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Reconsideration of the Political Economy of Market Transformation: On the Basis of Incentives and Labour

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'Incentive incompatibility' was regarded as one of the key concepts to question the sustainability of a socialist economy. This concept does not closely link workers' motivation and the firm's performance, and as the workers' motivation diminishes, the sustainability of a socialist economic system cannot be certified. However, this is a theoretical assumption. Moreover, the actual labour situation is completely different. Even with low wages, an environment devoid of unemployment gave workers a sense of security. This encouraged firms to retain their surplus labour and allowed them to not only invest in resources for developing the workers' skills but also to provide social safety nets such as life infrastructure and welfare goods. In this way, incentive to the firm's management did not dysfunction at all. I believe that a kind of norm existed concerning how the firms survived in a socialist economic system and that such a norm compromised interests in the middle term.

However, the market transition has completely changed such a labour situation. Following the transition, it was certain that both the government and firms (management) did not wish to introduce radical changes with regard to the workers (jobs); however, the inertia was quickly overcome. The traditional labour system in the socialist setting was uneconomical in the face of severe market competition, where the countries and companies themselves found it difficult to survive. First, many workers quit the labour market, which resulted in apparent unemployment. Even in cases where workers could retain their jobs, the opportunity for enhancing one's skills and the provision of safety nets, which were once the privilege of workers, became extremely uncertain.

It is interesting to note whether the companies in the countries that have undergone economic transition—including Russia—developed systems that are compatible with incentives for workers. Such a system seems to have been established at a superficial level in Central and Eastern European countries, where a strong traditional economy has been institutionalized. However, with regard to the labour situation in Russia, with the exception of some firms such as foreign affiliated ones and those belonging to the energy sector—which acquire considerable foreign currency—there does not seem to be a change in the general attitude of the workers. I shall cite a typical example.

In Russia, the wages of workers are categorized into two: white and black. While the white wages refer to the official wages that are stipulated in the labour agreement, the black wages refer to the unofficial amount that are not specified in any official documents and is known only to the person concerned. Taxation naturally applies only to the white wages. Employers prefer black wages in view of taxation and some other deductions. When paying the medical benefits of employees in the case of illnesses, the employers' cost burden increases in the case of white wages. In addition, as a longer employment tenure leads to an increase in costs, employers resort to black wages or hiring non-regular employees. Black wages put employees at a disadvantage with regard to their pension amount in the future. Moreover, factors such as an increase in non-regular employees and people engaging in side jobs and foreign workers indicate that workers' incentives in the actual labour environment are not uniform. These factors contributed to the increasing income disparities during the 2000s, which was initially characterized by stable economic conditions. Under these circumstances, it seems difficult to associate workers' motivation to work with low wages. Further, the existence of billionaires clarifies the presence of income disparity between management and labour and the monopoly of profits by management under the pretence of stock options and allotments. The above situation may be indicative of a weak link between the performance of enterprises and workers' incentives.

Do certain factors during the market transition period make it difficult to solve the problem of 'incentive incompatibility'? I do not regard the market transition or maturity of markets as a decisive factor of the weak link between the performance of enterprises and workers' incentives. Even in matured capitalist economies, it is doubtful whether companies and markets have organized and effective incentive compatible systems. As many companies prefer undertaking wage systems that link individual achievements with the amount of wages, there is a partial collapse of the lifetime employment and seniority wage systems. A merit-based pay system seems to function when workers are strongly motivated to achieve results, but this system is too oversimplified to be applied in the actual labour environment. Moreover, it is difficult to measure the results of this system. I do not think that the system of motivating workers would be successful in cases where an individual worker cannot enjoy the fruits of his achievements or where the worker is overburdened from work. Moreover, the Anglo-American system of incentive compatibility is not compatible with the traditional Japanese system, where skills are developed in the internal labour market. This is because workers do not have a strong sense of belonging to the companies that employ the merit-based pay, and the development of skill formation is problematic owing to the extraordinary result-oriented measures. The increase in non-regular workers is a result of the decrease in personal expenses brought about under the pretext of introducing variety in employment opportunities and increasing the flexibility to employ and dismiss workers. The percentage of non-regular workers in Japan has grown from 15.3% in 1984 to 33.5% (17.32 million) in 2007 (Ministry of Internal Affairs and

Communications, Japan). As these workers are in danger of being considered as machines, it stands to reason that there is a fragile link between their income and growth within their respective companies. In fact, many non-regular workers, including those employed in established sectors such as automobile and home appliances, were laid off because of the 2008 recession. Worse still, owing to a low level of social security, these workers might have lost credibility within societies and local communities in Japan. As collective competition goods are important aspects that characterize the economic and corporate systems, workers need to be provided with public conditions that would enable them to effectively develop their ability. Hence, workers cannot be regarded as ordinary commodities.

