to the complexity of this exercise, EMNCs may be particularly prone to channel funds for foreign investments through tax havens, many of which are located in zones that are OECD-contiguous.

Data differ widely in nature, coverage and trustworthiness and are at most suggestive. Still, Table 8.2 makes it clear that, depending on the country, each of these various hypotheses is somehow confirmed:

- Korean and Russian firms have heavily invested in their respective neighbourhood, either to take advantage of high growth rates and export potential (Koreans in China and ASEAN countries); or to access natural resources and exploit a common recent history and culture (Russians in former Soviet republics).
- South African blue chips, on the contrary, have mostly invested in European markets, although this is partly an accounting artifice due to the decisions to seek primary listing in London. The paradox is that, while largely shying away from the rest of Africa, in most such countries they do account for at least a large part of inward FDI (Goldstein, 2004).[2]
- Chinese firms have sought natural resources – in oil, mining and forestry – in Africa and Latin America.

- Finally, tax havens – mainly in the Caribbean and the Pacific, but also around Europe (the Channel Islands, Cyprus, Gibraltar, Liechtenstein and Madeira) – account for very sizeable shares of outward FDI, in particular in the case of Brazil, Russia and Singapore.[3] They are also being increasingly used by Chinese investors, though.

Also at the aggregate level, various indicators point to the importance of emerging economies as sources of FDI inflows to other, sometimes less-developed non-OECD countries (Table 8.3). Again, the quality of

Table 8.3 Geographical origin of FDI in selected economies (percentage of total accumulated flows or stock, depending on the country)

	AR	*AZ*	*BH*	*BW*	*CR*	*KZ*	*LK*	*MO*	*MT*	*NP*	*VN*	*UZ*
Argentina												
Brazil	3											
Chile	1											
China	6					4		38		11		
Croatia			16									
Hong Kong	3						10	2			7	
Hungary												
India									7	36		
Indonesia						2						
Korea	1					12	12	8		4	10	3
Malaysia	1							3	6		3	26
Mauritius								1				
Mexico	2				8							
Russia		5						3				
Singapore	2						17	1	9		19	
Slovenia			14									
South Africa				49					14			
Taipei, China											15	
Thailand	1										3	
Turkey		13				4						

Notes: Figures correspond to cumulated FDI inflows for the following countries: AR = Argentina 1990–2002; AZ = Azerbaijan 1994–2001; BH = Bosnia Herzegovina 1994–2003; BW = Botswana, end-1999 stock; CR = Costa Rica 1992–2003; KZ = Kazakhstan 1993–2000; LK = Sri Lanka 1979–2000; MO = Mongolia 1990–2003; MT = Mauritius 1990–98; NP = Nepal 'until 2001'; VN = Vietnam 1988–2003 (commitments); UZ = Uzbekistan 1997.

Sources: Foreign Investment Promotion Agency of Bosnia and Herzegovina; Leproux and Brooks (2004); UNCTAD, *Investment Policy Review*, various issues; UN Economic and Social Commission for Asia and the Pacific, International Economic Conference and Regional Roundtable on FDI for Central Asia, Dushanbe, 2–4 April 2003; Banco Central de Costa Rica; Nachin (2004).

data is such that comparisons must be made very cautiously. The importance of South Africa as a major FDI source for the rest of sub-Saharan Africa, however, is clear, as is, albeit to a smaller degree, that of Turkey in Central Asia. In the case of Argentina, while the weight of Brazil is relatively minor compared to traditional North Atlantic investors if the unit of analysis is the 1990–2002 period, shifting the focus to cumulative flows following the 2001 debt default changes the picture.[4] Possibly because they found that the opportunities of buying in a 'fire sale' more than offset the risks of operating in a poor business environment, Brazilian investors snatched various Argentinean assets.

A different way of looking at the same trends is provided by firm-level data, which are more accurate although less-inclusive. Based on the UNCTAD annual database of the world's largest MNCs, Table 8.4 provides comparative statistics on the top-50 MNCs from emerging economies *vis-à-vis* the world's 100 largest. For both categories of firms, the transnationality index (TNI) – a non-weighted average of the

Table 8.4 Summary statistics for the world's largest MNCs

	1998	*1999*	*2000*	*2001*	*2002*	*1998–2002*
(a) **World's top 100**						
Assets						
Foreign	1,922	2,124	3,113	2,958	3,317	72.58
Total	4,610	5,092	6,184	6,052	6,891	49.48
Sales						
Foreign	2,063	2,123	2,356	2,247	2,446	18.57
Total	4,099	4,318	4,748	4,450	4,749	15.86
Employment						
Foreign	6,547,719	6,050,283	6,791,647	7,038,000	7,036,000	7.46
Total	12,741,173	13,279,327	14,197,264	13,783,000	14,332,000	12.49
Average TNI	*53.9*	*52.6*	*55.7*	*58.0*	*57.0*	*5.75*
(b) **Emerging economies top 50**						
Assets						
Foreign	109	129	155	186	195	78.90
Total	449	531	541	528	464	3.34
Sales						
Foreign	109	122	186	145	140	28.44
Total	289	367	393	362	308	6.57
Employment						
Foreign	400,475	383,107	403,000	541,361	713,624	78.19
Total	1,546,883	1,134,687	1,321,449	1,275,493	1,503,279	−2.82
Average TNI	*36.6*	*38.9*	*35.3*	*44.8*	*49.2*	*34.43*

Source: UNCTAD (various years), *World Investment Report*.

incidence of foreign assets, sales and employment in the total for each indicator – shows an increase since 1998. For the top EMNCs, however, the increase is far more dramatic – from 36.6 per cent to 49.2 per cent in 2002 – although their TNI still remains considerably lower than for the OECD peers. OECD-based MNCs respond to the new opportunities opened up by liberalization in emerging markets with a set of offensive moves that can give them a salient position in the newly liberalized economies. Successful domestic firms may respond to these offensives through a combination of achieving a pre-emptive market position, attaining a critical size, creating national brands, exploiting national competitive advantages, adopting best international practices, and altering core values. According to Mathews (2002b: 468) the late-comer firm is good at 'linking with various kinds of contracting or licensing arrangements, and leveraging resources (knowledge, technology, market access channels) from such linkages'. As a result, EMNCs may engage in non-sequential internationalization across countries, which Cuervo-Cazurra (2004) defines as 'the selection of countries that are very different from the country of origin for the firm's first international expansion'.

Finally, it is important to highlight that industry dynamics are very different. In complex manufacturing sectors such as aerospace, for instance, only Brazil has managed to break into the small circles of countries capable of producing more than 100 aircraft per year, and even China struggles well behind (Goldstein, 2005a). On the other hand, the 2003 *Engineering News Record* ranking of the world's 100 largest contractors includes 18 firms from emerging economies, of which 16 have foreign sales (almost by definition, via a direct overseas presence) in excess of US$100m (Table 8.5). Although the size of the domestic market, and the obstacles that foreign companies face there,[5] provide them with an advantage, no fewer than 43 of the top 225 firms by sales hailed from China. Thanks to dimensions other than cutting-edge technological skills, in particular low labour costs and economic diplomacy, such companies have access to a low-cost workforce that they post overseas when needed. Tighter controls over corruption malpractices in OECD countries, especially since the 'Convention on Combating Bribery of Foreign Public Officials in International Business Transactions' was signed in 2001, are also reportedly benefiting competitors from countries that are not parties to this legal instrument. Price competition from some Chinese contractors can be stiff, although they insist they had to work hard to establish reputations, especially in Africa where the work and the working conditions are demanding.[6]

Table 8.5 The geographical distribution of the world's 100 largest contractors (country ranking by average firm revenue in 2003)

Country	*Average revenue (US$m)*	*Average internationalization (US$m)*	*Number of firms*
France	14,380	58.76	3
Sweden	14,056	81.84	1
Netherlands	8,625	52.14	1
Germany	6,719	52.72	3
Austria	6,468	72.58	1
Spain	6,364	18.50	5
Japan	5,363	20.78	19
UK	3,882	52.30	5
China	3,868	15.33	12
Australia	3,709	18.55	1
Korea	3,608	28.92	2
USA	2,555	14.96	35
Italy	2,245	51.67	5
Greece	1,824	100.00	1
Norway	1,644	63.36	2
Brazil	1,576	81.28	1
Egypt	1,318	14.51	1
India	1,228	6.60	1
South Africa	1,174	50.84	1

Source: *Engineering News Record* data.

The open questions

The preceding section has shown the extent to which research on MNCs from emerging economies has developed since the mid-1980s, following a similar methodological framework to that used for analyzing international business in a developed country context. Nonetheless, the existing literature has largely left unexplored a number of key issues relating in particular to the external environment in which such firms operate – the role of policies and politics, as well as the dense network of contacts in which they are submerged – no less than the internal sources of their success: their capabilities and their use of human resources.

The role of policies

Although the debate on the role of the state in spurring economic development and industrial competitiveness remains one of the hottest one in social sciences, there is no denial that in emerging economies government actions play a key role to compensate indigenous firms' lack of ownership and internalization advantages (Yeung, 1999). Government strategic interventions in the form of large-scale public investment in skill formation, establishment of public research institutions, fiscal incentives for innovating firms, and a 'soft' patent system to legalize reverse engineering contribute to strengthening indigenous technological capabilities and allow firms continuously to recombine foreign technology and indigenous R&D. Multinational expansion is a new phase in the growth of the firm and EMNCs, despite fresh competencies, still start from a weaker competitive position than their established rivals, prompting governments to develop new tools to assist them. To some extent, the same risks of capture and misplaced priorities in policy action that plagued twentieth-century industrial policy may present themselves, although the fact that, by definition, EMNCs' operations in foreign markets make it much easier to exert discipline on them, and prevent the 'wrong' firms receiving subsidies when they do not deserve them.

Short of examining the policy–OFDI nexus in sufficient detail, suffice here to sketch the recent Chinese experience. Following the 1978 launch of economic reforms, controls on the overseas activity of Chinese companies were progressively relaxed as the government became cautiously interested in exploring new business opportunities. Permitting outward FDI was indeed one of the Fifteen Measures of Economic Reform approved by the State Council in 1979, although one reserved until 1985 only to trading companies and selected provincial and municipal economic and technological institutions (Taylor, 2002). Speaking in 1994, the Vice-Minister of Finance, Zhang Youcai, clearly stated that authorities 'vigorously encouraged and supported the relevant authorities and powerful large- and medium-sized enterprises to make investments and initiate operations abroad so as to diversify their business and become internationally operated conglomerates' (quoted in Wall, 1997).

Early in the twenty-first century, the pressure of domestic overproduction and of rising international reserves on the fixed currency regime convinced leaders of the opportunity of launching the 'Go Out' policy so encouraging overseas investment.[7] The State Asset Supervision and Administration Commission (SASAC) was set up in April 2003 with the mandate of turning the country's top SOEs under its control into 50 global multinational corporations. Although every company that wants to invest overseas must get regulatory approval, in 2003 the Ministry of Commerce (MOFCOM) and the State Administration of Foreign Exchange (SAFE) introduced a programme that allowed overseas investments of less than US$3 million to be approved at the local government level rather than through the lengthy and complicated process of applying to Beijing. In October 2004 a further marked easing of controls on overseas investment by local companies was announced and application approval procedures were streamlined.[8] Under the new rules, the government would no longer judge the feasibility of overseas investments, leaving such judgments to the companies involved. Applications will require submissions on fewer topics and will be accepted via the internet, while the number of investment destinations requiring approval by the ministry will be cut from 30 to seven. Investments in other destinations can be approved by local authorities.[9]

Some government agencies are also developing more specific policies aimed at supporting their MNCs' expansion drive. In Central and Eastern Europe, these include long-term investment guarantee schemes to cover against both commercial and non-commercial risks, equity participation, and advisory services (Kalotay, 2003). In 1996, Thailand's Prime Minister formed a special committee to examine the country's outward investment flows and to find ways to support the investing activities of Thais abroad. Trade and Investment SA, part of that country's Department for Trade and Industry, even had a numerical target of raising outward FDI in key sectors to ZAR 3.5bn over the 2002–04 period. In Brazil, one of the measures of the new Política Industrial Tecnológica e de Comércio Exterior (PITCE) launched in March 2004 is the creation of 38 multi-dimensional external trade units within the Banco do Brasil to support the internationalization strategy of national firms. Worries that Korean companies have concentrated too many of their overseas subsidiaries in China prompt Kang and Lee (2004) to suggest that the government collects and disseminates new information on issues such as market demand, labour market conditions, custom and government policies to companies that are willing to invest in more distant locations, but who hesitate due to lack of reliable information.

Finally, home governments may react with hostility to the emergence of their own MNCs. This is far more than a theoretical possibility, as shown in Central and Eastern Europe where most transition governments perceived outward FDI as 'unpatriotic' (Svetlicic and Rojec, 2003).

The role of politics

In the 1970s, 'solidarity' was an important motivation for South–South investment flows. Host governments showed a strong preference for MNCs from fellow developing countries. To draw from Latin American mining again: for example, in Peru and Colombia authorities preferred

Brazilian firms for deals in copper and coal, respectively, expecting them to be more sympathetic to requests for technical assistance and technological transfer.[10] The consequence, however, was that often they forfeited the benefits of superior technology, management and market access that Western corporations could possibly provide.

In extraction industries, political considerations still play a key role. State-owned China National Petroleum Corporation (CNPC) has emerged as Sudan's largest foreign investor, reflecting China's diplomatic philosophy, which preaches noninterference in other countries' internal affairs. In South America, the case of PDVSA is particularly interesting because this Venezuelan firm has long been a leading EMNC. PDVSA is promoting a plan to integrate oil and gas companies under Venezuelan leadership as a way of joining regional energy suppliers and consumers to provide energy more cheaply and more efficiently, bolster the region's influence in energy, and counter Washington's influence in the oil industry. Under a 2001 accord that sweetened a deal that Venezuela already had with Central American and Caribbean countries, Venezuela offers about 30,000 barrels more a day at bargain-basement credit rates. The country also provides fuel oil to Argentina in a complicated barter exchange and has offered assistance to Bolivia as it embarks on a plan to strengthen its state-owned energy company. In June 2004 Venezuela and the 13 small, scattered countries in the Caribbean agreed to start up a regional energy company, PetroCaribe, which would receive Venezuelan oil under preferential terms.

Companies like these epitomize 'the emergence of a new breed of second-tier transnationals with business models premised on their comparative advantage in unsavoury markets where more socially responsible companies fear to tread' (Pegg, 2003). While not necessarily oblivious of the need professionally to manage state-owned enterprises, some governments are also inclined to pressure them into acting as foreign policy instruments. South African parastatals, in particular Eskom Enterprise, are expanding into the rest of Africa to deepen Pretoria's broader objectives of regional integration in infrastructure.

To the extent that firms from small economies, which do not enjoy the luxury of a large captive market, are important outward investors, host governments may find them less threatening than competitors coming from a larger country. Pangarkar (2004), for instance, mentions the case of Sri Lanka, where companies from Hong Kong were warmly welcomed – whereas those from India faced hostility. There are, however, many examples suggesting that Southern investors are not immune from the dangers that are almost synonymous with emerging markets. Danger refers here to the high risk that business activity is hampered by poor transport links, an unreliable water and energy supply, and the lack of a legal system capable of passing good laws and enforcing them – although violence is another one. To mention but two cases in Indonesia – a country where many foreign businesses are reluctant to invest: (1) Cemex has so far failed in its attempts at taking a majority control from government in their joint venture, Semen Gresik, while (2) India's Bajaji found the market for taxi-rickshaws suddenly cornered by a local competitor with no manufacturing experience but having strong political connections.

Importantly, some of these episodes and associated risks resulted from clashes between foreign firms and domestic competitors, rather than between foreign firms and host government (Wells, 1998). While certain modes of EMNCs' strategic governance may be appropriate in their home countries, the different configurations of political, social and institutional relationships that prevail in other emerging economies may easily turn to be hostile, notwithstanding *prima facie* commonalities in the business systems (Yeung, 2004).

A second set of inconveniences derive from the political goals that motivate foreign investors. In Russia, for instance, the oil and gas majors have acted as 'patriots' that execute the country's foreign policy through their overseas operations and this has invariably provoked suspicions in host economies (Vahtra and Liuhto, 2004). As the *Financial Times* noted, 'East European governments have tried to limit Russian energy investments, usually acting quietly to avoid offence'.[11]

Finally, investors from emerging economies may be as upset by political upheavals as competing corporations from industrial countries. In the late 1990s, a number of Mauritian firms had invested in neighboring Madagascar (in particular) and in Mozambique. Much of the FDI was vertical in nature, the objective being to take advantage of very cheap labour available in those countries. To that end, the most low-skilled labour-intensive processes were moved to Madagascar. This factor was strong enough to offset the negative consequences of an unfriendly investment environment, creeping political instability, lack of rule of law, and institutional quality, and so on. However, following the political crisis in 2002, all the firms closed down. It is only now, with the return of political stability, that some are considering returning, although quite a few developed such an utter distaste for Madagascar that they will never again consider investing there.[12]

The role of diasporas in homeland FDI

Most existing theories of economic development ignore the dynamic role of inter-firm interactions and, instead, stress state policies and macro-economic forces as the decisive factors creating a country's industrial structure. At the non-government level, a parallel contributing factor to 'investment diplomacy' in explaining South-South FDI flows is provided by ethnic ties, kinship, and the role of diasporas in homeland FDI. For individual firms and managers, the information costs of plunging into hitherto unknown markets are very high and the possibility of resorting to trusted sources of information and social capital may therefore make all the difference between investing or not.

The interpenetration of extensive capital flows and business networks has received considerable attention in the literature, especially in the context of trading centres' specialization in matching buyers and sellers in different markets. Feenstra and Hanson (2004), for example, examine the role played by Chinese business communities ('bamboo networks') in East and Southeast Asia in intermediating a substantial fraction of trade between Asia and the rest of the world. Through their cross-border investments and global trade networks, these business communities have also facilitated the rearticulation of mainland China and India into the global economy.[13] In trade, expatriates command specific advantages over domestic producers because of superior knowledge of foreign markets and technology; they also score higher over foreign companies in their knowledge of local languages, adherence to shared values and norms of social behaviour, and possible familiarity with the problems of managing low-wage unskilled labour. Moreover, to the extent that expatriates' specific skills are unobservable and non-contractible, Western MNCs cannot internalize them by hiring (Guha and Ray, 2000).[14] Slightly modifying the OLI (Overseas Labour Investment) framework, Chen and Ku (2002) further argue that, in the presence of market imperfections, ethnic ties may provide privileged access to location-specific advantages which in turn reinforce the competitive position of EMNCs *vis-à-vis* other firms based in third-party countries.

On the basis of a gravity model of bilateral FDI, Gao (2005) finds that cultural ties with Hong Kong, Taiwan and Singapore alone are responsible for 60 per cent of total FDI into China.[15] The fact that such companies often enter foreign markets at an early stage in their life-cycle, possibly before they have accumulated improved and internally-derived technological capabilities, suggests that the internationalization process is not incremental but is rather is driven by networking capabilities – the ability to draw from complementary resources of different partners and to turn them to the firm's benefit (Pananond, 2001). The rapid pre-1997 growth and international expansion of two nascent Thai multinationals, Charoen Pokphand (CP) and Siam Cement, was led by industry-specific factors such as scale and scope economies, as much as by their networking capabilities – the ability to draw on resources of different partners and to turn them to the firms' benefit. Three types of network relationships that were crucial to both these firms' domestic and international development were: ties with financial sources, links with foreign technology partners, and political connections. The practice of drawing on both technological and networking capabilities continued in their international expansion activities, thereby accelerating their diversification – while at home the CP group is rather focused on the production of food (it is the world's largest producer of animal feed and tiger prawns) in China it is also dabbling in telecoms, insurance, retailing, pharmaceuticals, petrochemicals, breweries and even motorcycles.

The Asian economic crisis, moreover, seriously undermined the social and institutional foundations of Chinese business communities in Southeast Asia. Confronted with increased hostility, or almost outright riots as in the case of Indonesia, Chinese business communities increasingly recognize the limits of their 'home' country-based accumulation strategies and turn to globalization as an alternative growth strategy. It must also be borne in mind that for many Chinese business firms international diversification, *in primis* on the mainland but also to other locations such as Australia or Canada, was made necessary by the fact that in their home countries new business opportunities were denied by state regulations of different kinds. For instance, Digal and Goldstein (in progress) refer to the case of the Sy Group, which invested in China to counter the restrictions of the Philippines' 1954 Retail Trade Nationalization Law. The emergence of Chinese business communities in Southeast Asia cannot therefore be solely conceived as an indigenous evolutionary process of social and institutional change. Outside forces obviously play a key role.

The case of India is different, insofar as many emigrants have built large, diversified conglomerates in the host countries, *de facto* severing business (although often not personal and social) ties with India. The three Hinduja brothers, for instance, have created a multi-billion international business trading empire with interests in communications and media, automobiles, financial services, oil and lubricants and pharmaceuticals. Not only do their headquarters remain in London – where they have made large donations to the Victoria and Albert Museum and the Prince's Youth Trust – but their Indian investments are limited to IN CableNet, a multi-systems operator. Indian companies established by Non-Resident Indians include Jet Airways and Zee Television.

Although smaller in scale, diaspora investors can be found in other countries as well. The Mohammed International Development Research & Organization Companies (MIDROC) is Ethiopia's largest private investor. It groups the extensive and multi-faceted business interests of Sheikh Mohammed Hussein Al-Amoudi, who was born in a town located some 400km north of Addis Ababa from an Ethiopian mother and a Saudi Arabian father. The Sheik started business as a young man in Saudi Arabia, and in Ethiopia alone MIDROC has investments covering all sectors of the economy and employing around 15,000 people. Gulzar International, a Dubai company set up by an Afghan refugee, is constructing a $25 m Coca-Cola bottling company, the first big-ticket investment by the diaspora since the end of the Taliban regime.[16] Italy also hosts considerable investments by three Argentine companies established by Italian immigrants in the late 1940s (Techint, Bulgheroni-Bridas, and Gallo).

In the 'zoology of international business', yet another typology is exemplified by Hong Kong's Jardine Matheson, constantly ranked among the largest EMNCs, which can be best described as an expatriate MNC.[17] Founded by William Jardine and James Matheson as a commission business in 1832, it is the biggest of the British-owned 'hongs'. Jardine Matheson owed its success to the strategic decision to eschew speculation and to concentrate on building a pattern of relationships within and outside the business that would foster the flow of information, the knowledge with which to interpret it, the ability to influence others, and a reputation for probity that would attract and retain trading partners (Matheson Connell, 2003). The British-based Keswick family, descendants of the firm's opium-trading founders, remains Jardine's principal shareholders.[18] In 1984 the *hong* moved its legal domicile to Bermuda, and in the 1990s it shifted its stockmarket listings out of Hong Kong to London and Singapore.

