Trust, Envy, and the Political Economy of Industrial Development: Economic Groups in Developing Countries

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Abstract

In middle-income developing countries, economies of scale and scope imply that establishment of large firms will facilitate economic progress. Emergence and effective operation of such firms require a modicum of interpersonal trust. Unfortunately, in many developing countries, trust is not easily available, either via the market or as a public good. In this context, the economic Groups -- multi-enterprise firms akin to the Japanese <u>zaibatsu</u> -- present in the industrial sectors of many LDC's play a special role. Deriving from the same communal, ethnic, or tribal group, Group members have relatively low costs for obtaining information and enforcing sanctions in the event of non-compliance. Accordingly, Group members face special incentives that make for reliable and trustworthy behavior. The economic success of Group firms, however, incites envy on the part of those excluded. Moreover, for reasons discussed in the paper, the Groups generally fail to control their countries' political system. The conjunction of the Groups' economic success, social hostility, and political weakness leads to a special political-economic dynamic.

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I. Introduction

Economists and economic historians have noted that one cannot take for granted the existence of markets for goods and factors.[1] Certain social and political conditions are necessary for the emergence and efficient performance of such markets. In a similar fashion, one cannot take for granted the existence of large-scale firms. Certain social and psychological conditions are required for their emergence and effective operation. One of these conditions is a modicum of interpersonal trust.[2]

Trust facilitates efficient relations with the suppliers of inputs to the firm as well as with its customers. Even more pertinent in the present context, interpersonal trust permits effective operation of the senior management teams that direct large firms. If firms are to achieve economies of scale and of scope, large, multiproduct production units are required. Strategic direction and operational management of such firms typically exceed the capacity of a single individual, and require a senior economic management team. Quite apart from its other effects in promoting economic efficiency, interpersonal trust is essential for such management teams to function effectively.

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[1] See, e.g., Douglass C. North (1986). Of course certain economic conditions must also be satisfied. On this point see, for example, George Akerlof (1970).

[2] Kenneth Arrow has expressed the general efficiency-promoting effects of trust as follows (1974, p. 23):

> Trust is an important lubricant of a social system. It is extremely efficient, it saves a lot of trouble to have a fair degree of reliance on other people's word...Trust and similar values...increase the efficiency of the system, enable you to produce more goods.

The fact that trust enhances economic efficiency does not make it available. On the contrary, Kenneth Arrow has noted (1974, p. 23):

> Unfortunately [trust] is not a commodity which can be bought very easily...Trust and similar values...are not commodities for which trade on the open market is technically possible or even meaningful.

Moreover, not only is this an area where the market fails, but social and psychocultural conditions may not provide the requisite amount of trust and honesty as a public good. The problem may in fact be especially acute in less-developed countries (LDC's). Arrow continues (_ibid_., p. 26):

> It has been observed, for example, that among the properties of many societies whose economic development is backward is a lack of mutual trust. Collective undertakings of any kind...become difficult or impossible not only because _A_ may betray _B_, but because even if _A_ wants to trust _B_, he knows that _B_ is unlikely to trust him.

In a similar vein, Albert Hirschman (1958, pp. 14-20) suggested that in many LDC's, economic transactions are typically viewed as exploitive rather than as mutually beneficial. Opportunism may be particularly unbridled in sociocultural contexts characterized by the ensuing "ego-centered image of change." Likewise, Alexander Gerschenkron (1962, pp. 18-19) has noted how the lack of trust inhibited the flow of capital in early industrial environments. He also commented (1962, p. 48) on the widespread prevalence of commercial dishonesty in such contexts.

One may wonder, therefore, how the problem of trust has been resolved in contemporary less-developed countries. The question of trust for the operation of large firms is of special concern because in some activities, large size is apparently a necessary condition for efficient production. In the absence of large-scale firms operated by local people, LDC's might face a dilemma, both of whose choices they would consider unattractive. One possibility might be to forgo -- for organizational reasons -- efficient local production in important activities. The other option would be to leave those activities to foreign companies, a contingency that may be unwelcome for social and political reasons.[3]

There is evidence that LDC's have been successful in overcoming the problem of trust and firm size. In developing countries where other necessary conditions (e.g., exchange-rate policy) have been satisfied, firms that are domestically-owned and managed have been able to achieve the economies of scale and scope necessary to compete successfully in world markets. For example, most of Korea's rapidly growing and increasingly diversified manufactured exports have come from local firms rather than from multinational corporations.[4] Accordingly, this paper considers how the problem of trust necessary for efficient operation of large-scale firms has been dealt with in developing countries during recent decades. Part of the answer lies in a special form of industrial organization that has emerged in LDC's, the economic Group. I have analyzed other aspects of this institutional form in earlier papers (1976, 1978). Here we focus on the Groups and trust.[5] Because of the importance of trust, industrial development in which Groups play a noticeable role has its own political-

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[3]A third possibility might be entry by a domestic state-owned enterprise, which would draw on the country's bureaucratic mechanisms and tradition to overcome the problem of trust and firm size. That option may involve efficiency costs in terms of high monitoring costs and limited capacity to respond to changing market conditions.

[4]See Larry Westphal _et al._ (1981), especially p. 54, Table 6.