Without incentive compatibility, a situation would arise where young people would leave their companies within three years of employment and many would be driven to poverty. The 'working poor' is not a contemporary Japanese term but has been traditionally used in this context. In the beginning of the twentieth century, many regular workers belonged to the lower strata of society, and at present, mature economies seem to be recreating the same situation. The view that living conditions do not improve by taking on additional work is applicable even in present times. According to OECD data, the poverty rate of Japan in 2000 was 15% and was ranked as the fifth worst in the world. We cannot disregard poverty among the employed. As wages decrease, it is doubtful whether the Japanese incentive system can support itself in the face of global competition.

These problems are not solely restricted to the workers. It is clear that company managers are also responsible for these problems, as is evidenced from company scandals or corrupt investors who caused financial crisis. Because the stock option enables managers to gain short-term profits, they might resort to unethical practices. 'Long-term commitment'—which is specific to Japanese companies—has to be regenerated in order to recover responsible management in the long run.

When employees are strongly motivated to work, they are appropriately evaluated and rewarded with wages; they then return to their work routine, and the outcome of their work are associated with the performance of the company in the end. If we consider this system as an incentive compatible one, then designing such a system is not as easy as described in economics textbooks, and it is not automatically institutionalized. One of main difficulties with regard to institutionalization is that workers are not commodities but human beings. One's sense of values cannot be exported, and they are institutionalized path-dependently. Moreover, even though human beings live in a social environment, they do not aim for their goals by only considering the competition. In order to pursue goals, it is important to cooperate and collaborate with other generations. Furthermore, security and safety are also indispensable. Therefore, organisations (companies and governments) are required to institutionalize these factors. While companies should build institutions on the basis of the interests of the stakeholders, the governments should regulate and address the problems (labour administration) associated with incentive incompatible situations (e.g. unfair layoffs or wage reduction) and provide safety nets.

Returning to the 'Economics of Transition', the end of market transition may become a current contentious issue. I think that there is too much emphasis on conventional standards when evaluating the degree of market transition. As the transition indexes of the European Bank for Reconstruction and Development (EBRD) are typical samples, enterprise restructuring (privatization and the global level of corporate governance), market and trade (trade liberalization and competitive policy), and financial institutions and infrastructure are the main standards for evaluating market transition; moreover, a higher level of freedom and deregulation mean further progress of transition. Such an evaluation considers the extent of convergence as the degree of transition and regards the liberal Anglo-American model as ideal. However, we need another standard based on labour and incentive to work in order to evaluate the degree of transition, which is from an incentive incompatible organisation and an incentive compatible one. The importance of the standard would depend on how society shares its values, which would motivate workers, and if companies can incorporate that standard in their respective organisations. Though transition countries have developed their markets by aiming at matured market economies or joining the EU, this did not automatically resolve their problem with regard to incentive compatibility. In fact, even matured economies do not succeed in organizing incentive compatibility. I think that transition countries could find the answer to the meaning of labour, the method of evaluating labour value, and the problem of motivation by rethinking their own legacy, debts incurred, and the legacy of socialism. Needless to say, this is also applicable to Japan. If the regularization of non-regular workers is regarded to be important in the long run, then we have to re-evaluate the Japanese management system in the same context.

Labour does not adjust itself to the adequate degree in 'impudent' markets and companies. If we consider social intervention within the welfare sector or the labour regime (supporting the provision of collective competition goods) as socialistic, the notion of the institutionalization of an incentive compatible system in a mixed economy may not be redundant. This viewpoint accepts the diversity or variety of capitalist systems. A shift in the way of thinking in a transitional political economy—based on theories ranging from a convergent theory of an ideal model to various theories—enables us to tackle the old, new, and unsolved problem regarding the examination of why people work and how their companies motivate them.