Nurturing and sustaining competencies

International expansion and global operations demand considerable investments to accumulate the three essential ingredients of dynamic capability – the so-called Chandlerian three-pronged investments in 'production' (minimum efficient scale plants), 'distribution' (forward integration into marketing), and 'management' (managerial hierarchies for internal coordination). One might caution these precepts globally, as

Chandler reported primarily on his research in the USA, Germany and the UK (Chandler, 1990).

At an early stage, acquiring companies from China turned foreign targets into sources of technology for producing the high-specification models in demand in the OECD markets. The China Bicycles Corporation, for instance, in which the International Finance Corporation of the World Bank Group has a 15 per cent equity stake, transferred the technology of an American bicycle company back to its Shenzhen plant which now has a highly successful export market. More recently, with surplus production capacity rapidly increasing, from the perspective of Chinese companies there is ample motivation to expand overseas. As markets have been deregulated, competition has heated up in many sectors to the point where slim or vanishing profit margins and oversupply are constant features of the economic landscape.[19] Add to that the fact that procedures for bankruptcy are primitive at best, it is clear that many large companies are heading abroad from China out of desperation rather than as the result of solid growth plans.

China's national champions are expanding their overseas activities to promote product differentiation and powerful brand-name promotion. This, however, is not an area of strength for these firms, and the parallel with Japan is illustrative. When Japan began its major period of mergers and acquisitions abroad in the 1980s, the country's main advantage was superior management techniques and more efficient manufacturing structures and processes. These advantages were transferable, but the key advantage of Chinese companies – cheap labour costs – relies on physically locating production in China. The broader point is that failure to keep pace along the three dimensions may inexorably drive companies out of business. Although it is far too early to tell, some analysts question the long-term sustainability of the international expansion of Haier – a 80 billion yuan (US$9.7 billion) conglomerate with over 30,000 employees worldwide sometimes regarded as the 'GE of China'.

The strategy of Haier can be contrasted with that of Galanz, another Chinese company that makes 40 per cent of the world's microwave ovens.[20] Galanz has gone global by sticking close to home. Established in 1978 as a textile company, Galanz began making microwaves in 1993 and soon started exporting as a contract manufacturer for other companies. It makes microwaves for 248 companies, including GE, Fillony and Harvard, and exports ten million items a year. All production is done in Shunde in Guangdong province, where cost and quality can be easily monitored and any part can be supplied within 20 minutes. Galanz now boasts the world's largest microwave oven factory. Shunde is also ideally located in the industrial hub between Guangzhou and Hong Kong and exporting is logistically easy. Nonetheless, Galanz is so dominant – it boasts a 70 per cent market share in China – that it risks running the ire of anti-trust authorities.

In developed countries, broad diversification has been argued to deter firms from actively seeking international expansion by diverting resources and providing other avenues for growth. Moreover, business diversification demands managerial centralization to be sustainable, but this hinders organizational and technological learning across subsidiaries (Wright *et al.*, 2005). Yet, if diversification is no more than a risk-hedging strategy – in fact a rather appropriate one in environments characterized by a high degree of political and economic instability – then portfolio investment is probably more appropriate than FDI.

In developing countries, in contrast, the more efficient and competitive firms, which are also the most likely to undertake international expansion, may have been led to diversify in order to avoid the costs of inefficient capital markets (Khanna and Rivkin, 2001). Instead of creating new products, the business groups leverage domestic and foreign contacts to combine foreign technology and local markets, sequentially entering new unrelated markets (Leff, 1978). But as the selection environment changes with the opening up of the national economy to increased world competition, the business groups evolve, sometimes to the point of making the transition to producing self-standing product innovation (Kock and Guillén, 2001). The burden of managing a variety of unrelated business lines in subsidiaries located in multiple locations is made lighter by the long-established practice of resorting to a network architecture which is more conducive to information sharing than traditional hierarchical structure. Moreover, family-owned conglomerates may find it easier to make long-term financial commitment towards internationalization than Western competitors that act under the more immediate (although possibly value-enhancing) pressure of financial markets. In this context, business groups may internationally diversify either to capitalize on existing resources and capabilities or to acquire and develop new ones in host-country environments (Hoskinsson *et al.*, 2004). The first strategy of international exploitation is likelier to happen in other, similarly-endowed emerging markets, while the second one (international exploration) leads the groups to invest in more developed OECD markets.

Short of disposing of a large dataset, suggestive evidence on conglomeration and/or multinationalization links is provided by the experience of developing countries where diversified groups have a particularly high weight. With economic liberalization, many emerging economies' conglomerates have adopted the 'focus on core competencies' imperative that is currently fashionable in the West (Hamel and Prahalad, 1994). Nonetheless, conglomerates with an international reach remain pervasive. Building the kind of institutions that can support well-functioning markets for capital, management, labour, and international technology takes many years, if not generations (Khanna and Palepu, 1999).

Spreading out businesses and management talent can overcome the distortions and red tape common in developing markets. The early history of Indian MNCs suggests that diversified domestic conglomerates were the first to advance into foreign markets, deploying their execution skills. In the 1960s groups such as Tata, Birla and the Kirloskars began to expand their production activities trans-border by investing in East Africa and Sri Lanka, regions with strong cultural and ethnic links to India. As an example, in 1995 Birla was operating in 15 countries. These inroads, however, did not really respond to strategic planning, as ties among different independent-minded pieces of the corporate empires were often tenuous at best. In contrast, in the twenty-first century, the Tata group has ambitious globalization plans 'to move Indian manufacturing to a world class-level and a useful place to start is subassembly or key component manufacturing by setting up plants overseas'.[21] Each of the group's businesses would in the future be judged on its potential to be among the world's top three in the sector and on its ability to generate higher returns than the cost of capital.[22] The 2000 buyout of Tetley of Britain by Tata Tea, to create the world's largest tea company, was followed by a cooperation agreement between Tata Motors and MG Rover [though by 2005, the MG Rover group was being wooed by the Shanghai Automotive company: eds], the setting up of a software centre in Shanghai by Tata Consultancy Services, and the purchase of the truck division of Daewoo by Tata Motors and of the steel division of Singapore's NatSteel by Tata Steel, as well as plans to open hotels in Beijing and motor vehicles plants in South Africa and Thailand.[23]

In other emerging economies results are similar. In Chile, the hypothesis that group-affiliated firms are more profitable than independent ones in their foreign investments cannot be rejected (del Sol and Duran, 2002). Two highly-diversified conglomerates, Koç and Sabancı, not only continue to dominate the Turkish economy, but they have also developed internationally. Currently Europe's fifth-largest white goods company, Arçelik plans to double its sales in the next five years on the back of its investments in Germany and Britain (Goldstein, 2005b). Migros Turk, another Koç-affiliated firm, opened its first Ramstore Shopping Centre in Moscow in 1997, now operates more than 40 such stores in Russia, Kazakhstan and Bulgaria and plans to spend US$150 million a year opening new stores.[24] Nonetheless, the experience of D'Long, a big Chinese conglomerate with sizeable overseas interests that went bankrupt in 2004, is also indicative of the risks of such a strategy.

The impact on the host economies

Early work seemed to corroborate the expectation that EMNCs are better than OECD peers because they have a better appreciation of host economies' conditions, are culturally closer, use 'intermediate', small-scale technologies that directly substitute labour for capital. In a rigorous study, Lecraw (1977) controlled for industry composition and found that in Thailand foreign investors from other developing countries use more labour-intensive technology than either Thai firms or OECD investors.

As no such study has been carried out recently that includes a large sample of EMNCs among the foreign investors, it is necessary to limit ourselves to a few examples. In India, Hyundai Motors set up it largest overseas assembly factory in Tamil Nadu, where it also operates an aluminum foundry and a transmission line. Major suppliers from Korea also invested in the Ulsan automobile cluster, often through joint ventures with Indian partners. Hyundai now has 85 per cent domestic content, higher than any other foreign-owned car-maker in India (Park, 2004). In a similar vein, Park and Lee (2003) compare different foreign investors in the Shandong province in China and find that Korean firms relied much less on backward linkage with local firms than subsidiaries of US and Hong Kong firms.

On the other hand, Peru Iron was privatized in 1992 and sold to the China Shougang International Trade & Engineering Corp. for US$120 million, even though the company was only valued at US$22 million. Shougang's relationship with Peru has been rocky, marked with frequent labour troubles and spats with the government. A 2002 Peruvian congressional report cited Shougang's various failures to meet required investment targets, forcing the government to levy fines of US$12 million against the company. Further fines were issued in 2002 after the collapse of a containment area at one of Shougang's mines caused environmental contamination. The accident was said to be due to deficient design, non-compliance with prevention and safety rules, and the lack of an emergency plan. South African supermarkets in Zambia, Mozambique and Angola have been accused of sourcing almost exclusively from South African suppliers and of selling goods that are past their expiration date. Asian investors in the clothing industry in Lesotho, Namibia, and Swaziland have also been blamed for disregarding labour and environmental regulations.

A parallel issue is whether EMNCs, to the extent that they operate with essentially the same technology as their domestic counterparts, directly compete with – and eventually in detriment to – them. In his study of Nigeria, Narula (1997) suggests that while the scale and industry of operations are similar, emerging MNCs use technology which, 'although not necessarily proprietary, is "different" in that it has been "bundled" after being "unbundled" in other locations. This results in a lesser need to adapt the equipment, and reduces the cost of operation, although this reduction in costs is probably partly offset by the cost of maintaining a larger expatriate staff'. In Vietnam, where frequent electricity break-outs and the lack of a broadcasting network or satellite technology makes TV watching rather haphazard in some remote mountainous and rural parts of the country, TCL from China developed a 'powerful receiver' colour TV that provided much clearer reception than other brands (Yi, 2004).

Operating in OECD markets

EMNCs wish – and indeed need – to establish a direct presence in OECD countries to develop new resources and capabilities. They may find the welcome not too warm. In November 1995 the French government announced that it had reached an agreement with Daewoo to sell Thomson for one symbolic franc. Besides the polemic regarding the decision to dispose of a firm that, despite making losses, still held very remunerative patents, what made many French anxious was the idea of seeing a household name transferred to Korean owners. Nine years later, the first visit by officials from Bluestar – the first Chinese company to become, with no car manufacturing facilities of its own, the owner of a foreign carmaker – to Ssangyong, South Korea's fourth-largest automaker, was accompanied by worker protests that blocked entrances and prevented the Chinese visitors from entering.[25] And in 2003 the fears raised by the attempt of Mahindra & Mahindra, the Indian vehicle maker, to take over Valtra, a Finnish tractor manufacturer, were such that Helsinki provided financial backing to a rival consortium of local investors.[26] Ironically, the national security fears that surround the review of the IBM–Lenovo deal by the US government's committee on foreign investment bear a strong echo with the argument used by the Iranian parliament in blocking foreign control of Irancell.

Although data points are still far too few to allow for rigorous analysis, there is some evidence that, as far as industrial relations and relations with suppliers and customers are concerned, EMNCs find it relatively difficult to adapt to the business environment of more developed countries. Haier's autocratic management style, for instance, was something of a culture shock to American workers, many of whom found the deal an oddball, driven more by politics and prestige-building than common sense.[27]

Conclusions – the way ahead

This chapter has provided a broad overview of a phenomenon that – while not new in absolute terms – has grown in importance and accelerated in speed over the past decade or so. An analysis of data, besides pointing to the limitations that are intrinsic to all FDI figures and are even more serious in the case of Southern home investors, has highlighted that some emerging economies have become relevant players in the global economy and that some EMNCs may by now claim right to the status of real 'global players'.

For a EMNC aspiring to become a profitable international player and recognized brand, acquisitions may improves its chances, but in international business the 'edge' of low labour costs – one of an emerging economies' advantages in competing with Western rivals – is less and less important. In countless industries, the big winners are mainly masters of an ultra-efficient management of suppliers, assembly and distribution.

An important point emerging from this study is the heterogeneity of internationalization patterns and the need to explore in great depth the linkages between the political and institutional environment, on the one hand, and corporate trajectories, on the other. This point is certainly not novel – the 'varieties of capitalism' literature finds its origins in the analysis of OECD economies – and has even greater heuristic pertinence in the case of MNCs based in countries where, on account of weaker entrepreneurship, government institutions and policies have been so crucial in determining economic successes and failures.

Despite the caution that is needed when generalizing from what is a still limited number of studies, policy-makers in emerging economies should not view the relocation of their firms to labour-abundant countries as a challenge. When the parent company carries out labour-intensive activities abroad, upgrading usually take place in the (by now) relatively capital-abundant home country. In other words, to the extent that EMNCs invest overseas to optimize the use of their resources, corporate relocation of production through multinational activity is an additional instrument that emerging economies have to exploit their comparative advantage to the fullest.

Notes

1 The official names for these entities are Hong Kong (China) and Taiwan Province of China, shortened here for simplicity.

2 If the end of the apartheid regime has certainly contributed to the acceleration of South African investment in other countries in the region, the majority of the firms surveyed by the SA Foundation (2004) already had a presence in other African countries well before 1994.

3 At least in the case of Brazil, the relative weight of tax havens is indeed in all likelihood underestimated, since destinations such as Ireland, Luxembourg and Switzerland receive abnormally high FDI outflows. Due to Taiwan, China government restrictions and tax benefits, Taiwanese investment in China is often routed through third countries. Because official PRC statistics for foreign direct investment report immediate origin instead of original source, the British Virgin Islands currently rank as China's second largest source of FDI.

4 This, however, does not show up in the table since a major Brazilian investment, Ambev's takeover of Quilmes, was registered in Luxembourg where the latter is incorporated.

5 'The Chinese either have the skills to a large extent and [... for] skills they don't have ... they are very clever at acquiring them in joint ventures', says Carlos Möller, international director at Germany's Bilfinger Berger, 'but they are reluctant to give out a large share'. 'Firms Cautious Despite Uptick', *Engineering News Record*, 23 August 2004.

6 In Africa, Chinese companies reportedly pay their own workers salaries which are lower than those paid to local managers ('La Chine déstabilise l'Europe', *J.A./L'intelligent*, 28 November 2004). See also Pheng and Hongbin (2003).

7 Taiwan has long had its own 'Go South' (陳水扁) strategy. The policy, first announced in 1994 and reintroduced by President Chen Shui-bian in 2002, aims to lessen Taiwan's economic dependence on China by encouraging business firms to invest in Southeast Asian countries.

8 'China eases control on overseas investment', *Financial Times*, 12 October 2004.

9 In December 2004 the State Development and Reform Commission (SDRC) had raised the approval ceiling for provincial authorities.

10 However, Wells (1983) also notes that governments may prefer to deal with experienced firms from OECD countries, rather than with up-and-coming competitors from poorer countries.

11 'Oil and gas needs give Moscow influence', 11 February 2005.

12 According to a survey conducted by Vinaye Dey Ancharaz, Senior Lecturer in International Economics, University of Mauritius (personal communication, 1 December 2004).
13 Empirical analysis indeed shows that in the early stages of South Korean FDI, firms targeted areas with large populations of emigrant Koreans in the USA, northeast China and central Europe.
14 No employer can determine whether an employee is deploying his skill in managing low-wage labour or exploiting his local connections to the fullest. Such contracts cannot be monitored, verified or enforced.
15 The total FDI stock would be lowered by about 45 per cent if China's economic centre were located in New Delhi, India, and would be lowered by about 70 per cent if China's economic centre were located in New Delhi *and* there were no cultural ties.
16 'Seeking the most hardy investors', *Financial Times*, 30 September 2004.
17 Indeed, while we follow UNCTAD and consider this an EMNC, Wells (1983) does not – arguing that 'not only must the ownership be in the hands of developing country nationals but management must be from the local culture' (p. 7).
18 Although the Keswicks hold less than 10 per cent of the group, the family dominates voting rights through a complex ownership structure that in theory is supposed to render Jardine raider-proof.
19 At the end of 2003 excess supply characterized 78.8 per cent of China's main indicator commodities.
20 'Microwave power', *Fortune*, 24 November 2003.
21 Ratan Tata, in 'Tata takes its wares to the world', *Financial Times*, 26 September 2003.
22 Ratan Tata, in 'India's largest group faces end of an era', *Financial Times*, 29 September 2004.
23 Daewoo production has already risen by 10 per cent since the ownership change ('Tata Motors looks to widen investor base', *Financial Times*, 27 September 2004).
24 'A retail invasion from Turkey', *Business Week*, 15 December 2003 and 'Strong growth in the pipeline for Koc' (*sic*), *Financial Times*, 3 December 2004.
25 Bluestar won against General Motors (GM), DaimlerChrysler and Shanghai Automotive Industry Corp (SAIC) to take control of the SUV maker despite the fact that its only connection to car manufacturing is a chain of auto repair shops from which it derives a sixth of its sales. The rest of its business comes from detergents, petrochemicals and a chain of noodle shops. An interesting twist was added to the affair by an SAIC announcement that the government had appointed it as the sole Chinese bidder for the deal and Bluestar did not have permission to take over Ssangyong.
26 'Finnish ministers face pressure as Indian group targets Valtra', *Financial Times*, 29 August 2003.
27 'Haier Reaches Higher', *Fortune*, 12 September 2002.

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9

Is Lean Production Sustainable? The Rise and Decline of Neo-Fordism

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Introduction

Significant changes are underfoot that are transforming the mass production system (MPS) that has dominated many economies for most of the twentieth century. Womack *et al*. (1990) had noted the shift from mass production towards a lean production system (LPS) in recent decades. However, I suggest that these changes do not extend far enough, and will need to incorporate greater concern for sustainability in the twenty-first century. These further changes will lead in the direction of what may be called a 'sustainable production system' (SPS).

This chapter argues that lean production represents only a transitional feature in the shift away from mass production. In this regard, we shall examine the limitations of lean production that impinge adversely on the longer-term resilience and sustainability of lean production. These will generate forces that lead towards more radical changes in production systems and their associated institutions.

Conceptual foundations of mass and lean production: from Adam Smith to Taiichi Ohno

Lean production practices draw on key concepts that may be traced back at least to Adam Smith. Briefly, we examine here some significant ideas from Smith, Frederick Winslow Taylor, Henry Ford, Kiichiro Toyoda and Taiichi Ohno, to note the significant underpinnings that they provided to the practices associated with mass production and lean production.

Adam Smith: division of labour and specialization

Smith's conceptualization of specialization and the division of labour laid the foundation for a view of the production process in which the effective meshing of separate and specialized individual contributions to the production of goods, enhanced societal well-being more significantly than less-specialized methods of production and self-reliant forms of economic activity. From the opening statement of his famous text, we learn that, 'The greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity and judgment with which it is anywhere directed or applied, seem to have been the effects of the division of labour' (Smith, 1776, Book 1, chapter 1).

Smith attributed this outcome to three reasons: 'first, to the increase of dexterity in every particular workman; secondly, to the saving of the time which is commonly lost in passing from one species of work to another; and lastly, to the invention of a great number of machines which facilitate and abridge labour, and enable one man to do the work of many'. In relation to specialization, Smith noted that, 'the improvement of the dexterity of the workman necessarily increases the quantity of the work he can perform; and the division of labour, by reducing every man's business to some one simple operation, and by making this operation the sole employment of his life, necessarily increased very much dexterity of the workman' (Smith, 1776, Book 1, chapter 1).

Frederick Winslow Taylor: scientific management

Frederick Taylor advanced Smith's ideas further by elaborating on how the division and coordination of specialized work activities could be determined more systematically to achieve even better results. He formulated his ideas and findings into the principles of 'scientific management'. With a strong focus on improving efficiency and performance in work processes, Taylor (1947) emphasized the need for proper planning, inspection, measurement, recording and monitoring. Taylor sought to demonstrate how work performance could be raised very substantially, by discovering the best manner of organizing work activities, through systematic observation, calculation and detailed analysis. By these means, the division and specification of specialized work tasks, suitable training, and the appropriate payment systems and rates of reward, could all be determined scientifically. Furthermore, 'In the spirit of Adam Smith, he believed in the proposition that men are motivated largely by financial gain; thus, he could justify almost any productivity-enhancing measure as long as it improved wages … He pressured workers into producing quantum leaps in efficiency in exchange for incremental increases in pay' (Gabor, 2000, p. 7).

In many cases, this involved centralized control, removing autonomy of thought and action from the worker, and determining by prescription the precise nature of the efforts, sequence, speed and timing of the work tasks. The detailed specification of the requirements of the job were carried out by 'work study engineers' who issue directives to employees to eliminate idle time, unnecessary efforts, unfocused concentration and conflict, that are 'wasteful' and that impinge adversely on productivity. These efforts to determine specific ways of 'working smarter, not harder' tended to lead to prescriptions of the 'one best way' to conduct work – that is, the way determined by the work study engineer, not the employee engaged directly on the job:

> Along the way, scientific management changed the way of life of the expanding ranks of industrial workers. The most skilled among them saw the Taylorites break their work down into its component parts so that men with little skill or training could master it. Bit by bit the factory worker lost control of his tools, the process of production, even the way he moved his body as he worked. (Gabor, 2000, p. 7)

Furthermore, Gabor (2000, p. 43) suggested that 'Without Taylorism, large-scale mass production would have been impossible.'

Henry Ford: mass production

The above concepts and practices fitted very well with, and found practical application in, the practices of mass production that emerged from the efforts of Henry Ford. Ford's car manufacturing plants became embodiments of Smithian and Taylorist principles.[1] Furthermore, Ford's growing success and renown served to confirm for many people the validity, universality and undisputable superiority of those principles. This fed the growth of American pride, and enhanced conviction in the superiority of the 'American way'.

However, Shimokawa (1993a, p. 87) argued that 'the mass production system itself was not something that started on the basis of Ford's idea. Rather … [it emerged from] a combination of trial-and-error efforts on the part of a group of engineers and management executives within the Ford organization after production of the Model T began in earnest.' Shimokawa also noted that:

> the Ford system already contained, from its very beginning, a concept very similar to the concept of a JIT production system: the

> idea of effecting a synchronization of production with a minimum inventory of parts and partially processed components, along with the corollary of instituting synchronization in the delivery of necessary parts. (*Ibid.*: 90)

However, as a result of unexpectedly high demand for the Model T, production at Ford evolved into a system that placed strong emphasis on mass production to achieve large economies of scale, based on continuous automation and synchronization of assembly-line production.

This led Ford away from the possibility of a just-in-time ('pull') production system and into a 'push' production system in which outputs from earlier stages in the production process were continuously pushed on to later stages in the production process by the rapid speed set for the assembly line. To ensure a smooth and continuous flow of the assembly line, stocks of material inputs were built up just in case shortages were to occur and interrupt the continuity, synchronization and economies of scale imperatives of the mass production system. The substantial benefits of that production system in increasing the total volume of output, lowering costs and raising profits for Ford, while producing affordable cars for the mass market, were offset by the prerequisites of simplification and deskilling of work tasks, standardization of materials, fixed schedules, constant and rapid speed of the assembly line, and uniformity of the final product. Ford is widely quoted to have remarked on the Model T that, 'You can have any colour you like as long as it's black.'

The significant constraints associated with the mass production system made it, in effect, a very rigid system of production. This was not apparent initially, when the competition was insignificant, demand for affordable mass produced cars was high, and the economy was booming. However, in later years and decades, conditions changed substantially and the severe constraints, rigidity and wastefulness of the mass production system became increasingly problematic.

Kiichiro Toyoda and Taiichi Ohno: just-in-time 'lean' production

Kiichiro Toyoda conceived of the idea of just-in-time (JIT) production from his reading of Henry Ford's writings and from his observations of the operations of the Ford River Rouge plant. According to Shimokawa (1993, p. 84):

> the heart of this [JIT] production system lies in making mass production efficiency compatible with flexible production, which is

> symbolized by multi-product small-volume production adjusted to demand trends.
>
> JIT is in reality a more thoroughgoing line synchronization … [of] the starting point for the Ford system, one that created a system able to adapt flexibly to quantitative and qualitative changes in production through communications to all corners of the workplace … as they respond to market trends and shifting conditions on the production line by using notice boards (*kanban*) on which were posted information on when, where, and who has to produce how many lots of parts and where the lots have been delivered.[2]

Toyoda's desire for a more flexible production system stemmed from the smaller (than the USA) market in Japan which would not be able to absorb the large volumes of output needed to achieve the economies of scale associated with American Fordist mass production. However, it is noteworthy that Toyoda was unable to introduce JIT practices during the conditions of wartime Japan. Specifically,

> [his] 'just in time' ideas could not be put to the practical test because what he originally worked out for passenger-vehicle production was absorbed by wartime production, and as a result Toyota's auto production had to start from plants mass producing trucks to meet wartime demand. At the Toyota plant undivided attention had to be given to raising the scale of mass production of wartime-standard trucks made to meet wartime production schedules, and large numbers of unskilled workers had to be taken on; it was impossible, then, to undertake the necessary experiments called for by his ideas, only a small portion of which were to survive. (Shimokawa, 1993a, p. 99)

Instead, Taiichi Ohno implemented JIT production practices in Toyota after the Second World War. In 1954,

> he instituted a system that began with the final process and indicated the number of products that would be needed and the production sequence desired, then, in order, had the later stages go to take delivery of parts from earlier processes, and the earlier processes would make only the amount that had been taken away by the later processes; this method permitted the synchronization of all the parts of production, from final assembly to raw materials, in a chain-reaction type of arrangement. (Shimokawa, 1993a, pp. 102–3)

Over time, relative to Fordist mass production, Japanese firms have been successful in developing superior forms of just-in-time production based on *kaizen* practices, and employee management involving long-term employment, extensive job-rotation and on-the job training, strong teamwork and keen employee motivation. Together, these constitute the so-called lean production system (LPS) (see Ohno, 1988; Womack *et al.*, 1990; Monden, 1993; Kotha, 1996; Itagaki, 1997). These, in combination with very effective corporate supporting networks (*keiretsu*), provided Japanese firms with very significant competitive advantages (among others, see Hayes, 1981; Krafcik, 1988; Monden, 1993, Spear, 2004). As the Toyota (Japanese) lean production system was an improved, more sophisticated and more flexible application of Ford's early ideas, it may be labelled Neo-Fordism, to delineate both its genealogy as well as its constraints.

The diffusion and impact of lean production

There has been an aura of superiority about lean production that has prevailed until the present. Indeed, where it appeared that there are 'two seemingly irreconcilable visions of management – the scientific and humanistic – that have battled for hegemony both in the corporate workplace and in American society itself' (Gabor, 2000, p. xii), lean production in Japan appeared to have achieved a successful integration and synthesis of both approaches to management. This seemed to provide lean production with the capability to transcend the tensions and conflicts that seemed to characterize adversarial industrial relations in the West. The emergence and growing acclaim for lean production coincided with problems experienced elsewhere, including the USA. Skinner (1985, p. 83) noted that, 'By 1980 … [American] confidence in manufacturing leadership had largely collapsed'. This helped to create a 'learn from Japan' movement in the USA that also spread to Europe, Asia and other countries (see Sanidas, 2001; Kaplinsky, 1994; Kawabe, 1997; Kriegler and Wooden, 1985). Because of growing accusations of 'unfair competition' and rising trade tensions between Japan and the USA, caused by rising exports from Japan of cars and other products in the 1980s, and growing US trade deficits, the Americans threatened Japan with trade sanctions and other retributions. As a consequence, after the 1985 Plaza Agreement, the yen appreciated markedly against the US dollar, and Japanese (car) companies began to set up car assembly plants in the USA in collaboration with American car companies, to forestall more severe trade consequences. The earliest well-known collaboration occurred between General Motors and Toyota in the NUMMI plant in Fremont, California, in 1984.[3] Thus, Toyota introduced its LPS to General Motors. Soon other Japanese car companies followed (including Honda, Nissan and Mitsubishi). By this means, the LPS was diffused in America, and that raised performance in America significantly (Sanidas, 2001).

However, over time, as markets for cars (and other products) became increasingly saturated as the 'long-wave' economic downswing progressed, this improved performance from the introduction of the LPS eventually resulted first in declining profits, and subsequently in increasing losses. At present, General Motors is in severe financial strife, with about US$300 billion in debts.[4] Ford is also in significant difficulties.[5]

In Japan, the economy slumped in the 1990s, and has experienced slow growth since then. The recovery from that crisis remains tenuous. These conditions have also helped to reveal the limitations and problems associated with the LPS. These include traffic congestion, labour shortages, excessive product variation, stressed suppliers and financial constraints on product development (Cusumano, 1994). Most significant in this regard is the substantial financial difficulties of the Japanese car companies in the 1990s to the present. With the exception of Toyota and Honda, other Japanese have been partially or wholly taken over by foreign competitors; for example, Nissan by Renault, Mazda by Ford, Isuzu and Suzuki by General Motors, Mitsubishi by Daimler-Chrysler. Clearly, the LPS has not saved the Japanese car companies from having financial difficulties. Indeed, these companies have also been subjected to severe restructuring and cost-cutting.

Smitka (1993) had been pessimistic about the prospects for the Japanese car industry, and Shimokawa (1994, p. 156) had noted that:

> The Japanese automobile industry, which set about de-maturing the world automobile industry … does not necessarily have a promising future. It is certain that automobile industries of the world will compete harder and harder, and trade friction will linger for a long time.

Subsequently, Shimokawa (1994, pp. 158–9) also noted that:

> Ironically, an excessive concern for model diversity and production flexibility resulted in the destruction of the 'lean system'. Indeed, he predicted that 'The low-profit age for the Japanese automobile makers is set to continue for some time to come owing to the maturity of the domestic market and trade frictions in the economically advanced countries.'

These difficulties led to significant changes in the Japanese car industry. The experience of Nissan is very significant in this respect. After suffering substantial losses and ineffective initial reforms earlier in the 1990s, an alliance with the French car manufacturer, Renault, led to the appointment of a foreign corporate head, large-scale restructuring, major plant closures and many job losses along the American model. This breaking of the social contract implicit in the Japanese employment system was supported by the Nissan union, MITI and the government (see Tiberghien, 2005, pp. 365 ff), following a period of financial crisis and stockmarket slump in Japan and other Asian countries. The experience of low-level economic growth and the prospect of rising unemployment (Khan, 2003) also gave impetus to these efforts. The subsequent return to profitability in Nissan following these efforts provided apparent confirmation of the necessity and the wisdom of the drastic changes.[6]

However, Oidon (2003) reported that:

> The number of Nissan employees in Japan reduced from 57,000 in 1990 to 38,000 in 1998. It became obvious that Nissan's management policy was to cut the number of employees as easily as cutting the tail off a lizard. Without knowing the pains experienced by the workers, it gave up the idea of company reconstruction and quickly turned to foreign capital without shame.

Indeed, when Renault, acquired a substantial stake in Nissan in 1999, more substantial restructuring and cost-cutting was imposed by Carlos Ghosn,[7] a Renault-appointed CEO, resulting in five factory closures and 21,000 retrenchments.[8] Opposition to the changes included the following objections:

> The plan imposes many sacrifices upon workers while disclosing the company's negligence and responsibility for the past management system as well as its social responsibility as a well-known company.
>
> There is no doubt that as a result of the plant closure, the workers will be transferred to other plants located in remote areas where they are unable to commute, or forced to accept early retirement.
>
> The plan will not only destroy the lives of workers at the plants and the parts-producing companies as they may be pushed into bankruptcy by low-cost competition, but also will affect the local economy where host plants and companies are located. (Oidon, 2003)

Nevertheless, the changes proceeded, the social costs were ignored, and subsequently Nissan's profitability improved significantly. But, clearly, the Japanese employment system had been undermined.

In Mitsubishi, too, there had been evidence of significant strategic, performance, financial and ethical problems,[9] and subsequent substantial cost-cutting to reduce manpower. Next, Mazda followed the earlier restructuring and cost-cutting examples set by Nissan and Mitsubishi. In this respect, these companies were emulating the strategies initiated earlier by American car manufacturers, General Motors, Ford and Chrysler, for whom lean production had also not proved to be sufficient to resolve their problems (see Keller, 1997).

The China price

More than ten years ago, Dassbach (1994) predicted that America was headed for 'low-wage lean production', arguing that 'if "high-wage lean production" can be profitable, "low-wage lean production" can be even more profitable.' However, on that point, at present China could beat all competitors in this field, and would thus be a much better investment location. To appreciate this argument, we should take note of 'the China price' phenomenon (Engardio and Roberts, 2004; Dawson, 2005).

At present, all major American, European and Japanese car manufacturers have established production facilities in China, and these facilities are likely to increase over time. Thus, 'the China price' will become an even stronger factor in global competition over time. This is causing growing apprehension around the world (see Greider, 2001; Fishman, 2005), as more and more foreign companies relocate their production of cars[10] (and a wide range of other products) to China. In his 2004 Annual Report statement, Toyota's President noted that:

> The development of operations in China is currently our most intensive overseas allocation of management resources. Toyota is concentrating on China because success in that market will be a decisive factor determining the balance of power in tomorrow's automobile industry. With that in mind, I want to carve out an approximately 10% share of the Chinese market by around 2010. To achieve that target, we will reinforce and expand our operational foundations at an unprecedented pace.[11]

As the global economic downswing progresses, the economic imperative in the intensifying competitive process in the game of corporate 'musical chairs' continues to spur this development. Investment, production, employment, wage levels, working conditions, and living standards in other locations and countries are likely to be significantly stressed by this development. Directly and indirectly, there will be increasing pressures for further restructuring, rationalization, cost-cutting, downsizing, outsourcing and other adjustments in response to this development. To appreciate the effects, consider the changes that Toyota has introduced in recent years:

> Toyota's cost cutting Program [introduced in 2000] – dubbed CCC21, or Construction of Cost Competitiveness for the 21st Century – has been a remarkable success. With just one year to go, the plan is on track to save the auto maker some $10 billion over its five-year time frame. Not only is CCC21 sourcing components more cheaply but Toyota has also improved the parts' quality. The program has even bested archrival Nissan Motor Co. whose chief executive, Carlos Ghosn, kicked off the savings scramble in 1999 by pledging 20% cuts in procurement costs.

But where does Toyota go from here? Even after putting its supply network through the wringer, Japan's No. 1 carmaker can ill afford to rest. Toyota may be under more pressure now to cut costs than when it began CCC21. So the drive is on to replace expensive materials, benchmark Toyota's auto parts against Chinese-level pricing, and squeeze its Japanese suppliers further by relying more on non-*keiretsu* parts makers. 'We need to adjust our cost-cutting drive to meet a whole new set of challenges', says Katsuaki Watanabe, 62, the executive vice-president who helped devise and supervise CCC21. In a sign that streamlining is still a top priority, the company announced on 9 Feb. 2005 that Watanabe would take over as president of Toyota from Fujio Cho in June (Dawson, 2005).[12]

These statements highlight three important issues. First, Toyota (and its competitors) is trapped on a treadmill where it appears to be 'under more pressure now to cut costs than when it began CCC21'. That is, the pressures are relentless and rising. Second, Toyota's Japanese suppliers, operating in Japan with Japanese wage costs, will be expected to match the price of materials produced by suppliers operating in China with Chinese wage costs. The deep significance of what is being proposed can only be appreciated by the realization that the general level of manufacturing labour costs in China is more than fifty times lower than that in Japan (see World Bank, 2002, p. 45). Third, the statement that Toyota will 'squeeze its Japanese suppliers further by relying more on non-*keiretsu* parts makers', means that Toyota is prepared to go outside its traditional ('family') network of suppliers. This is likely to weaken (if not threaten) that 'family' network. That is, Toyota, too, will become leaner and *meaner*, just like other lean producers. Indeed, Oidon (2003) reported that:

> Despite the fact that Toyota Motor Company was recording the highest current account profits in its history, it did not stop attacking workers using 'economic depression' as an excuse. Production has already reached the limit of plant capacity, yet the downsizing tactics were still on the way to being implemented. Many workers are exhausted from overtime work every day. They say, 'When I get home, all I can do is take a sip of alcohol and go to sleep. How could I possibly remove my exhaustion?' It is no wonder that the number of suicides is increasing, and there is no guarantee that we will have no accidents at work as happened at big-name companies like Bridgestone where workers also suffered from restructuring. All those troubles can be attributed to a failure of management and its malicious proposal.

Nevertheless, attack from the management never stops. In addition to the recent degradation of the salary system, the company abolished the age-based salary system totally and proposed a change in the retirement allowance system. The company and the union officers held several meetings to discuss 'possibilities to change the company's severance systems'. Through the months of discussions Toyota management tried to abolish the age-based salary system of the plant workers, as it had already done to the office workers. This way the management developed an integrated pay system, the 'merit-based system'. Management emphasized that with the current salary system, we had no chance to 'win the international economic war with countries like China'. They also told workers that the 'age-based system is already out of fashion' and 'even if you make an effort at work, you won't be rewarded properly under this salary system'. In fact, they were only making poor excuses such as the rapid growth of Asian countries and domestic economic repression for exploiting workers. In order to increase company profits, it does everything from forcing workers to compete with each other to exploiting them with unacceptable salaries.

The exploitation can also be observed in the change of the retirement allowance system from the 'basic amount of salary at the time of retirement times the coefficient' to 'evaluating one's performance every year during one's employment period, and convert the total points to the retirement allowance'.

In short, where improved working conditions, commitment, employment security and trust have been weakened or even evaporated for many American employees much earlier (see Mills, 1996), these aspects of the Japanese employment system will also come under serious threat, as Japanese companies, including Toyota, strive to raise profits in the 'battle for global supremacy',[13] which is also a battle for survival as more competitors are eliminated from the field.

Lean production and workforce management

Despite some expressions of interest in the well-being of employees by Frederick Taylor and Henry Ford, this was not sufficient to offset perceptions in various quarters that their influences on work practices are often excessively controlling, manipulative, alienating, and even exploitative. These characteristics tend to be more pronounced in periods of intense market competition, in economic recessions, in labour-surplus situations, and in activities that are susceptible to mechanization and automation. These concerns can generate significant stress, tensions and conflict in organizations between management and employees.

Human Relations management theories and practices[14] have emerged seeking to resolve these problems and to promote more enlightened forms of management, based on notions of common interests, concern for the well-being of employees, employment security, investment in human capital through extensive training and development efforts, multi-skilling, teamwork, positive rewards and better working conditions (quality of working life) to improve motivation, morale, esprit de corps, and provide a sense of community in the organization. The lean production system in particular, and the Japanese employment system in general, is widely portrayed to place strong emphasis on these positive features.

However, the reality in several cases does not clearly support this portrayal. For instance, Clarke (1998) argued that:

> the evidence in virtually every case study [indicates] that: (1) workers generally find work very stressful under lean production; (2) lean practices are usually most fully implemented where unions are weakest or non-existent; and (3) outside Japan, the introduction of lean practices has been associated with substantial downsizing. This evidence undermines proponents' claims that lean production requires

> or delivers a committed workforce and that employment security is an essential contributor to commitment. If lean is not currently meeting the needs of workers for sustainable work, it is difficult to envisage how it will evolve in that direction.

In relation to the tendency towards the displacement of labour in the production process, Sei (1993, pp. 14–15), noted that, ‘In the new type of labour organizations, the core of the system consists of engineers who are working with a very small group of remaining workers with highly advanced skills. These new organizations have the effect of conspicuously lowering the significance of direct workers involved in the production processes, through the realization of extensive automation.’ One assessment of the experience in the USA reported that:

> what is critical in current changes in workplaces, is not the replacement of Fordism by lean production and the end of alienation of employees from their work, as the supporters of flexible systems of work organization and Lean Production would have us believe. Rather companies that prioritize work reorganization in their efforts to regain competitiveness and increase productivity, are intent upon changing the production standards and the wage effort bargain implicit in the post World War II compromise reached by automobile companies and their employees in North America. New models of work organization are therefore not about empowerment but rather about reasserting company control over how hard, how long, and under what conditions employees will work. Rather than encouraging participation and improved quality of worklife, employees experience less control over their work day and find work in automobile plants harder and more constraining. (Yates, Lewchuk and Stewart, 2001, p. 48)

According to Post and Slaughter (2000), from the perspective of employees,

> the 1990s has been a decade of intense economic contradictions. On the one hand, profits are at their highest level since the 1970s. Corporations are doing better today than at any time in the last thirty years. And most ordinary working people are doing worse. What’s wrong with this picture?
>
> Part of the reason we’re hurting is the changes employers have made in the way they organize work, and therefore in the way they

> make us work. The new work system, which got its start in the auto industry in Japan but is now used all over the world, is called lean production.
>
> Lean production is the cutting edge of the corporations' and governments' attempt to reorganize social life. Lean Production judges everything and everyone on the basis of speed and productivity. If anything or anyone does not fit the needs of speed and productivity, they are disposable – whether they are a good, service or whole categories of people.

Furthermore, they argue that:

> The heart of lean production is reorganizing work to cut costs. Sometimes it goes under names like 'Total Quality Management' or 'team concept' or 'reengineering', but we prefer the more accurate title 'Management by Stress'. Any worker is familiar with the 'slogan of the month' new programs management comes up with to increase productivity. While they say they want workers' 'input', what they're really looking for is more 'output'. (Post and Slaughter, 2000)

Indeed, the rhetoric of lean production may hide some unpleasant realities:

> From management's point of view, the beauty of lean production is 'eliminating waste' – getting rid of 'excess' activities, materials and workers. The only problem is, their definition of 'waste' includes most things that make work life bearable, like breaks, or a reasonable pace, or a set work schedule, or a decent pay check, or job security. To get the greatest bang for the buck, lean production stresses workers to the limits of their capacities. (Post and Slaughter, 2000)[15]

Earlier concerns about lean production practices in Toyota's operations in Japan had also been raised by Kamata (1982), who wrote:

> I wanted to show the inhumanity of it all – not only its inhumanity but also the unquestioning adherence to such a system. Is the prosperity of a modern, industrial society worth such a cost, such a cruel compulsion of robot-like work? If the production of cars – mere machines – necessitates such a sacrifice of human freedom, just what does this say about the paradox of modern civilization? (Kamata, 1982, p. viii)

Kamata believed that the work situation in Toyota had worsened despite the introduction of robots for selected operations such as painting and welding. Indeed, more recently Tsutsui (1998, p. 187) provided the following assessment:

> In some ways, however, the Toyota system did constitute an application of Taylorite principles more rigorous than even what American managers were accustomed to. Pursuing waste elimination with a thoroughness bordering on obsession, Ohno and his colleagues were able, in the words of one Western analyst, to 'out-Taylor us all'. In his attempts to slash 'non-value-added work', for instance, Ohno applied job routines far stricter than the standards recommended by American Taylorites or the experts of Japan's efficiency movement. Under the Toyota regime, standard times for workshop tasks were based on the abilities of the most skilled workers, rather than being pegged at an average level or set in accordance with scientifically determined optimal times. As Ohno explained, 'If you are going to run the operation 10 times, take the shortest time as the standard. Some people say this makes the standard too stringent, but what is stringent about it? Whatever method takes the shortest time is the easiest.' What's more, Ohno warned, 'When you establish standard times, leave no breaks at all for workers to attend to personal hygiene.' Indeed, Ohno seemed to believe that even the slightest wasted motion or idle time on the part of workers was a form of idling and had to be eradicated. Going beyond the most rigid Taylorite notions, Toyota ordered that employees with time to spare stand at attention by their machines or report to a designated area so that managers could see that they were underutilized and could assign them additional duties.

What implications do these practices have for the famous 'Japanese employment system'? Since the economic slowdown in Japan in the 1990s, the Japanese employment system, which seemed to be the bedrock of the LPS, has been subjected to criticism from various quarters for myriad reasons. The decade-long economic slowdown seemed to suggest that, even if the Japanese employment system had been a necessary condition for Japan's earlier economic success, the economic downturn demonstrated that it is not a sufficient condition. Some have doubted whether it is even a necessary condition, and called for reforms to rid it of rigidities, and to make it more responsive to market requirements. In this regard, instead of seeing, as Dore (1982, p. xxxvii) did, that the good performance of Japanese workers in earlier decades in companies like Toyota was based to a significant degree on the implicit social contract ('trustful submissiveness') incorporated in the Japanese employment system, pro-market observers such as Schaede (2003) have blamed the inflexibilities of that contract for Japan's economic slowdown in the 1990s. They see the abolition of that contract as the solution paving the way for more radical market-oriented restructuring of production operations and of worker-management relations along American lines.

Another line of criticism of lean production, and its associated workforce management practices, argues that it is actually not so different from its predecessor, especially with their common roots in Scientific Management. Contrary to perceptions that lean production represents a fundamentally different and superior production system to that of mass production, Tsutsui (1998) argued that lean production has its roots in the same principles, practices and ideology of Taylor's Scientific Management that support Fordist mass production. He noted that:

> In the particular economic, social, political, and technological context of twentieth-century Japan, the practice of Taylorism was subtly reshaped into a specifically Japanese approach to modern management. Seeking an enhanced formulation – a 'revised' Taylorism – that combined mechanistic efficiency with a 'humanized' appeal to labor, Japan's industrial managers experimented with a variety of institutional forms, rhetorical tactics, and methodological innovations. The Japanese refinement of Scientific Management, eventually systematized and disseminated as the total quality control concept of the 1960s, allowed firms to exploit the technical benefits of Taylorism while avoiding the determined opposition of workers and labor unions. Thus, while remaining consistent with Taylorite imperatives, the Japanese practice of modern management ultimately traced a distinct trajectory of development. (Tsutsui, 1998, p. 11)

Tsutsui also observed that, 'throughout this century, both American and Japanese management experts have been speaking in the same idiom, an idiom premised on a "humanized" revision of Scientific Management'. However, he argued that:

> In Japan as in the West, managerial commitment to the humanization of work has remained shallow and, for the most part, rhetorical rather than practical: even Japanese innovations like quality circles, so widely praised as models of democratic and compassionate

> management, were born of the perennial managerial drive to Taylorize the shop floor. Although a few scholars have detected latent revolutionary implications in contemporary Japanese arrangements … such potential is, and appears likely to remain, deeply repressed. (*Ibid.*: p. 243)

Furthermore, it may be argued that the fundamental reason that even the Japanese version of 'humanized Scientific Management', expressed in the tenets of lean production, remains shallow, may be attributed to the primacy accorded to the economic imperative; that is, the overriding focus on the financial bottomline, which has also been the ultimate criterion of success in Taylorist principles, practices and metrics. For this reason, too, the LPS does not offer an effective solution to the problems of the competitive process during the phase of economic downswing. During this phase, whatever earlier reality there may have been, behind the humanist rhetoric purporting to promote security, trust, teamwork and cooperation for mutual benefit, will be squeezed by the perceived need to become leaner and meaner in the struggle to improve profitability (see also Kamata, 1982; Post and Slaughter, 2000; Yates *et al.*, 2001; Bruno and Jordan, 2002). However, despite all the leanness and the meanness, Japan's general economic performance remains in the doldrums (Patrick, 2002; Khan, 2003; Madsen, 2004), and there is also substantial social deprivation and dislocation (Hosak and Shimokawa, 1999; Bhaskaran, 2002; Curtin, 2005).

Lean production in China: possibilities, problems, and prospects

Although lean production has not provided a panacea for either the USA or Japan, can lean production provide a bright future for China? Chen *et al*. (1997), and Lee (1998) have reported on the introduction and spread of lean production in China. Undoubtedly, lean production techniques will be strengthened and diffused further, and will also improve China's economic performance significantly. Indeed, coming from a relatively low base compared, for example, to the USA, lean production is likely to dramatically advance production capabilities and performance in Chinese manufacturing.[16] However, it can be expected that this process could also heighten economic and social disparities in China (see Ong, 2004; Wolfe, 2005), as well as compound further its environmental difficulties (Economy, 2004).

Moreover, as China industrializes and develops further, this will increase American perceptions of China as a looming 'strategic competitor'.

Already the US–China Economic and Security Review Commission (2004) had expressed significant concerns, proclaiming that 'the Commission believes that a number of the current trends in U.S.–China relations have negative implications for our long term economic and national security interests, and therefore that U.S. policies in these areas are in need of urgent attention and course corrections' (2004, p. 1). Indeed, the Commission asserted that 'China will likely not initiate the decisive measures toward more meaningful economic and political reform without substantial, sustained, and increased pressure from the United States' (2004, p. 2; see also Bronfenbrenner and Luce, 2004; Williams, 2004; Yuan, 2005). Klare (2005) and others perceive that China's continuing development will lead to growing US–China competition for oil and other resources, and this also poses significant potential for conflict.

Indeed, at the turn of the century, a very influential group associated with the Project for a New American Century (PNAC) had proclaimed that, 'At no time in history has the international security order been as conducive to American interests and ideals. The challenge for the coming century is to preserve and enhance this American peace' (PNAC, 2000, p. iv). In this context, 'American strategy for the coming decades should seek to consolidate the great victories won in the 20th century … while setting the conditions for 21st-century successes, especially in East Asia' (PNAC, 2000, p. 5). Specifically, 'Raising U.S. military strength in East Asia is the key to coping with the rise of China to great-power status' (PNAC, 2000, p. 19).[17] Within the US military, there has also been an expectation of continuing conflict. One member of the military warned explicitly that:

> There will be no peace. At any given moment for the rest of our lifetimes, there will be multiple conflicts in mutating forms around the globe. Violent conflict will dominate the headlines, but cultural and economic struggles will be steadier and ultimately more decisive. The de facto role of the US armed forces will be to keep the world safe for our economy and open to our cultural assault. To those ends, we will do a fair amount of killing. (Peters, 1997)

In this context, any significant improvement in economic performance that may be derived by China from advances in lean production is likely to add to its difficulties as much as this adds to its benefits. For instance, it could be cited to justify and support existing American allegations that China is competing unfairly. Inevitably, according to Roach (2005), 'With America beset by record trade- and current-account deficits, the drumbeat of protectionism is getting louder and louder in Washington. Not surprisingly, the assault is taking dead aim on China.'[18]

Thus, once again, the tendencies towards over-production and under-consumption are generating tensions that are promoting conflict; on this occasion, exacerbated by the dynamics of the lean production system. However, any outbreak of hostilities would be very damaging to the now highly vulnerable just-in-time supply chains that are relying on efficiencies from very fragile low-inventory practices. As these vulnerabilities intensify, we will see a reversal from just-in-time to just-in-case production practices, commencing with growing inventories of critical inputs including, in particular, stockpiles of oil and other strategic resources. These changes will reverse and negate the efficiencies gained or expected from lean production practices, and production costs can be expected to rise significantly, generating stronger downward pressures on profitability. This will lead more competitors to be eliminated in a host of industries, with damaging economic, social and political consequences. At its worse, managers will again discover, as Kiichiro Toyoda did in the 1940s, that lean production is not feasible in situations of conflict.

Arguably, during the downswing phase of a 'long wave', there is no good conventional solution in the competitive process, which tends to produce a few 'winners' but more and more losers.[19] Consequently, this means that globally economic deprivation and social disparity will worsen. Indeed, there is evidence of growing deprivation and hardship from the USA[20] in the West, to China[21] in the East, as well as in various intermediate locations (see Chossudovsky, 1998; UNICEF, 2004; Oxfam, 2005).

The immense dimensions of the worsening social crisis is reflected in the remarks of the former president of the World Bank. During his last media interview as president of the World Bank, James Wolfensohn offered an apocalyptic view of what would happen if world poverty and the lack of equity and social justice were not urgently addressed:

> There would be a 'tsunami', a great wave of instability, he said, that would threaten world peace and cause great suffering around the globe …
>
> 'I believe we have made progress but I believe it has not been adequate', he said. 'In the next 25 years the world's population will grow by 2.5 billion people and all but 50 million of these people will be in the developing world. Unless we look seriously at the issues of poverty and equity, the chances of stability on our planet are very remote.' (Gawenda, 2005)

Will a lean and mean production system, that is intent on squeezing out every 'wasteful' minute, component, person and benefit from the production process, be able and willing to offer productive work with good incomes to all (or most or many) of the present and future billions of people who will be seeking gainful employment? That would be extremely unlikely; and that is one of the principal reasons why lean production will not offer an effective solution to the looming crisis (see Arends, 2004; Liu, 2005). That is why it is critical to find different ways to work, different ways to create employment, different ways to operate organizations,[22] and different ways to manage people, based on a different and better production system.

Towards a sustainable production system (SPS)

Lean production has been clearly demonstrated to be superior to mass production across several dimensions, and has now been significantly emulated and adopted by the leading companies, for example, in the global car industry. The rise of Japan as an economic powerhouse was due in no small measure to the development of the LPS, which evolved from its origins in the Toyota production system. This system has been exported abroad to many locations and has evolved into various hybrid forms. It continues to be a very formidable system underpinning the international competitiveness of Japanese firms and their foreign subsidiaries, and the LPS will undoubtedly continue to evolve further both within Japan as well as abroad.

However, the benefits from the LPS that were available to one or a few companies are not available (to the same extent) when the LPS is diffused more widely to many more companies around the world. Beginning in the 1980s and intensifying in the 1990s, the other domestic and international bases for Japanese economic success have been eroded significantly. Consequently, in the 1990s and at present, micro effectiveness at the level of the LPS no longer translates directly into macro success for the Japanese economy. The recent and continuing economic uncertainties in Asia vividly demonstrate that it does not guarantee success for other Asian countries too.

On the economic dimension, lean production will not provide long-term salvation to Japan, the USA or China, because it does not offer effective solutions to the problems of intensifying competition arising from excess production capacity, already high and faltering levels of consumption in advanced industrial economies, the imbalance between 'overconsumption' in the USA and 'overproduction' in Asia which has led to large deficits in the former, financed by foreign capital inflows and supported by a fiat US dollar based largely on faith (and unrestrained military power), and large accumulated surpluses in Asia (especially in Japan and China) based on the same fiat currency that is in danger of further substantial depreciation.

Consequently, the forces that have been unleashed by competition and intensified by the recent economic crisis are generating pressures for organizations to consider more seriously the possibilities for creating a Post-Fordist production system that is more sustainable, and that focuses emphasis on management for sustainability based on the 'quadruple bottom line' (see Cheah and Cheah, 2003). After Frederick Taylor, Henry Ford and others worked out the key management principles of the MPS, and Kiichiro Toyoda, Taiichi Ohno and others worked out the key management principles of the LPS, we are now able to see their achievements and their flaws. It is now important for concerned people to invest the time, effort and resources to surpass what had been achieved before, and to work out the key management principles of a superior production system that can offer more substantial benefits to more people, without the major failings that have been encountered so far. This task is important because there is a serious economic crisis that has deepened over a period of time, that will not be resolved easily and at little cost.[23] Furthermore, it is not just an economic crisis, but also an ecological crisis,[24] a social crisis,[25] and an ethical crisis.[26]

Sustainable development has become an increasingly important concern in the world. Previously, this had largely been deemed to be a concern of governments and non-profit organizations, or of no concern at all. However, this is no longer the case, and increasingly business organizations too must participate and incorporate sustainability issues into their planning and operational activities. Sustainability, or the concern for long-term viability, covers four main dimensions:

1 economic sustainability (that is, business activities must be economically profitable);
2 social sustainability (that is, in addition to individual or private gain, the activities must also promote community and societal well-being, for instance by reducing social divisions, inequity and conflict);
3 ecological sustainability (that is, the activities must also be ecologically friendly and not damaging to the environment); and
4 ethical responsibility (that is, the activities must not be morally reprehensible).

A sustainable production system will need to incorporate these four dimensions of sustainability.

Economic profitability has been a traditional concern of private firms. However, at present and in the future, this concern can no longer be pursued with a narrow focus. Private firms can and should also address more directly broader issues of public concern (see Douthwaite, 1999). The private sector has to be more concerned about both the immediate environmental effects and long-term ecological impact of their activities, for dangers to the global environment generate significant direct and indirect costs and problems for private enterprise. Finally, management in all organizations need to pay more than lip service to ethical principles and practices to 'do the right thing'.

The emergence and eventual consolidation of the SPS will depend on a combination of individual, organizational, national and international efforts to effectively manage the transition through the crisis from the MPS and the LPS (see Figure 9.1).

Undoubtedly, efforts to conceptualize and develop practical applications of the SPS based on the 'quadruple bottom line',[27] are in a relatively early stage (see Cheah, 2000; Cheah and Cheah, 2003 and 2005). However, there are already several other significant attempts to conceive of and to promote an alternative (see Schumacher, 1974; Hawken, 1993; Harman and Porter, 1997; Hawkins *et al.*, 1999; Henderson, 1999; Theobald, 1999; Korten, 2002; Brown, 2003).

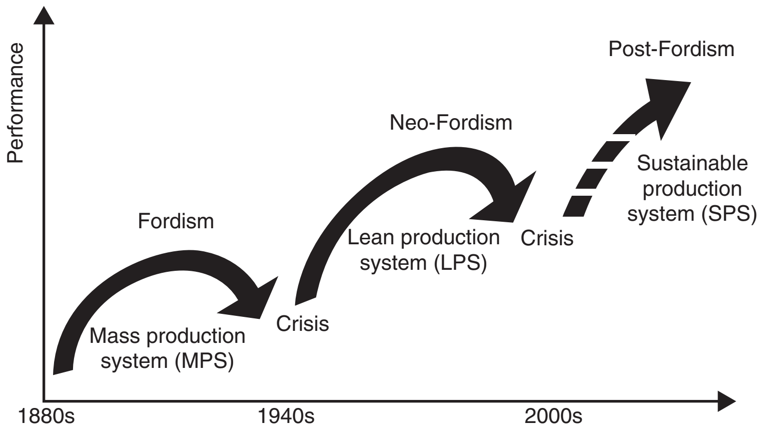

Figure 9.1 Fordism and production systems: transitions through models of systems

Conclusion

Adam Smith provided important concepts that helped to lay the early foundations for the subsequent evolution and flowering of the mass production system and, its successor, the lean production system. Smith's principal focus in expounding on the merits of the division of labour, and specialization, was directed at the promotion of economic growth and the expansion of the market. From this origin, the economic imperative dominated the issues, and it has never been significantly challenged. However, the conventional mass production system and, its extension, the lean production system, are not sustainable, and they are breaking down from their own internal tensions and conflicts. This leads to an anticipation that a process of systemic change must occur if the Earth and its diverse life-forms are to have the possibility of a viable future.

For that purpose, 'lean optimization', 'lean hybridization' (Shimokawa, 1993b) and 'multi-project management' (Cusumano and Nobeoka, 1998) do not extend far enough in confronting the limitations of the LPS. Nonaka and Takeuchi (1995, p. viii) have argued that, for Japanese firms, 'knowledge creation has been the most important source of their international competitiveness'. Moreover, 'faced with the longest and most severe recession in recent history in the early 1990s ... Japanese companies are trying to break away from what worked in the past and move into new and untried territories of opportunity. The pressure of the current crisis and the need to globalize even further are forcing Japanese companies to turn to a more advanced form of knowledge creation' (Nonaka and Takeuchi, 1995, p. ix).

However, even more fundamental shifts in the focus of prevailing management practices and development processes may be required, to move beyond lean production to sustainable production; that is, producing goods and services in a manner that is sustainable for people, organizations, communities, nations and the world, based on the effective integration of economic, ecological, social and ethical imperatives.[28] This gives rise to the concept of a sustainable organization; that is, an organization that is focused on the quadruple bottom line, to promote the conditions necessary for sustainable living.

Notes

1 According to Gabor (2000, p. 5),

> Henry Ford's assembly line was a logical extension of Taylor's efforts to break up and speed up individual production tasks ... Similarly, the

decades-long search for the Holy Grail of employee productivity – and the quest for the perfect incentive pay formula – can be traced back to Taylor's attempt to develop the first scientifically based formula for determining a labor rate that would produce the greatest output. Most recently, the reengineering craze of the 1980s, in which so-called turnaround experts gutted company payrolls in an employee-be-damned frenzy, echoed the excesses of Taylorism.

2 Levinson (2003) correctly made a claim for the American origins of lean production ideas, but he does not focus (as Shimokawa, 1993, did) on how practices at Ford and other US enterprises diverged from those original ideas.
3 See http://www.autointell.net/nao_companies/general_motors/gmnummi.htm and http://www.nummi.com/timeline.html
4 For recent developments in General Motors, see: http://uspolitics.about.com/b/a/154502.htm; http://www.theautochannel.com/F/news/2005/03/17/014922.html; and http://biz.yahoo.com/ap/050321/gm_labor_21.html?printer=1
5 See http://www.businessweek.com/bwdaily/dnflash/apr2005/nf20050426_7826_db035.htm
6 Recently, Matsushita Electric, another major lean producer, also engaged in substantial retrenchments to improve corporate performance (Rowley, 2005).
7 For a personal account of how Ghosn was favoured by Nissan, see Kobayashi (2001, pp. 7–8).
8 See http://www.amrc.org.hk/4904.htm; http://www.wsws.org/articles/1999/oct1999/nisso20_prn.shtml; and http://www.businessweek.com/2000/00_43/b3704263.htm
9 See http://www.atimes.com/atimes/Japan/FE11Dh02.html; http://www.businessweek. com/2000/00_41/b3702244.htm?scriptFramed; http://www.freep.com/money/business/mitsu23_20000823.htm; and Bruno and Jordan (2002).
10 See http://www.atimes.com/atimes/China/GC22Ad01.html; http://www.theautochannel.com/news/2005/04/17/041195.html; http://www.businessweek.com/magazine/content/05_23/b3936033_mz011.htm; and http://www.chinadaily.com.cn/english/doc/2005-05/16/content_442555
11 http://www.toyota.co.jp/en/ir/reports/annual_reports/04/president/4.html
12 See also, http://www.detnews.com/2003/autosinsider/0311/11/autos-320810.htm; and http://www.washingtonpost.com/wp-dyn/content/article/2005/05/30/AR2005053000059_pf.html
13 See http://www.edtec.unsw.edu.au/wmmeta/self_managed_meta/adfa/GLOBAL 1–56k.asx
14 See http://www.accel-team.com/human_relations/index.html
15 For some claims of health and safety hazards, see Clay (1999).
16 For examples of reported improvements from lean production in another low-wage country, India, see: http://www.1000ventures.com/business_guide/cs_lean_gsep.html; http://www.1000ventures.com/business_guide/cs_lean_rts.html; and http://www.1000ventures.com/business_guide/cs_ lean_te.html
17 See Bush (2002) for another broad-ranging and robust statement of the USA's intentions and strategies, including preemptive actions to forestall possible or perceived challenges to US global dominance.

18 For a recent US intelligence assessment of China as a 'rising power', see http://www.cia.gov/nic/NIC_globaltrend2020_s2.htm. See also Chapman (2005), and a Chinese response to the recent remarks by the American Secretary of Defense, Donald Rumsfeld, on the 'threat' from China (*Peoples Daily*, 2005). For one revealing analysis of the nature of the embellishment of this threat and the demonization of China, see Lewis (2005).
19 The last economic depression showed that even 'winners', such as Ford, eventually became losers, as overproduction combined with underconsumption crippled the economy, and people, organizations and government were all powerless to halt the slide, first into widespread unemployment and subsequently into war. For a historical perspective of the dynamics and consequences of that process, and possible insights into what may lie ahead in the future, see: http://www.edtec.unsw.edu.au/wmmeta/self_managed_meta/adfa/FORD56k.asx
20 See Shulman (2003); Partlow (2003); Proctor and Dalaker (2003); http://www.alternet.org/module/printversion/21544; http://www.rutlandherald.com/apps/pbcs.dll/article?AID=/20050605/NEWS/506050396/1024&template=printart
21 See http://www.atimes.com/atimes/China/FG21Ad02.html; http://wsws.org/articles/2003/jan2003/chin-j31_prn.shtml; and http://wsws.org/articles/2001/jun2001/chin-j15_prn.shtm
22 http://www.faireconomy.org/press/2004/EE2004_pr.html; http://www.faireconomy.org/press/2002/titans_pr.html
23 See Roach (2003), Krugman (2003), Korten (2001); http://www.mindfully.org/Reform/2004/Economic-Armageddon23nov04.htm; http://www.wwdemocracy.nildram.co.uk/democracy_today/rees.htm; http://iisd1.iisd.ca/pcdf/corporat.htm
24 See Brown (2001 and 2004); http://www.abc.net.au/4corners/content/2005/s1325819.htm; http://www.abc.net.au/lateline/content/2002/08/20020815ll_climate.ram; http://www.abc.net.au/lateline/content/2002/10/20021010ll_drought.ram; http://www.chifley.org.au/ publications/ index.php?publicationID=7; http://www.amazon.com/exec/obidos/tg/detail//0385468091/102-2037269-5753757?vi=reviews
25 See Oxfam (2001, 2002 and 2005); http://www.hermes-press.com/bowden1.htm; http://www.heise.de/tp/english/special/eco/6099/1.html; http://www.theage.com.au/news/World/World-Bank-head-settles-his-account/2005/05/25/1116950752984.html
26 See Krugman (2002), Partnoy (2003), Klinger and Sklar (2002), Palast (2003), Griffin (2004); http://www.abc.net.au/lateline/content/2002/08/20020806ll_ramsay.ram; http://www.scoop.co.nz/mason/stories/HL0409/S00302.htm; http://www.atimes.com/atimes/Middle_ East/ FJ08Ak02. html; http://reese.king-online.com/Reese_20021014/index.php; http://www.informationclearinghouse.info/article6423.htm; http://www.ccr-ny.org/v2/reports/docs/Civil_Liberities.pdf; http://www.informationclearinghouse.info/article7044.htm; http://www.newtimesbpb.com/issues/2004-09-30/news/norman_print.html; http://globalresearch.ca/articles/CLE409A.html
27 See, for example, http://www.reputex.com.au
28 Of course, there are no guarantees that the process of systemic change will be concluded successfully.

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Part 3

Ways Forward

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10
A New European Model

Johnny Munkhammar

Introduction

The European Social Model is the focus of European public debate and policy-making. This has been the situation for years, but the debate has become even more intense. The main question is whether this Model is a cause of many of Western Europe's serious economic problems or part of the solution.

Clearly, there are problems. The average US citizen is about 40 per cent richer than the average Western European. The aim of the Lisbon Agenda (March 2005) of economic reforms, started in 2000, was to close that gap in ten years; but since then it has widened. Unemployment is high in most countries; in Germany it is at its highest level in 75 years. Many people are dependent on the state throughout Europe; in Sweden, about 60 per cent of the adult population is dependant to some extent. People wait for years to have treatment in public healthcare, and public schools are performing more poorly every year.

But what is the main cause? Most claim that the European Social Model is not the cause – in fact, the Lisbon Agenda clearly states that it should be preserved. The Wim Kok report for the EU (November 2004), *Facing the Challenge*, which previewed the Agenda, said that 'To achieve the goals of higher growth and increased employment *in order to sustain Europe's social model* (my italics), will require powerful, committed and convincing political leadership.' Jacques Chirac, the French President, stopped a Directive from the EU Commission to create a single European market for services – expected to create at least 600,000 new jobs – giving as the reason that the directive threatened the European Social Model.

There is a European Social Model, but it should rather be called the Western European Social Model. There are differences, but also central features. High taxes, regulated labour markets, large government transfers and public welfare services – schools, healthcare, child and elderly care – are the core parts of this Model. Despite all the talk about keeping it, reforms to dismantle it are taking place. They have different names, such as Agenda 2010, but they have one direction in common: towards lower taxes, free competition in welfare services, higher employment.

My thesis is that many, if not most, economic problems in Western Europe originate from this Model. And without reforms, the problems will get worse. Now, two strong trends put it under increased pressure: the globalized economy and the demographic situation. And, further, the enlargement of the EU is speeding up the process. This is why the new EU Commission pushes for more economic reform, this is why corporate taxes decrease, this is why pensions reforms are pushed ahead, and so on. Leading politicians know basically what has to be done, but reform is slow because it is hard to give the opposite message to what they have said for decades to the citizens. A perceived 'U-turn' is not desired by politicians who depend on their voters for reelection.

When radical reforms are done, however, Western Europe can go from economic doom to boom. Lower taxes will make this part of the world more competitive and growth can increase. Less-regulated labour markets can create more new jobs. Lower levels of economic transfers from the state and lower taxes can get more people to work and fewer to be dependent on government. Free competition can improve welfare services. Reforms may be hard to push through, but the results will come – and bold politicians will be rewarded.

In this chapter, the following questions will be answered: What are the main features of the European Social Model? When and why did it emerge? What are its main effects? Which are the challenges towards it? What reforms need to be done?

The European Social Model – features and differences

The origins of several basic factors for economic development can be found in Europe; private property, free trade, stockmarkets and the principles of industrial production. Indeed the march of humanity from permanent poverty to ever more prosperity started in Europe, which was followed by North America. After the Second World War, Communism occupied Eastern and Central Europe, and there the planned economy became a fact.

Western Europe remained politically free. Economically, the main foundations for a market economy were still there, despite all the disturbances of a War Economy. And indeed the economic development was fast and strong during the first decades after the war, not least due to necessary reconstruction. But the foundations for the market economy were increasingly put aside and the state took possession of an ever-larger part of society. High taxes and public monopolies would steer and plan development. The so-called mixed economy was created – or, to give it another name – the European Social Model.

It might be more relevant today to call it the Western European Social Model. There are differences – the tax pressure in Britain is about 39 per cent and in Sweden 51 per cent and the rest are in between. In the continental Western European countries there is a tradition to have private production of welfare services, though they are tax-financed, whereas in the Nordic countries and Britain they are provided by public monopolies. In some countries, the labour market is heavily regulated by government, and in others it is heavily regulated by the so-called social partners.

But there are clear main features of the model. The tax pressure is very high and rose from about 20–25 per cent in 1950 to between 40–50 per cent in 1980 – whence it remained. Governments finance and provide, one way or another, welfare services such as education, healthcare, child and elderly care. In various forms, the model also contains systems for social security: public pensions and income transfers for unemployment, sick leave, early retirement, and so on. The labour market is also highly regulated, or arranged in a corporatist way.

This model emerged largely between 1950 and 1980. It was always said that it was for the welfare of the people; but there were other mechanisms behind this:

- First, in those days, many politicians believed in the centrally planned economy. A monopoly would be the best way to use resources efficiently. Thus, they put schools, healthcare, elderly care, pensions and so on into monopolies. Now everyone knows that the planned economy, which basically is a big monopoly, was a total failure. Thus, we live with systems that everyone now knows are based on the wrong assumptions.
- Second, we have public choice. In order to win elections, politicians promised citizens ever more benefits from the state. And year by year, election by election, taxes were raised and governments did more. Not to mention all the special interests that want their share – and when all get their shares government grows.

Government grew, but it had little to do with the welfare of the citizens. The core principle of the model was that there should be only one that provides welfare services and social security: the state. The state has many names, and these things can be provided at national or local level. But the public sphere is the public sphere.

Effects of the model

Since the Model was completed, about 1980, problems increased. In China, GDP has increased by 650 per cent since 1980; in Western Europe it has increased by some 60 per cent. In the USA, the economy has doubled. The average person in 38 American states is wealthier than the average person in any European country except Luxembourg. Sweden, the country that went farthest in the direction of big government, fell from being number four in the OECD league of countries ranked by GDP per capita (PPP) to number 14 by 2003.

This is a fact. The global economy grows, in 2004 by about 5 per cent – thus, everyone can win. Just because China has a very strong growth, Europe doesn't have to have low growth. But growth has been low for decades and it has coincided with the creation of the European Social Model. Since growth is a measure of all the resources that are created and which we live off, this is a serious problem.

Unemployment is notoriously high, though there are big differences. In some Western European countries it is fairly low, such as in Denmark, Britain and Ireland. Those countries are, however, the ones that have reformed the labour market to the greatest extent, and actually in this regard have already left the Model behind. In the larger countries of Germany, France and Italy, unemployment is very high. In Sweden, the official figure is rather low – about 6 per cent – but much is hidden behind statistics and government programmes; in reality it is about 20–25 per cent, according to the largest trade union, LO.

Another measure is employment – which is low. Between 1970 and 2003, employment in the USA rose by 58.9 million, which is equivalent of a 75 per cent increase. In France, Germany and Italy together, it rose by 17.6 million people, or 26 per cent. In Sweden, with a population of nine million, only slightly more than three million go to work on an average day, and 2.25 million people that are today defined as of 'working age' don't work.

The people that don't work live off something else, usually the state. There are public systems with economic transfers to those that are unemployed, sick, have become parents, have been harmed at work, early retirees, and retired people. The people that work in the public sector produce services in fact, so they don't belong to the same category; but the fact remains that their salaries come from the taxes derived from the private sector. A comparison between the number of people working in the private sector and the total number of people supported by the state shows that the latter group is much larger, and in several countries about twice as large.

The welfare services that are provided by the public sector have great difficulties. While there have been improvements in productivity due to innovations and new ways of organizing, it has so far been on the margin. In Sweden, the average number of patients a doctor sees every day has decreased from nine in 1975 to four in 2001. In many Western European countries – though not all, for instance Belgium is a country where people are rather content – there are protests about the quality of healthcare. Schools are performing poorly also, and tragic examples are reported from public elderly care – and all are getting increasingly hard to finance.

Monopoly is simply not a way to organize effective uses of the resources. It cannot match demand with supply. Another reason behind the problems is that the resources to the welfare services have not increased in parity with the demand for them since 1980. And the demand increases due both to demography and the fact that demand for these services always increases when general prosperity does, even though it increases slowly. And, due to lower productivity in services than in goods, welfare services become more expensive every year.

Due to the large gap between the supply of welfare services and the demand for them, many people have started to buy private insurance. In Sweden, over two million people have private pension insurances and several hundred thousand people have private health insurance. They don't trust the public systems: it is noteworthy that this opportunity has only recently emerged, since there was no market for such insurance before. This development is spreading all over Western Europe, and a central point here is that these people pay twice. First through their high taxes – for systems they don't trust and largely don't use – and secondly, privately. This is a rapidly increasing group that effectively leaves the care of the state for private alternatives, and they share a wish that they should only pay once. This will push reform ahead.

Reasons for these effects

The state was supposed to provide welfare services and social security. And the state, the public sphere, is fundamentally different from the private society. Private companies, private property, free competition, free financing, interest in profit – all these are prohibited in the public sphere. And I believe that explains much of why it goes wrong. These are the forces of development, and if you prohibit them, you don't get much development.

Let's imagine prohibiting these forces in other fields. Does anyone think that we would have all these types of mobile phones with only one state telephone monopoly? Or take a more fundamental need: food. What kinds of food and drink would we have if it weren't produced and delivered by private companies? We would have lines of people waiting for bread, most likely, as we do have now in healthcare.

This model of big government is largely based on the assumption that there are resources that just wait to be shared by everyone. There is a big cake which government can just distribute to people. That is a fundamentally false assumption. All resources have to be created; there is not a car, not a hospital, no heating for your house, no food – nothing! – that is just there in nature. Thus, we have to create a society with the best opportunities for the forces that create the resources. The European Social Model does, to a large extent, the opposite.

Sometimes, people can accept all these negative consequences because the European Social Model is all about a very important value: solidarity. We have big government to help the poor. That is simply untrue, it is a myth. In Sweden, where we have the biggest state of all, only two out of ten euro an average person pays in tax is redistributed to someone else. Eight euro returns to the same individual in various forms, such as income transfers or services. Why can't you keep those eight euro, or some of them at least, by yourself and decide what to do with them? Because the point is that government wants do decide what you should do with your money. They want to run your life and have you be dependent on the state.

Another fact that shows that big government is not for the poor is that in Western Europe we tax the people with low incomes more than anywhere in the industrialized world. They are the ones paying so much that they don't have money left after tax. Thus, they have to have income transfers from the government – which they have already paid for with the taxes.

Challenges and reforms

If we look a bit further into the future, we see that the challenges get tougher and the Model becomes even more unsustainable. The globalized economy and the demographic situation are two trends, which affect us strongly today, and will have a greater effect tomorrow. Here are four main fields of the model that are in great need of reform:

1 *Abolish public pension age*. When public pensions were introduced in Sweden, the pension age was 67 and life-expectancy 55. Now, the real pension age is 58 and life-expectancy is 80. So pension reform had to be done, and it contains positive and inspiring elements, but much more still has to be done. Looking ahead to 2050, under the current systems the population of working age in Germany would be reduced from 56 million today to 41.5 million; in Italy, it would decrease from 39 to 22 million. The expenses would explode across Europe: in Spain, for example, the public pensions' share of the public expenses would increase from 50 per cent today to 80 per cent in 2030.

One could claim that nobody should be forced to work. But the choice not to work must be paid for by oneself. And consequently nobody should be forced to retire at a certain age. We could replace the pension age of today with a system that gives you a basic public pension, and the earlier you retire, the lower it is. If you wait until 75, it gets rather high. Of course, above a basic public level you can save for private pensions, but that is another issue. This pension reform would lead to more work being done and with less expense on the public pension – and hence lower taxes.

2 *Reduce benefits in public social insurance*. The European countries have similar systems of mandatory public social systems for sick-leave, unemployment, parenthood leave, and early retirement. In Sweden, there are in practice no limits to how long you could live off these systems. The basic public level of contribution is 80 per cent of the salary, but most people have higher levels than that, due to negotiated extra benefits. For a person with an average income, the gross benefit from going to work instead of living off these systems is about 5–10 euro a day due to the high taxes when you do work. Thus, many people choose not to work and many people are dependent on the state.

This is highly destructive. You cannot punish work and reward living off the work of others. Especially if you believe that it would be good if more people do work to achieve growth increases. There should be a limit to how long you can live off the systems, and the high levels should be reduced to a basic level, perhaps half of the level today. Then, incentives to work would be of a totally different kind and public expenses substantially lower. The labour supply would increase. In turn, less government intervention would open a new market of private insurance where free competition would create new and better systems that would, for example, make sick people healthy again so they can get back to work.

3 *Free enterprise in welfare services*. In Western Europe, as mentioned, the government finances most welfare services like healthcare, child and elderly care, and primary, secondary and higher education. In many countries, the services are also almost entirely provided by government. Basically this is the system of the planned economy – one that finances, one that provides, it is a monopoly. Thus, you get lines of people waiting for treatment, you get inefficiency and a waste of resources. In the labour market perspective you get people working in the public monopolies with low salaries having little influence: and you hamper the emergence of a new service sector.

Today, the public welfare services try to perform everything for everyone but fail for so many. The resources would be better used if there were a clear limit as to what the public services provide and what they don't provide, and thus you clearly understand what you have to buy for yourself. And the basic services paid for by the government should always be procured in the market among private companies. This would lead to better functioning services and a vast market for private welfare companies. When traditional industries move abroad, to Asia and elsewhere, it is also essential to let the companies of the new service-society emerge. That competition would improve the services. The staff could get better salaries since they get to choose between different employers and, not least, be able to start their own businesses.

4 *Lower taxes*. Western Europe has the highest taxes in the world. Naturally, this makes our climate for creative business and work less attractive, not least in the global perspective. In Sweden, the average wage per hour for a worker in industry is about 20 euro, in China it is 1 euro. It is not matched by a difference in productivity, and taxes are of course one explanation for the difference. Every third Swedish company has outsourced production in recent years. This is not a threat – the fact that China, India, Brazil and others grow is a great promise – but it is a challenge for the West.

Several taxes have already been lowered. Capital taxes are lower, since capital otherwise leaves the country. Corporate taxes have been lowered too. But the total tax pressure remains stubbornly extreme – and harmful. The reforms of pensions, social security and the welfare services that have been mentioned above would make radical tax reductions possible. Especially harmful taxes on work and enterprise could be abolished, and the total tax pressure lowered. This would make work more attractive, improve the business climate and increase economic growth.

Hope and inspiration

So Western Europe needs radical reforms and basically it knows what to do. But of course it is not easy; most leading politicians have told the people for decades that this Model is morally and economically superior. Doing the opposite quickly is a hard act.

This also shows that introducing systems of benefits from government to people is the last thing you should do. It becomes almost impossible to take away. When a majority of the voters live off the systems, they will hesitate before they vote to take them away. You know what you have, but not what you might get: there is a natural fear of the unknown.

But there are many shining examples of successful reforms throughout the world. In Western Europe we have Ireland. There's Australia and New Zealand. And many more. The best examples are close by, in Eastern and Central Europe. Of course in one way reform was easy there, their situation had turned very critical. But on the other hand everyone was dependent on government, so it was hard. Yet it worked.

In the ten new EU countries, the annual growth is twice that of the EU-15. There is development, optimism, new jobs, and better living standards. Slovakia has become the biggest car producer in the world relative to the size of its population. To a large extent, these countries have a limited state and a big society. In Hungary, for example, in 1992 the state accounted for 70 per cent of the economy: now, it is 14 per cent. They have limited regulations for companies and labour. And one of the main features is low taxes, especially increasingly the more popular flat tax – in nine of the ten new EU countries everyone pays the same percentage in tax regardless of income – simple, fair. And to work always pays off.

Of course competition from these countries is felt in the West. Austria lowered their corporate tax from 34 to 25 per cent, so Germany will decrease theirs from 25 per cent to 19 per cent. And, by the way, a high tax level is no guarantee that you get high revenues. Slovakia gets 2.3 per cent of GDP in corporate tax revenues from a 19 per cent tax level. A large Western European country gets 0.7 per cent of GDP from a corporate tax level twice as high.

This is a very good case study. And there are others. Sweden actually did a quite radical pensions reform; the levels of public pensions were reduced by about 40 per cent, and people now get to decide how to invest a share of their pension in the private market.

There are a few rules for successful reforms which Western European leaders could learn: know what to do, don't do too small things, explain it a thousand times, be persistent and await the positive results.

Conclusion

In the enormously successful economic history of Western Europe, the European Social Model has been a mistake and a setback. It has been a grand detour, which has delayed the further march towards increased prosperity. But it is what we have and therefore it is dear to many. Now, reforms are taking place in the opposite direction. It can always be discussed how many reforms are needed before one can say that the Model is gone. But a big change is needed. And it has started.

Strong forces try to stop change. Large Western European countries try to stop competition from the new EU members. They shut their eyes to the world. But the elevator doesn't stop falling just because you close your eyes. Sooner or later things will change.

And Western Europe will change more than Eastern Europe. In competition, the best will win.

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11
A View from Porto Alegre

François Houtart

Since 2001 Porto Alegre, a city in southern Brazil, has been the venue of an annual gathering of social movements, NGOs and intellectuals searching for alternatives to neoliberalism. They meet during the last week of January, at the same time that the World Economic Forum takes place at Davos. In 1999 it started with some 50 people constituting 'The Other Davos', when five movements from various continents (the Landless Movement of Brazil, the Trade Unions of South Korea, the Rural Cooperatives of Burkina Faso, the Women's Movement of Quebec and the Movement of the Unemployed of France), together with some intellectuals like Samir Amin, Susan George and Riccardo Petrella, were brought together in Zürich by the World Forum for Alternatives, with a press conference in Davos (Houtart and Polet, 2000).

In 2001, the World Social Forum was officially established in Porto Alegre. It brought together 20,000 people; in 2002 they were 60,000 and in 2003 some 100,000 gathered there, with almost 4,000 movements and organizations participating. In 2004, the gathering took place in Mumbai, with 110,000 participants, and in 2005 the meeting has again been held in Porto Alegre. In fact, continental, national, local and thematic meetings have been organized all over the world: in Europe, Africa, Asia, Australia and America.

The World Social Forum is not against globalization: its vision is, rather, of an alternative world. It does not reject a globalization involving material and cultural exchanges between human beings throughout the world, but it is opposed to a process dominated by the economic interests of a minority. Viewing the capitalist system from below can be said to be its point of departure.

Capitalism can claim with some reason to be the most effective system for producing goods and services – as long as not too many questions are asked about the conditions of production and how the results are distributed. Ecological destruction and social exploitation, which have been continuing since the fifteenth century are indeed considered externalities and are not taken into account unless social movements or public authorities react. As for the distribution of wealth produced in the world, UNDP statistics provide a clear picture: in 1992, the richest 20 per cent were absorbing 82.7 per cent of world revenue and the poorest 20 per cent only 1.4 per cent (UNDP, 1992). A decade later, according to the same source, the share of the richest 20 per cent reached 84 per cent:

> The widening chasm between rich and poor countries, as well as the rich and poor within them, indicates that, if we define the economy as 'the activity to ensure the material basis needed for the physical and cultural life of all human beings', the capitalist economic system is the most ineffective in history. Never has so much wealth been produced and never have there been so many poor people. Let us quote a few examples: according to UNICEF, 640 million children do not have decent housing, 500 million have no access to sanitation, and 400 million have no access to drinking water; 270 million lack health care and 90 million are undernourished. In Latin America alone, in 2000, there were 210 million poor. (CEPAL, 2001)

The Charter of the World Social Forum (April 2001) affirms that the movements and organizations who congregate in Social Forums are struggling against neoliberalism and against the global hegemony of capital while seeking alternatives. Among them some believe that it is possible to humanize capitalism. A neo-Keynesian formula is proposed at the world level, as against unbridled globalization in which the law of value imposes the rules of the game, without sufficient political or even ethical counterweights. It was believed that, in the same way that the nation-state provided a framework in which workers won a certain number of social rights, so should the operational norms of the economy be established through regional organizations (European Union, ASEAN, Mercosur, and so on) and international organizations guarantee respect for persons and environment.

Others take a more radical view: that the very logic of capitalism will eventually have to be changed. The writings of Karl Polanyi, the American economist of Hungarian origin, have shown how capitalism has disembedded the economy from society and made it into an end in itself, imposing its logic on all the other sectors of communal life. In other words, everything has to be reduced to a commodity for the system to function.

In fact, there is only one economic model, although it is applied differently, according to time and place. History has shown that capitalism is 'unbridled' when it can be, and 'civilized' when it must be. Often they are the same economic agents who behave differently according to circumstances. Moreover, the basic philosophy of capitalism defines progress in terms of growth, which is the fruit of capital accumulation and requires the freedom of enterprise and free trade. All that seems very logical, all the more so in that the 'invisible hand' of the market is supposed to regulate the system. The current discourse of *la pensée unique* has even become lyrical. The first director-general of the World Trade Organization predicted happiness for humanity for the first quarter of the twenty-first century if trade were to be completely freed at the world level, and Michel Camdessus, when he ran the International Monetary Fund, had no hesitation in claiming that the IMF's activities contributed to the building of God's Kingdom.

However, the reality is quite different when seen through the eyes of its victims. The social consequences of economic policies have been catastrophic since the neoliberal era was established by the Washington Consensus (the overall orientation of the world economy – being generally agreed by the international financial organizations, the Federal Reserve Bank of the United States, and the leading transnational corporations).

The gap between rich and poor does indeed only increase, in spite of David Brooks' (2003) reassurance that 'we are seeing a drop in global inequality'. The following figures raise doubts about such an affirmation: in Colombia, for example, despite modest economic growth, the Gini coefficient (measuring the gap between the highest and lowest revenues) was 0.544 in 1996 and 0.566 in 2000. Here the 20 per cent of the richest absorb almost 70 per cent of the national wealth, and the 20 per cent of the poorest only 2.3 per cent (DNP, 2001).

There is also a growing difference in revenue among wage and salary-earners. The wage-earners' total share of the social product has continued to diminish both in Europe and in the United States – and not only through a new definition of labour. In the USA in 1970 the average salary of an executive was 25 times more than the wage of a worker. In 2000, it was 600 times greater and, in 2003, because of the drop in stock options, 300 times greater (Skapinker, 2003). Between 1974 and 1981, the average wage declined 4.6 per cent in the services, and 10.9 per cent in industry (US Bureau of Labor, 1998).

The divide between the industrially developed nations and the poor countries, far from diminishing, is growing in leaps and bounds, apart from a few so-called emergent countries whose economic growth has been due to exceptional circumstances (such was the case of the 'Asian Tigers' which were helped by the West on a massive scale, especially the United States in its geostrategic objective to contain Chinese communism, and it led to large-scale interventions by the State, while the working classes were socially and politically muzzled by military dictatorships or colonial regimes). According to the World Bank, the gap between rich and poor countries was 3 to 1 in 1820, 10 to 1 in 1900, 30 to 1 in 1960, and 74 to 1 in 1999 (World Bank, 2000). Today people talk about the growth of China, but its past social transformation and the social cost of the present transition towards a market economy are all too easily forgotten. As for India, after its independence it followed a policy of selective development, supported by national capitalism and a strong intervention by the State, especially in the less profitable sectors. However, this policy increased structural inequality, which is now pursued through adoption of the neoliberal model.

During the last quarter of a century the wealth of the South (capitalism's periphery) has been captured by the centre to an unprecedented degree. The National University of Mexico has estimated that over a 22-year period, between 1976 and 1999, a difference of nearly 5 trillion dollars has developed between the financial flows of the North towards the South and those between the South towards the North (*Alternatives Sud*, 2002). Colonial occupation is no longer necessary: there are other mechanisms.

For a start, there is the classic tendency for the prices of raw materials and agricultural products to fall. In the field of agriculture world prices settle at the lowest level: in other words, they are set by capitalist productivist agriculture. Quite apart from the fact that this has often proved to be ecologically disastrous, it imposes its criteria on the small peasants who lose their means of existence and who are excluded from the process of internal modernization. Thus, the North American Free Trade Agreement between the United States, Canada and Mexico has had dramatic effects on the lives of millions of Mexicans. In less than a decade 28,000 small businesses have disappeared: in 2000 alone 200,000 jobs were lost. Between 1994 and 2000, the balance in agricultural trade dropped from +581 million dollars to −2,148 million dollars. Before the treaty, Mexico was importing 2 million tons of maize, yet by 2001 148 million tons were imported. Food poverty increased among rural people, from 35.6 per cent to 41.8 per cent through the decade from 1992 to 2002 (CIEPAC, 2001).

Following the same logic, in Sri Lanka a World Bank plan decreed that rice should no longer be cultivated because it is cheaper to buy it in Vietnam or Thailand. Rice has been cultivated in Sri Lanka for 3,000 years, it constitutes 70 per cent of the cereal consumed and 80 per cent of the small peasants grow it. Rice is part of the country's history, culture, literature and landscape. If it were to disappear, Sri Lanka being an island would lose its food security. And the fate of a million small peasants is at stake. What will happen to them? They will reinforce the urbanization of the country, says the World Bank; and thus they will supply cheap labour to attract foreign capital, adds the Sri Lankan government. But the process is not automatic, so the World Bank insisted that a tax on irrigation water be levied so that small peasants can no longer produce rice profitably. However, the government did not take action quickly enough, so the World Bank suspended its credits for a year. The levy of this tax has been privatized and the mechanism put in place is rolling out a mess. For instance, because the ownership of rice land is still collective, the government began attributing 1,200,000 title deeds to small peasants with the aim of enabling them to sell (at a low price, because of the constraints of the market) to local and foreign corporations.

As the policy of attracting foreign investment has been going on for a long time, Sri Lankan workers, who have a high level of education, waged vigorous social struggles to obtain a slightly more decent pay and a system for social security and pensions. But the cost of their labour became too high and foreign capital has flowed away to Vietnam or China, where the wages are lower. Hence the necessity to take action to lower the cost of labour and reduce social coverage and pensions. Sri Lanka now has one of the highest suicide rates in the world and most of the victims are small peasants.

Servicing debt is another mechanism of absorbing wealth. It absorbs increasingly large resources across the South. As is well-known, most of these debts are what are called in international law 'odious debts': expenditure on armaments by military dictatorships, often allies of the West; 'white elephants' (industrial or infrastructure projects that are useless, but profitable for the companies in the North, and certain politicians in the South); or pressures by the holders of petro-dollars. All this is accentuated by fluctuating rates of interest. Between 1980 and 2000, 4,500 billion dollars had been transferred from the South to the North: six times the debt of 1980. Between 1976 and 1999, Latin America transferred 2,331 million 973 dollars; Asia, 1,065 million 107 dollars; and Africa, 445,650 million dollars (*Alternatives Sud*, 2002: 21).

The social effects can be measured, for example in Africa, where debt-servicing is equal to four times the combined budgets of health and education, while Brazil could double its expenditure on these two items if it did not have to meet the costs of the debt. This effect became obvious during the 1990s. In many countries of Africa, Asia and Latin America, education and health budgets were reduced in order to apply Structural Adjustment Programmes. In Zambia, between 1990 and 1993 the country spent 37 million dollars on primary education, while 1,300 million dollars went to service the debt (Toussaint, 1998). In Africa in general, primary-school attendance dropped from 79 per cent in 1980 to 67 per cent in 1992 (UNDP, 1992). It was the same story for health. In Zambia again, 10 per cent less was spent on public healthcare in 1995 than in the previous 10 years and infant mortality increased by 20 per cent (Eric Toussaint, *ibid.*). It is extremely important to manage the education and health budgets – the latter so that infant mortality is reduced to yield greater numbers of potentially productive workers. And raising the education budget will ensure that millions of children will become thoughtful and productive – and able to contribute to the destiny of their nations. The two aspects are intercorrelated:

> There is no doubt that the intelligence of the peoples in the third world countries is to some degree impaired by poor nutrition. Inadequate nutrition impairs the growth of the body and brain and retards the development of intelligence. The principal kinds of inadequate nutrition whose adverse effects on intelligence have been studied are protein-energy malnutrition, iron deficiency and iodine deficiency. Protein-energy malnutrition retards growth and in extreme cases causes kwashiorkor and miasmas; iron deficiency produces anaemia, a lack of energy and it impairs intelligence; and iodine deficiency produces goitre, and in pregnant women impairs the neurological development of the brain resulting in cretinism and impaired intelligence. (Lynn and Vanhanen, 2005: 46)

Tax havens also absorb resources, because they are used by many of the rich in the South to deposit their money that – often illegitimately acquired – could otherwise be invested in their countries in economic or social projects. Furthermore, short-term interest rates have reached prohibitive levels. In 2004, Venezuela fixed their upper level at 30 per cent. During the 1990s they had reached 49 per cent in Brazil. The conditions demanded by foreign investors are often very exacting: not only are receiving countries obliged to undertake expensive infrastructures, they also have to exempt foreign corporations from paying tax (for ten years in El Salvador); and outsiders are playing on the competition between countries to attract investment. As for the social and hygenic conditions in the sub-contracting factories, they often resemble those of nineteenth-century Europe, while obstacles – often violent – prevent workers from organizing themselves in unions.

The brain-drain should also be mentioned in this connection. For it is the countries of origin that meet the costs of training people, while the countries that receive them reap the benefits. For a long time now, there have been more Argentinean doctors in the United States than in Argentina itself, while in 2003 Germany prepared to import 70,000 computer technicians from India. The rules and conditions of economic migration will soon assume considerable importance as 'developed' nations are realizing their birthrates are too low, and that they can compete for intelligent labour (as above).

European and US agricultural policies, which were contested at the WTO meeting at Cancún in September 2004, constitute another exploitation mechanism. The subsidizing of maize and soya in the United States increases the imbalance between North and South agriculture, while cotton subsidies are literally destroying the means of subsistence of hundreds of thousands of small producers in Burkina Faso and Mali. Similarly, the export of chickens from Europe to Cameroon has had the same effect on the local producers. These dumping policies are against the very principles of neoclassical theories which seems to be taking the place of the neoliberalism so dear to Friedrich August von Hayek and Milton Friedman.

In sum, there is a very real straitjacket constricting the economies of the South, while at the same time the North talks about the need for them to catch up, and for the rich countries to provide foreign aid. Indeed there was strong rhetoric at Davos (in 2005) as the developed nations – led by the UK – avowed their intent to alleviate poverty: but will they activate these ideals in practice? Time will tell. It is a first contradiction, but more must be added.

In the last few years the armaments race has been taken up again. In 1987 military expenses had reached 1,300 billion US dollars. They came down to 750 million during the 1990s. But since then they have gone up again to reach 950 billion in 2003, essentially because of the increase in the US military budget, which has grown from 296.8 billion dollars, when President George W. Bush took office, to 401.7 billion for fiscal year 2005. The increase in the military power of the USA is largely aimed at ensuring the control of the sources of energy and raw materials, as well as maintaining a presence of their economic power in key regions of the world: the Middle East, Central Asia, the Indian Ocean, Colombia (the bridge between Central and South America), Western and Central Africa. The war in Iraq has become emblematic of all this and has done nothing to stem terrorism. Its cost over the first 20 months mounted to 120,000 million dollars, while the development aid of all the industrialized nations combined hardly reached 50,000 million. The United Nations estimates that an annual amount of 80,000 million dollars could cover the basic needs of all humanity (literacy, access to primary schooling, basic healthcare, and so on). Between March 2003 and November 2004 some 100,000 people died in Iraq, less than half the number of victims of the South Asia tsunami catastrophe at the end of 2004 (*The Lancet*, 2004).

The World Bank's war on poverty has been waged for over 15 years now. Its objectives, recalled in the Millennium celebrations in New York in 2000, were to halve poverty by 2015. But the deadline has been seriously challenged. Even so, to accept that 400 million people live on less than 2 dollars a day (of which 100 million have less than 1 dollar) by 2015 is not a particularly ambitious goal, still less a revolutionary one. Especially considering that, in 2001, 497 of the richest people in the world together possessed a fortune of 1,600 billion dollars and that it would be perfectly possible to eradicate destitution, illiteracy and ensure basic healthcare for a whole population in only a few years, as has been proved by countries like Vietnam and Cuba (both of which have been complimented by the World Bank in this respect), and is in the process of being accomplished in Venezuela. That country's new Constitution of 1999 recognizes the right to health. In one year (2003), 90 new clinics were created and 14 million people obtained access to primary health care. The Government has selected 500 generic drugs to be given free of charge, thereby covering 80 per cent of the country's needs. Anti-AIDS medicines were bought from India, so saving 10 million dollars for Venezuela. A new training course has been set up for medical personnel, which includes the social aspects of health (*The Courier*, Geneva, 10 June 2004). It is thus possible to provide well-being for every person in the world and the means do exist. What is needed is the will.

Instead, a veritable genocide is taking place. Each day, from 14,000 to 20,000 people die of hunger. UNICEF in its 2004 report sounds the alarm. This is why social movements and NGOs defending their cause are using new tools of expression and communication. They utilize the Internet, and meet at the World Social Forum to exchange their experiences and to give global visibility for their actions.

But, it is not only the financial and juridical mechanisms that reinforce the process of private wealth accumulation, against the common good. Culture, too, is serving the purpose. In fact, the market's hold over education is becoming stronger and stronger. In the United States, the education business already takes up 82 million dollars worth of investment (Barker, 2000: 107–14). The universities are gradually being reduced to advanced technical schools for the service of the market. Research is becoming privatized, university chairs are being sponsored by transnational corporations, scholarships are being replaced by loans. Universities are obliged to become centres of competitive excellence and whole sectors of the 'humanities' are disappearing from the taught curriculum. Everything must become commoditized, the only way of contributing to accumulation. The educational sector becomes one of its new frontiers and, in its wake, a source of new inequalities.

Health, too, is being guided towards the same end. Privatization is also the order of the day, with healthcare, emergency services and health insurance being thrust into the market sector. In Vietnam, the recourse to medicinal herbs that covered up to 60 per cent of village needs has disappeared, to be replaced by foreign medicines that are three to four times more expensive. This is just one of the effects of opening up to the capitalist market. The pauperization of part of the population excludes access to this type of drug.

The huge wave of privatization of the public services, in the North as in the South, changes users into clients – as long as they can afford to pay. This represents a considerable source of profit for private capital. At the same time, pride in working for an efficient public service at a reasonable salary is being eroded.

It is not only the South that is suffering from an increase of inequality. In the North, too, the differences are growing. The gap between the wages of the workers and salaries of the executives has widened immeasurably over the last few years. Poverty is increasing in Europe where, in 2000, the 15 countries of the Union had 20 million unemployed. In France, the number of persons excluded from the banking system is estimated to be between 5 and 6 million, or about 10 per cent of the population (*Le Monde*, 10 June 2004). In the United States, according to the Bureau of Census, there were 24.7 million poor in 1977 (11.6 per cent of the population) and in 1997, 35.5 million (13.9 per cent) (Dalabar and Naifeh, 1998). In 2003, presidential candidate John Kerry cited the figure of 45 million Americans who were without medical insurance. There is more work available there than in Europe, but a new development is the working poor who need several jobs in order to survive and are forced to work after the age of 70 to compensate for their small pensions. And, all the while, huge fortunes are being made.

The large international institutions do not escape the dominant logic. The weakening of the welfare state, once the guarantor of social pacts and redistributor of wealth, is also weakened at the world level. The FAO and the WHO, for lack of sufficient funding, have had to obtain finance from private corporations for some of their programmes.

Thus, 25 years after the Washington Consensus and 10 years after the fall of the Berlin Wall, a wave of protest has been erupting round the world. The first important action against the WTO took place in Seattle at the end of 1999. Resistance is being organized against the decisions of the leading economic and political powers as can also be seen in the huge demonstrations against the G8, the World Bank and the IMF. As we have seen, these alternative world movements began to converge at 'The Other Davos' in 1999, and then were further developed in the World Social Forums at Porto Alegre and Mumbai – not to mention the continental, thematic and local forums – bringing together hundreds of thousands of people. The development of triumphant neoliberalism without any counter-powers has submitted, not only waged workers, but populations throughout the world, to the law of value. This has aroused the resistance of millions of people: workers, the indigenous peoples who are losing their ancestral lands (*Chiapas*), women in the informal sectors, who are the first victims of the privatization of public services – water, electricity, education, health – small peasants who are losing their means of subsistence, illegal migrant workers, people made jobless in the sectors affected by competition, middle classes who have been made more poor and thus more vulnerable, small and medium-sized businesses that cannot survive the opening of the markets, ecologists who are denouncing the inexorable destruction of the environment.

In sum, all those who constitue the 'useless masses' because they do not produce enough 'added value' or are not creditworthy, are mobilizing to insist that they, too, are human beings. In opposition to Margaret Thatcher (once Prime Minister of the UK: 1979–90) when she stated that there was no alternative 'to the capitalist market', they affirm that 'another world is possible' and in fact they are discovering that there are alternatives in all fields – economic, social, political and cultural – and at all levels, and both in the long and short term. It is not that alternatives are lacking, but the lack of political will to apply them.

The vision of Porto Alegre is that of the victims of the system, as well as those who identify with their cause. It reflects the views of those who have understood that the market is a social relationship and that the capitalist market creates unacceptable unequal relationships. The people meeting at the Social Forums demand the introduction of parameters ignored by capitalist logic into economic calculation: the so-called externalities. This is a first step to prevent the concentration of wealth in the hands of a minority, when majorities are victims of the system. They propose alternatives, essential for the survival and quality of life of all human beings. They constitute a globalization of resistences against the globalization of capital (Polet, 2004).

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12

Moral Capitalism

Stephen B. Young

I question whether the Anglo-Saxon model of development, or American capitalism, is the true face of capitalism. Its proponents passionately argue that aggressive individualism in competition for the highest cash returns is not only the heart and soul of capitalism, but also produces the greatest good for the greatest number of persons. And, equally, opponents of the Anglo-Saxon model accept it at face value as a pure type of capitalist rationality.

A distinction must be drawn between speculation and enterprise. Speculation is mere market behaviour with its own rationality while, separately, enterprise is a far more social undertaking. Speculation gains or loses money through predictions about the preferences of other market players. There is no inherent need for trust in a market transaction. But with enterprise, equity capital must be attracted, credit obtained, employees hired, suppliers cultivated and customers satisfied. Enterprise gains or loses profits depending on the quality of a series of relationships. Enterprise needs stakeholders while speculation needs little more than eager and potentially foolish buyers and sellers.

If capitalism is more about enterprise than speculation, then it must internalize a moral framework into its opportunistic rationality. This insight, I submit, is central to the presentation of capitalism by Adam Smith in his book on the *Wealth of Nations* (1776). Smith presumed that enterprise prospered through rationalization of specialization and division of labour. Capital stocks were necessary to buy the machinery and coordination that promoted increasing specialization. And, returns on such capital needed to be earned over time and not in stockmarket floatations. Smith was intrigued by enterprise, not speculation. He did not write about how the South Sea Bubble, or the Mississippi Company of John Law in France, had contributed to the wealth of nations. He described the dynamics of a new social institution – the enterprise using science and technology to make and sell new products.

Whenever enterprise falls under the spell of speculation and the making of returns from the floatation of securities, it falls away from long-term success and imposes costs on whomever it can. This, in short, was the track record of Enron and WorldCom.

Speculation has been well-known throughout history. It preceded capitalism and followed the growth of trading markets. A charming story on market rationality comes down from the ancient state of Ch'i in China before the time of Confucius. The Duke of Ch'i loved clothes made from an expensive purple cloth. One day he complained to his minister Guan Zhong over the high price of purple cloth. Guan Zhong replied, 'I can solve the problem. The next time someone enters your presence wearing purple cloth, hold your nose' (apparently the dye used to get the purple colour also left a smell). The Duke did as instructed and suddenly everyone stopped wearing clothes made from purple cloth. Purple cloth was dumped into the markets of Ch'i and the price for such cloth dropped substantially. Guan Zhong bought up the cloth for a song and give it all to the Duke.

Shrewd as this market manipulation was on the part of Guan Zhong, it was not true capitalism. Once we distinguish between speculation and enterprise, I conclude that we need more than market rationality as a guide for capitalism.

In 1994 the Caux Round Table network of experienced business leaders proposed a set of guidelines for decision-making in business. They are called the Principles for Business. They make express reference to the stakeholder relationships necessary for sustained profitability of enterprise. More fundamentally, the CRT Principles for Business attempt to articulate goals and objectives for enterprise based on moral ideals of *Kyosei*, human dignity and stewardship. *Kyosei* is a Japanese standard of conduct that values mutuality and interdependence among living beings and their environments. The vision of *kyosei* presumes that we live within a network of dependencies and that we thrive as those relationships increasingly support us in return for our support of them. *Kyosei* commands that our ideal of justice provide for mutuality and respect for that on which we depend.

Human dignity is an abstraction about human nature deriving from the Christian religious tradition. It is a foundation for the social teachings of the Roman Catholic Church asking that individuals and institutions respect the autonomy and subjective value of individuals. The standard of human dignity asserts the inherent worthiness of each individual – the irreplaceable uniqueness of everyone, the importance of self-identity and the subjective consciousness of the autonomous individual – the finite being that has a soul and can be saved from earthly sinfulness by faith or good works.

Stewardship values are found inherent in many religions, but the tradition of responsible behaviour that devolved upon the authors of the Caux Round Table Principles for Business was Calvinist. Protestants in general and Calvinists in particular emphasize a theology that has individual humans responsible for the good use of the power and opportunities that God places in their hands. Enterprise capitalism first arose in the Calvinist/Protestant societies of The Netherlands, England and Scotland in the sixteenth, seventeenth and eighteenth centuries. Enterprise capitalism, therefore, needs a moral basis from which to reach wealth and profitability. What guides this structure of economic rationality is a moral capitalism. We should not be surprised that economic activity is embedded in culture and values. The behaviours of people do seem tied to mental perceptions of value, beliefs and interests, which only subsequently are translated into market preferences and choices. We arrange our lives around intangible structures of meaning. An awareness of core values illuminates the various forms economic activity has taken. Let us start with China. Chinese business behaviour is embedded in a particular culture where order is given a high priority.

In the system schematically outlined below, an institutional goal of *tai he* (order, peace, harmony) is achieved through mechanisms of coordination and control. Markets and private property are used and a profit-seeking rationality is tolerated but only under conditions that constrain and repress individual freedom. At the level of principle the system seeks to channel self-interest towards ends approved by the political leaders. At the level of standards for implementation, the Chinese system relies on hierarchies of authority where permission must be sought for business activities. Figure 12.1 illustrates how this system provides for enterprise stakeholders in ways consistent with its standards, principles and ideal of *tai he*.

Now let us consider a similar chart illustrating the traditional *keiretsu* structure of Japanese capitalism. In the Japanese pattern – different from the Chinese – private property and markets are contained within a social fabric seeking *Ninjo* or a non-economic end of personal well-being at the psychological level. *Ninjo* obtains when a person is part of reciprocal relationships known to the Japanese as *giri-on* exchanges of consideration and favours. To provide for these *giri-on* relationships, Japanese organized their business endeavours into *keiretsu* groups of companies.

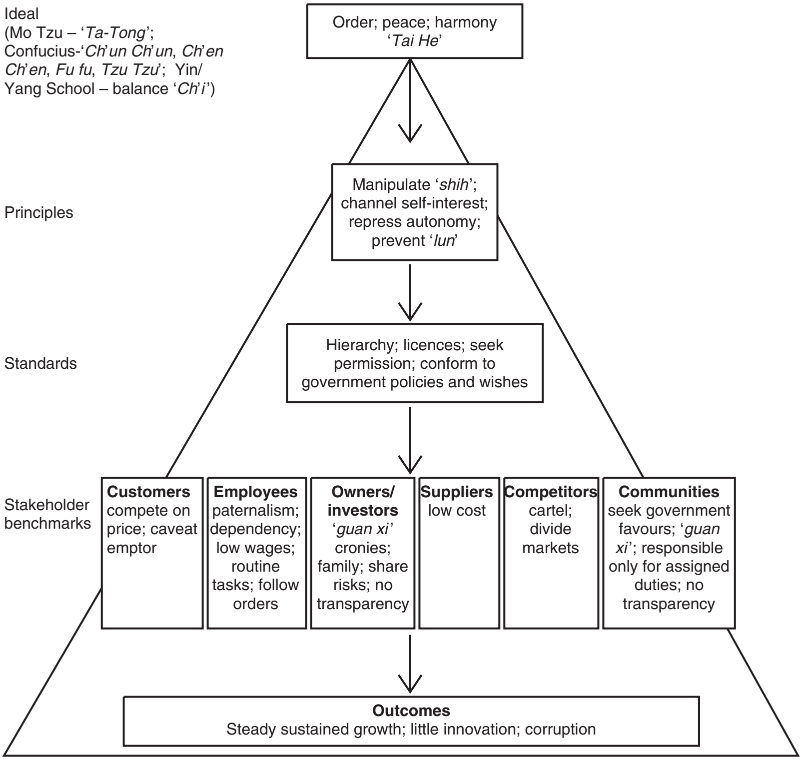

Figure 12.1 Chinese business value pyramid

This system was known to the wider world as 'Japan Inc.' In the early years of the twenty-first century it is breaking down however.

Stakeholders in Japan find their appropriate roles in support of a system that promotes the *keiretsu* as in Figure 12.2.

We can illustrate a third alternative system where private property and markets provide support for a system of social meaning. The culturally embedded ideal of the Mexican business world is a social status of dominion. The principles followed to arrive at this end are provision of honour and respect for the owner, tolerance of great personal discretion on the part of the owner, and looking at property as a kind of feudal territory or fiefdom. Accordingly, positions and titles are most important in Mexico, as are the prerogatives of ownership and the scope of one's influence – the number of clients and dependants one can claim title to. In this structure as illustrated in Figure 12.3, stakeholders do not rank very importantly.

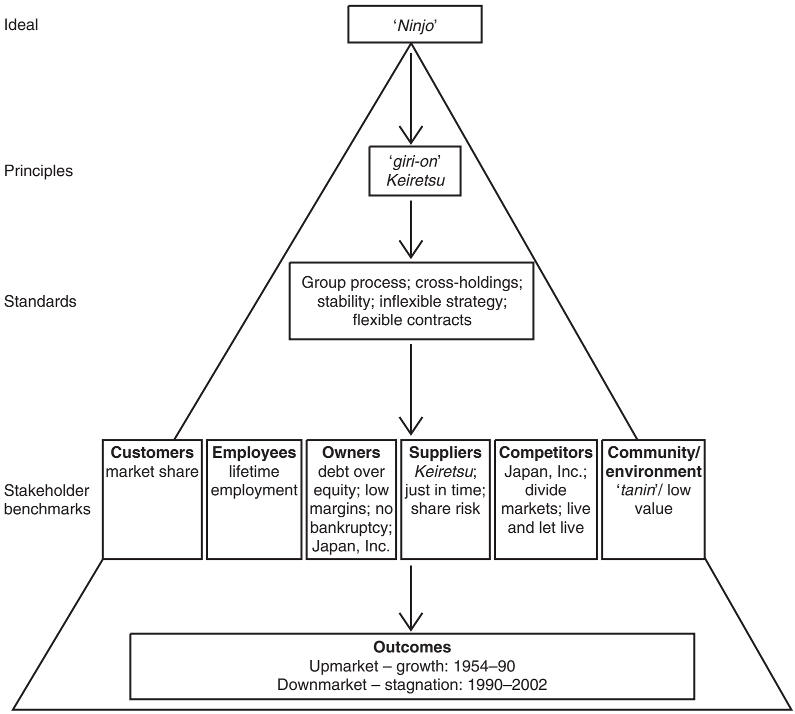

Figure 12.2 Japanese corporate value pyramid

This illustration of business norms and practices in Mexico seems to apply in large degree to other societies that, like Mexico, experienced cultural formation under Spanish colonial rule under the norms of the counter-reformation and the Hapsburg social structure. These societies would include the countries of Central America, South America and the Philippines. Business traditions in Sicily and southern Italy, also former Spanish Hapsburg dominions, also reflect patterns similar to those noted for Mexico.

If we look at Anglo-Saxon capitalism, especially in its more robust American expression, we can find it culturally embedded as well. The cultural matrix is that of Social Darwinism, the theory of adversarial individualism first propounded by Herbert Spencer in 1851. Spencer argued that individual humans, like individual animals, thrive best in a competition for mastery of their environment. Since only the fittest animals survive such struggles, Spencer concluded that only the fittest

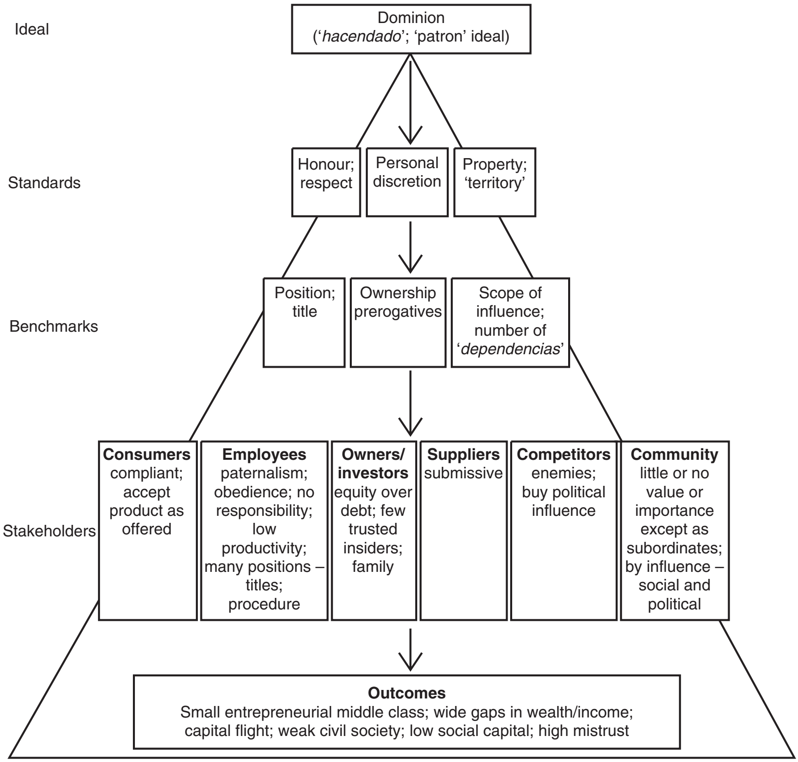

Figure 12.3 Suggested Mexican business value pyramid

humans should similarly survive. Spencer's vision has no recognizable moral core of the kind needed to sustain successful enterprise, so it should come as no surprise that intentionally Social Darwinistic companies like Enron fail.

But Spencer's formula promoting radical selfishness does give rise to a system of consistent behaviours, what I call a Brute capitalism. Figure 12.4 illustrates such a capitalism.

To design and then activate a more beneficial capitalism, what I call a moral capitalism, a set of values is needed as the culture bed nourishing the ends and supporting means of the system. The Caux Round Table Principles for Business can be taken up as the framework for such a cultural project with profound economic ramifications.

If the values of *Kyosei*, human dignity, and stewardship underlying the Caux Round Table Principles are highlighted and a set of principles and

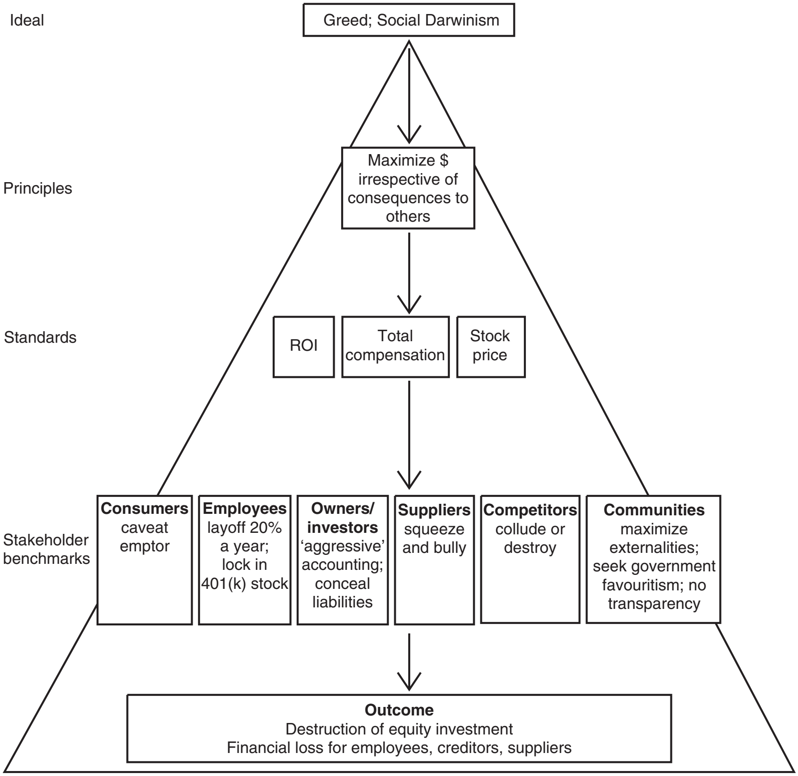

Figure 12.4 The irresponsible corporation – Enron

standards used for implementation, the resulting business dynamic is illustrated in Figure 12.5. The full text of the seven Caux Round Table Principles for Business and the associated standards to guide stakeholder relationships are provided at the end of this chapter in the Appendix. The most important of the seven general principles is the first, which affirms that 'the value of a business to society is the wealth and employment it creates and the marketable products and services it provides to consumers at a reasonable price commensurate with quality'. The first general principle also affirms the central thesis of a moral capitalism that a business must maintain its own economic viability in order to continue creating value for society, but its 'survival is not a sufficient goal'. A business is looked to from a moral perspective as a means of improving the lives of all its customers, employees and shareholders. In

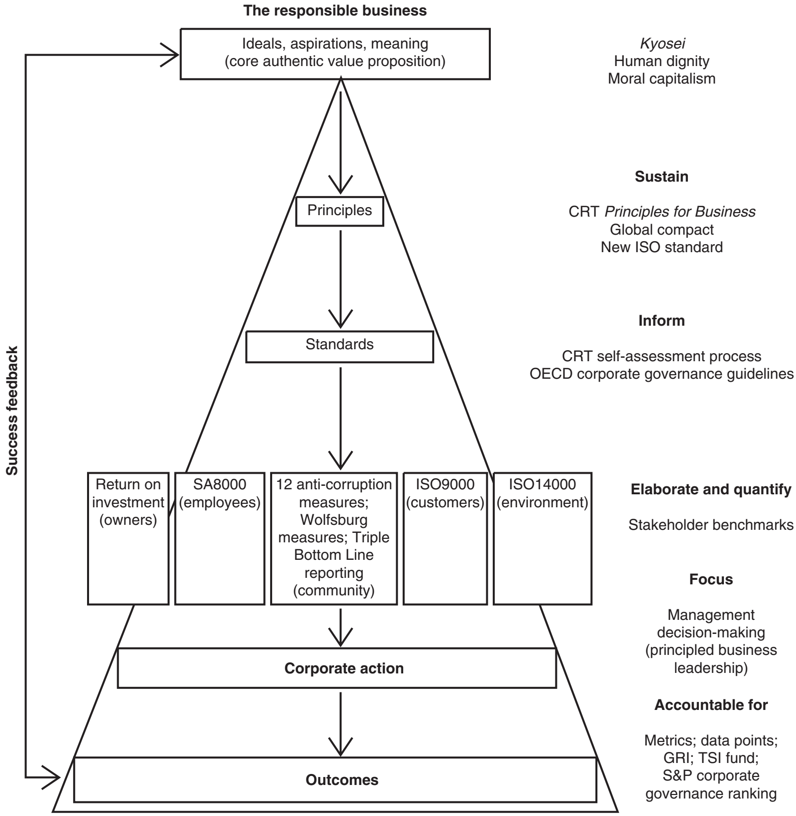

Figure 12.5 The Caux Round Table Principles for Business

addition, suppliers and competitors should be treated honestly with fairness and businesses must understand that they are responsible citizens of the local, national, regional and global communities in which they operate.

The six additional Caux Round Table general principles affirm that business must contribute to the economic and social development of the community at large through effective and prudent use of resources, free and fair competition, and with emphasis on innovation; that they must go beyond the narrow requirements of the law to honour sincerity, candour, truthfulness and transparency; that they should recognize that some behaviour, though legal, may still have adverse consequences; that they should cooperate in the liberalization of global trade; that they should protect, and where possible improve, the environment; and, finally, that they must avoid corruption, bribery and every form of illicit transaction.

With respect to customers, a moral capitalism takes them as providing the moral compass of value for the system of production and exchange, honouring consumer sovereignty in the marketplace. This respect for customers leads directly to the power of capitalism to upset and overthrow the status quo (what economist Joseph Schumpeter called the power of 'creative destruction'). Such constant and cold-hearted resetting of market equilibrium points keeps capitalism always at the cutting edge in serving society's needs and demands.

With respect to employees, a moral capitalism takes them as moral agents of enterprise, as human capital, not as a cost of production or fungible and expendable parts of a machine. In an agency relationship, the principal and agent are tied to one another with reciprocal contractual duties of loyalty and due care. Owners of an enterprise and those

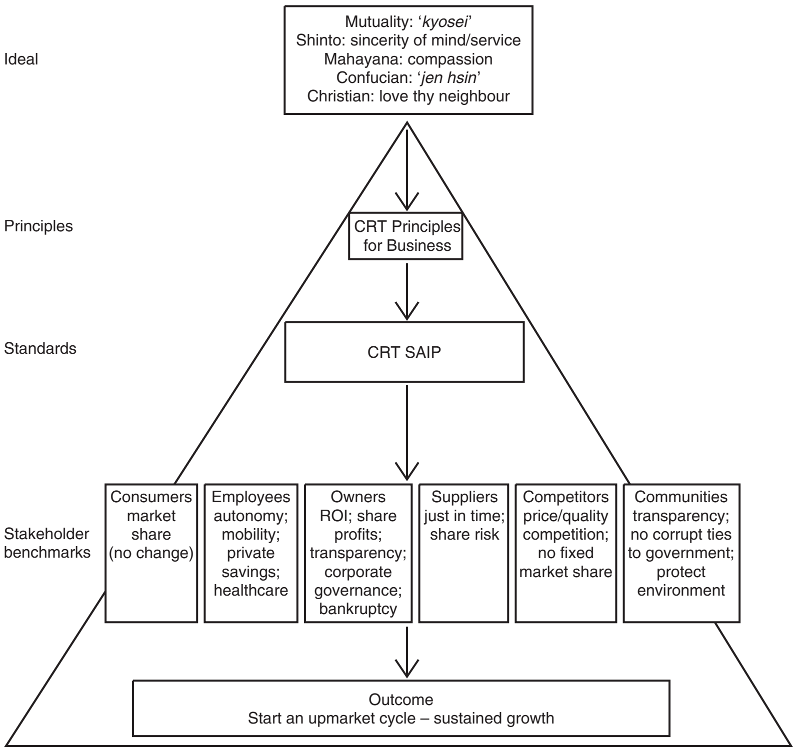

Figure 12.6 A suggested value pyramid for Japan

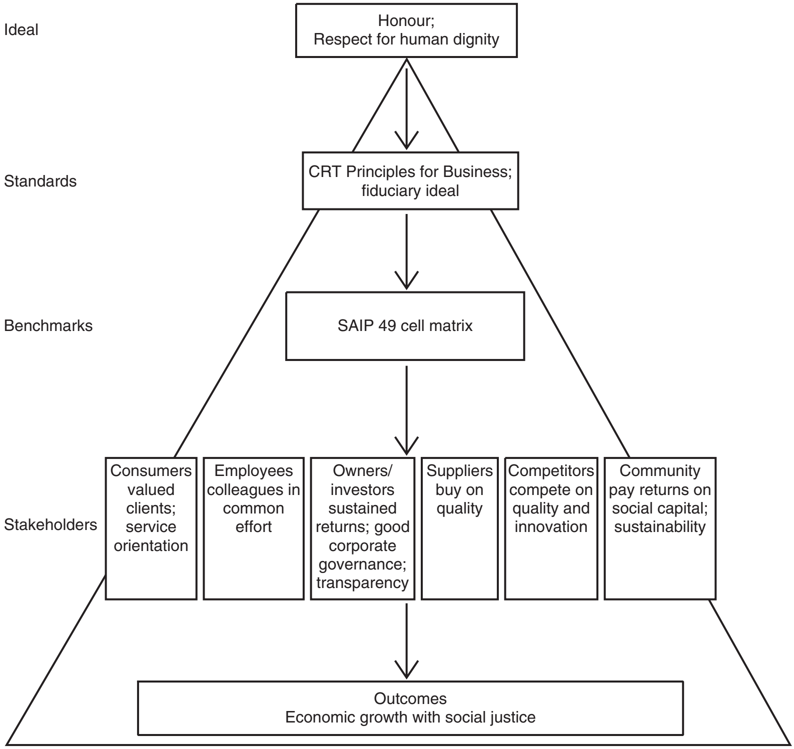

Figure 12.7 Proposed Mexican business value pyramid

who lend money to the business similarly deserve honest accounting. Management is stewardship of other people's money while transparent communications with creditors keeps funds flowing to the business. Suppliers, as demonstrated by the quality movement in manufacturing, are best taken as friends and colleagues and not as enemies to be exploited to the maximum extent their needs will permit.

Competition in a moral capitalism uses quality, service and innovation to avoid the trap of price competition. Lowering prices to gain market share ends up with a commodity industry where the increasing scale of production only delays the inevitable shrinking of profit margins to zero or worse. And, finally, with the stakeholder of community, business should contribute to the creation of social capital – the quality of life in a community – that in turn feeds good employees, customers with purchasing power, and sufficient infrastructure back into the business.

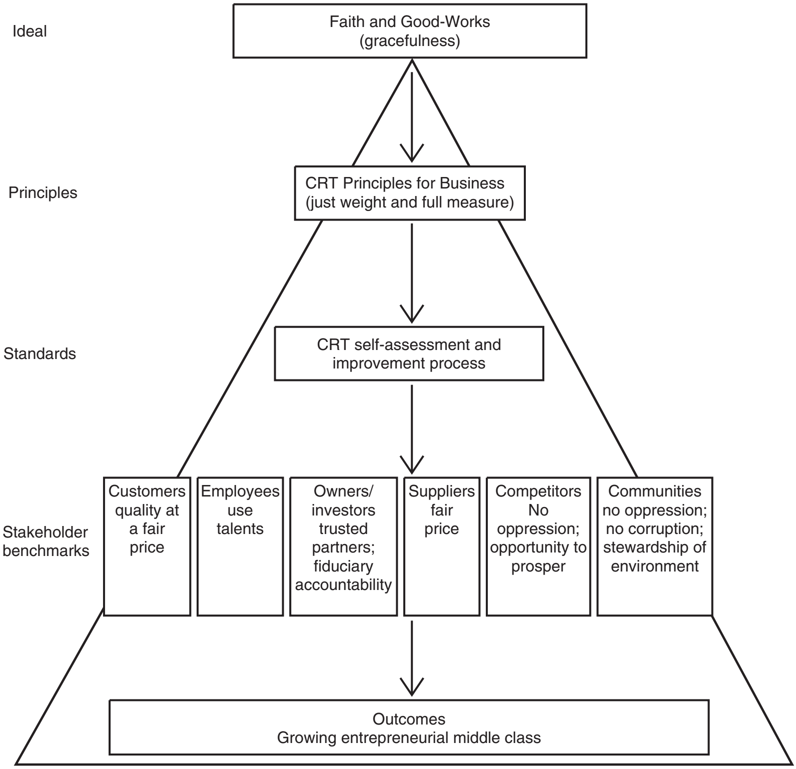

Figure 12.8 Koranic business value hierarchy

These are the norms of a moral capitalism. Actually they are little more than common sense, a self-interest accurately considered upon the whole.

Moral capitalism in cross-cultural settings

Now the general norms of the Caux Round Table Principles for Business can also be integrated into national cultural platforms for business behaviour. Such integration is perhaps a precondition for the implementation of a moral capitalism on a global basis. A suggested formula for such integration in Japan would replace *Ninjo* as the paramount ideal with *Kyosei*. The corresponding innovative paradigms for Japanese business would then resonate as illustrated in Figure 12.6.

An alternative to the traditional Mexican business value hierarchy would shift the paramount cultural norm from dominion to human dignity. The resulting system would reflect the schema shown in Figure 12.7.

And, if we turn to the Islamic world, we could integrate the principles and standards of a moral capitalism into a Koranic framework as in Figure 12.8.

Conclusion

Since there is no need to identify capitalism with Brute capitalism or the extreme individualism and short-sightedness with high externalities for stakeholders sometimes found in the Anglo-Saxon model, intentional efforts can move business practices towards a more moral form of free-market and entrepreneurial wealth-creation. What should be sought is optimal wealth creation for the global community with fair distributive outcomes resulting from the allocation of private-sector capital investment coupled with minimal negative externalities for stakeholders, including the environment.

A management process of quality control – with quality broadly understood as encompassing the aims of moral capitalism – can lead to decentralized business decision-making consistent with the desired goals. The quality movement in manufacturing brought about lower costs, higher quality products, more eco-friendly production technologies, and more satisfied customers. Similar results can be expected from a programme of moral capitalism.

Appendix: The Caux Round Table Principles for Business (1994)

Introduction

The Caux Round Table believes that the world business community should play an important role in improving economic and social conditions. As a statement of aspirations, this document aims to express a world standard against which business behaviour can be measured. We seek to begin a process that identifies shared values, reconciles differing values, and thereby develops a shared perspective on business behaviour acceptable to and honoured by all.

These principles are rooted in two basic ethical ideals: *kyosei* and human dignity. The Japanese concept of *kyosei* means living and working together for the common good enabling cooperation and mutual prosperity to coexist with healthy and fair competition. 'Human dignity' refers to the sacredness or value of each person as an end, not simply as a mean to the fulfilment of others' purposes or even majority prescription.

The General Principles in section 2 seek to clarify the spirit of *kyosei* and 'human dignity', while the specific Stakeholder Principles in section 3 are concerned with their practical application.

In its language and form, the document owes a substantial debt to The Minnesota Principles, a statement of business behaviour developed by the Minnesota Center for Corporate Responsibility. The Center hosted and chaired the drafting committee, which included Japanese, European and United States representatives.

Business behaviour can affect relationships among nations and the prosperity and well-being of us all. Business is often the first contact between nations and, by the way in which it causes social and economic changes, has a significant impact on the level of fear or confidence felt by people worldwide. Members of the Caux Round Table place their first emphasis on putting one's own house in order, and on seeking to establish what is right rather than who is right.

Section 1: preamble

The mobility of employment, capital, products and technology is making business increasingly global in its transactions and its effects.

Law and market forces are necessary but insufficient guides for conduct.

Responsibility for the policies and actions of business and respect for the dignity and interests of its stakeholders are fundamental.

Shared values, including a commitment to shared prosperity, are as important for a global community as for communities of smaller scale.

For these reasons, and because business can be a powerful agent of positive social change, we offer the following principles as a foundation for dialogue and action by business leaders in search of business responsibility. In so doing, we affirm the necessity for moral values in business decision making. Without them, stable business relationships and a sustainable world community are impossible.

Section 2: general principles

Principle 1: the responsibilities of businesses

Beyond shareholders toward stakeholders

The value of a business to society is the wealth and employment it creates and the marketable products and services it provides to consumers at a reasonable price commensurate with quality. To create such value, a business must maintain its own economic health and viability, but survival is not a sufficient goal.

Businesses have a role to play in improving the lives of all their customers, employees, and shareholders by sharing with them the wealth they have created. Suppliers and competitors as well should expect businesses to honor their obligations in a spirit of honesty and fairness. As responsible citizens of the local, national, regional and global communities in which they operate, businesses share a part in shaping the future of those communities.

Principle 2: the economic and social impact of business

Toward innovation, justice and world community

Businesses established in foreign countries to develop, produce or sell should also contribute to the social advancement of those countries by creating productive employment and helping to raise the purchasing power of their citizens. Businesses also should contribute to human rights, education, welfare, and vitalization of the countries in which they operate.

Businesses should contribute to economic and social development not only in the countries in which they operate, but also in the world community at large, through effective and prudent use of resources, free and fair competition, and emphasis upon innovation in technology, production methods, marketing and communications.

Principle 3: business behaviour

Beyond the letter of law toward a spirit of trust

While accepting the legitimacy of trade secrets, businesses should recognize that sincerity, candor, truthfulness, the keeping of promises, and transparency contribute not only to their own credibility and stability but also to the smoothness and efficiency of business transactions, particularly on the international level.

Principle 4: respect for rules

To avoid trade frictions and to promote freer trade, equal conditions for competition, and fair and equitable treatment for all participants, businesses should respect international and domestic rules. In addition, they should recognize that some behaviour, although legal, may still have adverse consequences.

Principle 5: support for multilateral trade

Businesses should support the multilateral trade systems of the GATT/World Trade Organization and similar international agreements. They should cooperate in efforts to promote the progressive and judicious liberalization of trade and to relax those domestic measures that unreasonably hinder global commerce, while giving due respect to national policy objectives.

Principle 6: respect for the environment

A business should protect and, where possible, improve the environment, promote sustainable development, and prevent the wasteful use of natural resources.

Principle 7: avoidance of illicit operations

A business should not participate in or condone bribery, money laundering, or other corrupt practices: indeed, it should seek cooperation with others to eliminate them. It should not trade in arms or other materials used for terrorist activities, drug traffic or other organized crime.

Section 3: stakeholder principles

Customers

We believe in treating all customers with dignity, irrespective of whether they purchase our products and services directly from us or otherwise acquire them in the market. We therefore have a responsibility to:

- provide our customers with the highest quality products and services consistent with their requirements;
- treat our customers fairly in all aspects of our business transactions, including a high level of service and remedies for their dissatisfaction;
- make every effort to ensure that the health and safety of our customers, as well as the quality of their environment, will be sustained or enhanced by our products and services;
- assure respect for human dignity in products offered, marketing, and advertising; and respect the integrity of the culture of our customers.

Employees

We believe in the dignity of every employee and in taking employee interests seriously. We therefore have a responsibility to:

- provide jobs and compensation that improve workers' living conditions;
- provide working conditions that respect each employee's health and dignity;
- be honest in communications with employees and open in sharing information, limited only by legal and competitive constraints;
- listen to and, where possible, act on employee suggestions, ideas, requests and complaints;
- engage in good faith negotiations when conflict arises;
- avoid discriminatory practices and guarantee equal treatment and opportunity in areas such as gender, age, race, and religion;
- promote in the business itself the employment of differently abled people in places of work where they can be genuinely useful;
- protect employees from avoidable injury and illness in the workplace;
- encourage and assist employees in developing relevant and transferable skills and knowledge; and
- be sensitive to the serious unemployment problems frequently associated with business decisions, and work with governments, employee groups, other agencies and each other in addressing these dislocations.

Owners/investors

We believe in honoring the trust our investors place in us. We therefore have a responsibility to:

- apply professional and diligent management in order to secure a fair and competitive return on our owners' investment;
- disclose relevant information to owners/investors subject to legal requirements and competitive constraints;

- conserve, protect, and increase the owners/investors' assets; and
- respect owners/investors' requests, suggestions, complaints, and formal resolutions.

Suppliers

Our relationship with suppliers and subcontractors must be based on mutual respect. We therefore have a responsibility to:

- seek fairness and truthfulness in all our activities, including pricing, licensing, and rights to sell;
- ensure that our business activities are free from coercion and unnecessary litigation;
- foster long-term stability in the supplier relationship in return for value, quality, competitiveness and reliability;
- share information with suppliers and integrate them into our planning processes;
- pay suppliers on time and in accordance with agreed terms of trade; and
- seek, encourage and prefer suppliers and subcontractors whose employment practices respect human dignity.

Competitors

We believe that fair economic competition is one of the basic requirements for increasing the wealth of nations and ultimately for making possible the just distribution of goods and services. We therefore have a responsibility to:

- foster open markets for trade and investment;
- promote competitive behavior that is socially and environmentally beneficial and demonstrates mutual respect among competitors;
- refrain from either seeking or participating in questionable payments or favors to secure competitive advantages;
- respect both tangible and intellectual property rights; and
- refuse to acquire commercial information by dishonest or unethical means, such as industrial espionage.

Communities

We believe that as global corporate citizens we can contribute to such forces of reform and human rights as are at work in the communities in which we operate. We therefore have a responsibility in those communities to:

- respect human rights and democratic institutions, and promote them wherever practicable;
- recognize government's legitimate obligation to the society at large and support public policies and practices that promote human development through harmonious relations between business and other segments of society;
- collaborate with those forces in the community dedicated to raising standards of health, education, workplace safety and economic well-being;

- promote and stimulate sustainable development and play a leading role in preserving and enhancing the physical environment and conserving the earth's resources;
- support peace, security, diversity and social integration;
- respect the integrity of local cultures; and
- be a good corporate citizen through charitable donations, educational and cultural contributions, and employee participation in community and civic affairs.

Reference

Caux Round Table (2005) 'The Caux Round Table Principles for Business', http://www.cauxroundtable.org/documents/Principles%20for%20Business.PDF (accessed July).

Part 4

Endpiece

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13

Futures – and Still More Complexity

John B. Kidd and Frank-Jürgen Richter

In the near-term

At the sharp end of business under the Anglo-American rules, and others, there is an annual need to file accounts to show to the public that the firm is correctly managed and its resources correctly assessed. Of course 'correct' is determined by rules which vary over time as international legislation determines how firms have had to be more open and transparent. One part of this is that multi-national firms have had to devise internal methods to be able to compare the performance of their subsidiaries operating in various countries; and another part is determined by the stakeholders wishing to see that their investments are being managed well, notwithstanding where in the world the firms are operating. As we have seen in earlier chapters, the big economic models vary quite considerably, and there is not a universal acceptance of the Anglo-American way. Understandably, accounting standards have not been applied fairly, or evenly across nations – there is considerable disagreement upon the principles to be applied. This has allowed variety to hide corruption.

Sarbanes–Oxley

Many have searched for a universal method of accounting. One system, GAAP (Generally Acceptable Accounting Procedures) has had widespread approval in principal, but less adherence in practice, especially across Asia. By and large we note that these are the rules 'that companies are expected to follow'. And we are warned – if a financial statement is not prepared using GAAP principles, be very wary! That said, we have to keep in mind that GAAP is only a set of standards. There is plenty of room within GAAP for unscrupulous accountants to distort figures. And so they did. … which resulted in the scandals of Enron and so on … and in turn new procedures were rapidly brought in, one of the latest being the US-based Sarbanes–Oxley Act of 2002.

All, however, is not well with the enactment of this Act – accounting professors Susan Eldridge and Burch Kealey of the University of Nebraska have reviewed the accounts of 633 of the *Fortune 1000* firms finding these firms have paid more than $3.6 billion for their 2004 audits, compared to $2.2 billion which they paid in 2003. This increase is due mainly to the costs of implementing the Sarbanes–Oxley Act (UNO News, 2005).

The Sarbanes–Oxley Act, or SOX as it is ubiquitously known, was passed in response to corporate financial scandals. It mandates that US businesses report on their internal financial controls, and to have those controls audited in a tight fashion by outside auditors. Many businesses have complained the law requires them to spend large sums of money to ensure their accounting systems are in compliance. The observed average audit fee increase of almost $2.2 million is significantly higher than the estimates of SOX implementation offered by the Securities and Exchange Commission. The SEC suggested that companies would face an additional $91,000 in costs to meet the new internal control requirements of SOX. Now the SEC has suggested that the SOX rules be relaxed a little to ease the burden on the accounting firms, and on the consultancies who have had to employ two teams – one to interpret SOX, the other to implement SOX. But the consulting firms passed on these costs to their clients who are stuck in a bind – to be compliant or to face heavy fines.

The *Business Gazette* of 10 June comments along the lines of:

> Compliance with the 3-year-old corporate anti-corruption law written by U.S. Sen. Paul S. Sarbanes (D) of Baltimore and U.S. Rep. Michael Oxley (R-Ohio) has become too costly and burdensome, some say. ‘It’s important to have some type of ethical oversight’, said Kathleen T. Snyder, CEO and president of the Maryland Chamber of Commerce, ‘but many businesspeople have told me that this law has overreached its goal and become a costly expense, without providing much overall accountability’.

http://www.gazette.net/200523/business/news/279722-1.html (accessed 10 June 2005)

This finding is quite likely to put the new system of strong checks into some disarray, leading once more to inventive accounting and misrepresentation. In turn this will allow critical observers to imply that if the micro systems are wrong then the macro systems cannot be right either, thereby denying any relevance to the Anglo-American development model, nor allowing any discussion of any merits it may have.

International Financial Reporting Standards (IFRS)

This is the new mantra in Europe, and one which will soon become mandatory. The standards cover several facets of the business – the declaration of all derivatives, an annual review of 'goodwill', a clearer itemized valuation of intangible assets like patents, trademarks and all intellectual property, the declaration of all pensions liabilities, and a declaration of all options granted to all employees, such as stock options. In following these new rules we see in *BusinessWeek* that firms have dramatically altered their bottom-line profits – some up, but many dramatically down (Capell and Ewig, 2005). Because of the need to declare more information, some firms have already found that by moving from historical cost accounting (based on original values) to fair-value accounting (based on ongoing gains and losses) they have discovered that curious and potentially damming statements they previously could have made are now simply not possible. This new clarity allows investors to make better company comparisons across borders or between sectors. It ought to promote better management too as international differences may not be hidden from the Board. In the same issue of *BusinessWeek* we have our attention drawn to the state of the US insurance giant AIG which indicates so far some US$1.7 billion of transgressions and errors in shareholder statements over a 14-year period (McNamee, 2005). In this article McNamee states that it is not only the declaration standards that must be upheld, but nations need to have regulators with better mechanisms of control and strong powers to enforce change.

These new accounting standards (IFRS) were developed by the London-based International Accounting Standards Board who see this European first-step as an move towards globalised harmony and, at the moment (mid-2005), about half the countries of the world have agreed to permit or mandate these new rules. The chair of IASB, Sir David Tweedie, says the standards will 'break down barriers to investment and trade, and stimulate growth'. We, the editors, consider that this form of standardization will promote global commerce, whereas battles over national or international economic models tend to uphold hostile feelings towards others' models and delay the real need to move trade into bi- or multilateral agreements.

Getting it together?

Sociometrics

Several of our authors in this book have mentioned 'culture' as one of the factors limiting or biasing economic models or development initiatives. Perhaps, therefore, it is time to review, albeit briefly, some of the findings of Hofstede. From global data in which variety was well-controlled, he found four factors that 'measured' cultural differences between nations, and later he added a fifth (Hofstede, 1980, 1991). Although some criticism has been made against his work, there are several corroborative studies which uphold his findings. He notes that organizational effects are governed by the Power Distance Index (PDI) and the Uncertainty Avoidance Index (UAI), while the more social aspects are governed by the Individuality (IDV) and the Masculinity Index (MAS) together with the long-term metric, Confucianism (CONF), also contributing to the social effects. We thus see in Table 13.1 that Western countries exhibit quite different scores on PDI and UAI than do Eastern countries, being generally less hierarchical (lower PDI) and more accepting of uncertainty (lower UAI) than the eastern nations. And in terms of their social aspects, the Eastern nations are almost all inclined to the longer term, and the West to short-termism (the West is lower on CONF metric).

Hofstede found these metrics from his studies in organizations, yet he suggested they indicate the 'software of the mind' and they characterized each nation's culture. It would not be far-fetched to suggest that the economic model that each nation finds acceptable would reflect its sociometric characteristics. Observably, as the UK and US data are so close it may be not surprising that they accept a similar economic

Table 13.1 Selected Hofstede indices

Country	*PDI*	*UAI*	*IDV*	*MAS*	*CONF*
USA	40	46	91	62	29
UK	35	35	89	66	25
Germany	35	65	67	66	31
Sweden	31	29	71	5	33
Hong Kong	68	29	25	57	96
China	80	60	20	50	118
Japan	54	92	46	95	80
Korea	60	85	18	39	75

Source: Hofstede (1980).

vision, hence the Anglo-American model that is described in Chapter 2. The communitarian model of Germany handles the uncertainty avoidance and the lower individuality index (when compared to the Anglo-US model and this also inclines to the Hofstede indices of Germany and several northern European nations). And the Asian model which stresses community spirit does so from the view of a strong hierarchy as reflected in their higher PDI scores and lower IDV scores. As the economic models do not come in a 'one size fits all' mode, neither do the sociometric characteristics, as we see nation by nation there are differences – 'cultural' differences as Hofstede might say.

Futures

The role of the business schools

In Chapter 1 we noted that Business Schools were created in the USA in Harvard University, and their website proclaims, 'Founded in 1908, Harvard Business School is nearly as old as the concept of management education itself – and in less than a century, the School has produced leaders and ideas that have shaped the practice of management in vital organizations of every kind around the globe'. Since that time a great literature has developed, apparently accessible to all. But this management literature (mainly written in English) is dominated in terms of volume by the American view, and so inevitably their models of the world are taught to the young business people of the globe – to aspiring Chinese, for instance, who will grow up learning the strictures relating to 'management' as written, for instance, by Chester Barnard (1938).

His *Acceptance Theory of Authority* states that managers only have as much authority as employees allow them to have. He suggests that authority flows downwards but depends on acceptance by the subordinate. In turn, the acceptance of authority depends on four conditions: (1) employees must understand what the manager wants them to do; (2) employees must be able to comply with the directive; (3) employees must think that the directive is in keeping with organizational objectives; and (4) employees must think that the directive is not contrary to their personal goals. By and large he treats the organization as culture-free and impersonal which in some ways follows the '[Protestant] work ethic'. It lies entirely within the Traditional or classical management genre which focuses on efficiency and includes bureaucratic, scientific and administrative management. Bureaucratic management relies on a rational set of structuring guidelines, such as rules and procedures, hierarchy, and a clear division of labour; scientific management focuses on the 'one best way' to do a job; administrative management emphasizes the flow of information in the operation of the organization. We know now that this 'one' way of managing does not work in all nations.

The number of business schools grew rapidly from the 1960s when there was a recognition of the right to better education and a recognition also of the need to educate managers in 'management'. However, the business schools have gone too far along the road to teach management *science* or administrative *science* and to exclude the difficult exploration of the *art* of management (Bennis and O'Toole, 2005; Tsurumi, 2006; Ghoshal, 2005). As Bennis and O'Toole say, the management of the business schools, through their internal appraisal systems, have erred too far towards the models and processes of hard science. They say the problem is that 'it is not that they have embraced scientific rigour, but they have forsaken other forms of knowledge', what we are describing as the *art* of management.

Following on from this is the pressure to accept the science of the Anglo-American economic model in addition to well-researched econometric models; or the application of decision analysis and artificial intelligence systems to portfolio management, and so on. All are artefacts of the western individualistic inhuman scientific management that was lauded by Chester Barnard so long ago.

Now more than ever we must recognize the pluralistic globe in which we live and work. Cultural sensitivity is a strong part of this recognition process, as is the acceptance that there is no best economic or developmental model that fits the whole globe, and that the newly developed or developing nations cannot be restricted by the straightjacket of the IMF or World Bank models.

Off-shoring: a dilution of the national model

Once large firms looked to vertical integration as the best way to control costs and quality – Ford made everything in-house from casting its engine blocks to making the car seats. Now most items are outsourced to satellite, specialist independent firms. The lauded Japanese production model also has satellite firms, but they operate within a vertical and/or horizontal family of partially owned firms – the *keiretsu* (Miyashita and Russell, 1994). In both models the outsourced firm operates locally, usually only a few kilometres from the final assembly plant, since the latter demands the suppliers keep all stock, and deliver just the right numbers of units just-in-time: a production model honed to perfection by Toyota in Japan.

Now the situation is somewhat different. For some years firms have been moving back-office tasks overseas to low-wage regions: these are tasks or processes that are easily defined and are an almost closed system so errors and timing problems will not greatly impact the core business. Accounting, payroll and sales are all examples of processes that can be outsourced or off-shored.

Now firms have to capture a global competitive advantage through correctly identifying what tasks can be outsourced or off-shored, and increasingly these relocatable tasks encroach upon what was once seen as core business tasks. For instance, ideas generation and innovation do not exist only at home (be this in the USA, Europe or even Asia), and more distant work clusters may be able to offer distinct advantages. So R&D is being moved to new regions, which may not be co-located with the back-office tasks.

Firms are pursuing multi-location off-shoring strategies based on collaborative Internet communications strategies with third-party companies providing a management buffer zone to track progress on all aspects of a firms business. They will manage cultural differences as well as engage in the merging of the differing and competing economic development models that have caused friction in the past as senior managers insisted, for instance, on the Anglo-American model being followed in Asia or South America where its modalities do not fit local ways of working and management reporting.

These methods are new to the business school teaching, and not yet recognized in the big economic models we have seen in Chapters 2 to 6. Yet, the chapters addressing 'alternatives' be they from the Porto Alegre group, or from those advocating sustainability as the quadruple-bottom-line in accounts, all incline to this new multi-faceted organizational management model. What is needed is to allow the young managers in the developing nations to be taught to view situations with open eyes and not to be taught dogma from the days of early industrialization.

Corruption, ethics and transparency

We are all products of our past – our history moulded our thoughts, mannerisms and our ways of behaving in private as well as with our public face. *BusinessWeek* in February 2005 ran a cover story 'Fakes!' in which they suggested that the global counterfeiting business is out of control, and where the target is anything from computer chips through to critical life-saving drugs. Hand-tools, motor bikes and cars are not exempt, and of course dollar notes are easy game (Balfour, 2005). The World Customs Organization thinks the illicit trade may cover 7 per cent of the world's trade – about US$512 billion in 2004. Apart from being potentially hazardous (especially in the case of fake drugs having no active components), the copies while thriving on a system of globalization, deny the originating firms of their rightful income following their heavy R&D expenditures. Eventually, the real firms will go out of business since the debts of R&D cannot be recovered, innovation will cease, and no new drugs, handbags or other artefacts will be produced.

The degree to which we are willing to be corrupt is captured by Transparency International who produce three measures annually to indicate how corrupt nations are – and implicitly, the members of their population – when compared to an absolute measure of honesty:

- The Corruption Perceptions index ranks countries in terms of expert opinion:

  they find that corruption is rampant in 60 countries, and the public sector is plagued by bribery. The CPI 2004 ranks 146 countries noting that most oil-producing nations are prone to high corruption.
- The Global Corruption Barometer survey assesses general public attitudes towards and experiences of corruption in dozens of countries around the world:

  In summary they find that political parties are the most corrupt institutions worldwide according to the Corruption Barometer 2004; and in six out of 10 countries, political parties are given the worst assessment.

  Governments must enhance their efforts to fight graft, starting with their ratification of the UN Convention against Corruption.
- The Bribe-Payers survey evaluates the supply side of corruption – the propensity of firms from industrialized countries to bribe abroad:

  they find that Russian, Chinese, Taiwanese and S. Korean companies are widely seen using bribes in developing countries; and that a high propensity to bribe overseas is also seen for companies from Italy, Hong Kong, Malaysia, the United States, Japan, France and Spain. Construction and arms industries top the sectors of heaviest bribery.

Sources: http://www.transparency.org/pressreleases_archive/2004/2004.10.20.cpi.en.html (accessed June 2005)

We talk here, in this last section, of the dark side of business, commerce or politics as this aspect, though hidden often from the general public, nevertheless impinges directly on many of the globe's poor, and the corrupt practices are promoted by the globe's most powerful people region by region. The effects of corruption, poor ethics and opacity bias the drivers in the economic development models. The latter assume generally efficient distribution of wealth and the efficient use of resources, but when 20–40 per cent of the capital of an aid project is 'mislaid' the remaining funds cannot achieve the project's target yield, so both the donors and the target recipients fail to match their (contractual) promise, and it is the robber barons who profit from these situations.

There is a further sorry state of affairs, mentioned by Houtart in Chapter 11:

> Servicing debt is another mechanism of absorbing wealth. It absorbs increasingly large resources across the South. As is well known, most of these debts are what are called in international law 'odious debts': expenditure on armaments by military dictatorships, often allies of the West; 'white elephants' (industrial or infrastructure projects that are useless, but profitable for the companies in the North, and certain politicians in the South); and pressures by the holders of petro-dollars.
>
> [He continues] The social effects can be measured, for example in Africa, where debt servicing is equal to four times the combined budgets of health and education, while Brazil could double its expenditure on these two items if it did not have to meet the costs of the debt. This effect became obvious during the 1990s. In many countries of Africa, Asia and Latin America, education and health budgets were reduced in order to apply Structural Adjustment Programmes.

The adverse effects of malnutrition in Africa impacts negatively on educational achievement. We mentioned the research of Lynn and Vanhanen (2005) in Chapter 1, noting that they found the Asian child more advanced than the average: in contrast, they find the African child greatly disadvantaged through malnutrition, unable to rise to the potentials they ought to express.

Thus, economic development models, poorly applied in Africa and other disadvantaged regions with tied conditionality on loan use and repayment have simply failed to develop these nations. To a great extent corruption has biased the loan management. While donors cannot be seen to support the inevitable baksheesh and loss of incoming capital by offering over 100 per cent grants, the stringent conditions posed by the World Bank, the IMF and so on have also led to the failure noted by Houtart.

In Africa at least some breakthrough is occurring. Tony Blair, hosting the G8 at its June 2005 meeting in Gleneagles, called for some US$40 billion debt to be wiped clear with two major conditions – that corruption be fought and eradicated, and democracy upheld. This has resulted in an instant response in South Africa where President Thabo Mbeki has sacked his Deputy – Jacob Zuma – on suspicion of receiving bribes. It was found that a 'generally corrupt relationship' linked Deputy President Jacob Zuma and his financial adviser Schabir Shaik, who had himself recently been convicted of soliciting a $100,000 bribe from a French arms company on behalf of Zuma.

Finally

It is well over 2,300 years since Alexander the Great solved the problem of the Gordian knot by slicing through its intricacies with his sword. In our time, such effective measures are sought but are rarely found due to the many interactions within modern infrastructure. Clear up one issue and others seem to develop far too quickly. It behoves us to remember the logical principle attributed to the mediaeval philosopher William of Occam: his principle states that one should not make more assumptions than the minimum needed, and it is often called the 'principle of parsimony'. It admonishes us to choose the simplest from a set of otherwise equivalent models of a given phenomenon. If one starts with too complicated foundations for a theory that potentially encompasses the universe, the chances of getting any manageable model are very slim indeed. Moreover, the principle is sometimes the only remaining guideline when entering domains of such a high level of abstraction that no concrete tests or observations can decide between rival models.

If we look away from economics at a differing technological sector, but no less broad than economic development, we find that Einstein spent the second half of his career trying to unify the forces of nature into one comprehensible system. The physics community today is mostly agreed that today's challenge lies in unifying Einstein's general theory of relativity (gravity) with quantum field dynamics (the aspect of quantum mechanics that links three other fundamental forces). There has been much excitement that string theory might be the secret – that our three or four-dimensional perceptions could be mere projections of an underlying ten-dimensional reality, through which the various interactions between space and matter propagate. However, as in much of science, there are many contenders for 'the theory of everything', so we will have to wait for the final breakthrough.

Equally, it is clear that no single economic development model fits all situations, and the alternatives are also limited in reach. Yet, point by point, the best of several models may be combined. And in the case of multinational firms it is clear that their subsidiaries must observe local customs while adhering to global accountancy standards: they must not be corrupt and they must operate ethically. It is possible that SOX may be eased, and in its place the IFRS may be used to offer consistency, comparability and transparency across national boundaries.

It is through the application of local detail that peers will learn to trust each other and learn how better to work with each other. That being so, we would hope they can overcome the deep cultural and behavioural barriers that exist and so learn how to treat the big development models as advisory (or exploratory) rather than use them prescriptively. In a similar vein we hope the global financiers in the World Bank, the IMF and so on will learn to look beyond the bottom line and support trade more positively, as well as support sustainability (in all its guises).

It is possible at some time in the future that there will be a unifying theory of economic development that acts just like the tenants of string theory – but for this we will have to wait.

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Index

Notes: f = figure; n = note; t = table; **bold** = extended discussion or heading/word emphasized in main text.