[5]In my 1978 paper, I referred in passing to the role of trust in the Groups (pp. 663, 666, 671), but did not discuss the topic.

economic dynamic; we will also consider that topic. We begin by clarifying some aspects of interpersonal trust in economic life.[6]

II. Aspects of Trust in Economic Relations

For the purpose of this paper, we focus on trust in three sets of economic relations: (a) trust between the firm and its suppliers of long-term capital; (b) trust between the firm's dominant owner(s) and the senior managers who administer and direct the firm; (c) trust in the horizontal relations within the team of senior managers. This focus follows from the specific questions we are attempting to answer. However, it excludes some issues of trust that researchers in other contexts have found interesting.[7]

Trust involves a greater degree of confidence on the part of one party that another party will comply with the terms of a (formal or informal) agreement. As such, trust reduces uncertainty and increases predictability in economic relations. Because of trust, messages can be believed and relied upon as a basis for action. Hence, trust lowers communications costs. If we view the firm as an organization that stores

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[6] Some readers may wonder whether a topic like trust is within the province of economics. However, note such works as Hirschman (1970), Arrow (1974), Phelps (1975), Collard (1978). More specifically, the analytics of trust constitutes part of the economics of uncertainty (see, e.g., John Hey [1979], p. 230). The role of trust in facilitating management of large companies also fits into the growing research program on the microeconomics of firms' internal organization. On the latter see, for example, Roy Radner (1985).

[7] For example, Wintrobe and Breton (1986) analyze trust in another situation: vertical relations between superiors and subordinates in taking advantage of the mutually-profitable opportunities for exchange that are opened by the difficulty of fully specifying labor contracts and the rigidity of renegotiating them.

and facilitates the internal flow of information [Prescott and Visscher (1980)], trust increases the efficiency of the entire operation. Finally, trust reduces the transactions costs both of monitoring performance and of providing for sanctions in the contingency of non-compliance. Many principal-agent problems are obviously mitigated when principal and agent can trust each other.

As this discussion suggests, trust promotes economic efficiency in situations where two parties would benefit by agreeing to an exchange, but the information and transactions costs of using contracts to monitor behavior and enforce sanctions for non-performance are high relative to the gains from the exchange. A potential efficiency loss arises because in the absence of mechanisms other than contracts, people will forgo transactions that would otherwise be mutually beneficial. More particularly, the conditions we have noted are of obvious importance for the effectiveness of a management team. For example, trust permits lessened concern about probity and shirking behavior on the part of other team members. The transactions and information-cost advantages we have noted are likely to be especially important in the context of a less-developed economy. Decision-makers in those economies in any case face considerable risk and uncertainty.[8] Consequently, conditions that increase predictability are welcome. Second, LDC's are often characterized by rapidly changing economic conditions. By reducing communications and monitoring costs, trust enables a firm to respond more quickly and flexibly to change [Burton H. Klein (1978), p. 161].

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[8]Economic and political instability are two causes of the high level of uncertainty that confronts economic decision-makers in LDC's. I have discussed other sources in [Leff (1984), pp. 260-262, 268-269].

To the extent that trust is present, it constitutes part of what Edward Prescott and Michael Visscher (1980) have termed a firm's "organization capital." That is, the market value of a firm's physical assets will be greater to the extent that the members of its senior management team trust each other. Accordingly, one would like to know about the conditions that engender trust in economic relations. Research on that subject suggests the following interpretation.[9] On atomistic economic grounds, trust is more likely to the extent that people have relatively accurate information about each other, and can therefore more easily identify individuals for whom honesty is truly an operational value. In addition, trust is promoted if participants are engaged in a continuing relationship -- in game-theoretic terms, a "super game" -- in which a party's move in one period must take into account the expectation of continuing interaction in subsequent periods. Finally, trust can develop more easily in relationships that are multifaceted, such that non-performance of agreed behavior in one domain can be countered with sanctions in other areas of interaction. With this background, let us see how the economic Groups fit into the picture. I have discussed the Groups in detail elsewhere, and shall therefore be brief in describing the salient features of this form of industrial organization in developing countries.[10]

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[9] See, e.g., Benjamin Klein and Keith Leffler (1981), Sherwin Rosen (1985), and Douglass North (1986).

[10] Since my earlier work on this subject, I have received information about the operation of Groups (under different names) in countries other than those originally cited. For example, Clement Moore Henry [(1980), pp. 121-125, 165, 189-206] and in personal communications has referred to the activities of the shillas in Egypt. Some additional published sources on economic Groups in other contexts include Thomas A. Timberg

III. The Economic Groups and Interpersonal Trust

The Groups are private firms that produce in several sectors of an LDC's economy. The Groups are owned, and their senior management is supplied, by a few individuals who are linked by relations of interpersonal trust. These people are from the same (broadly defined) family, but often include non-family members of the same communal, ethnic, tribal, or regional group.[11]

A Group generally has its beginning in the successful entrepreneurial activity of a single individual. His success in an original activity made it possible to attract additional capital from other people whose shared communal origin and experience enable them to trust each other (see below).[12] Because of these interpersonal ties, the Group was able to bring together the capital for new investments whose requirements exceeded the assets that a single individual could mobilize for an innovative venture. The double meaning of the word "credit", and the link between belief and trust are clearly relevant here. Similar patterns, in which trust enables people to mobilize economic resources from beyond the immediate family, have also appeared in early-development

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(1971); Hanna Papanek (1973); Leroy Jones and I. Sakong (1979); Naomi Lamoureux (1986).

[11] In the interest of brevity, I will henceforth refer to communal groups as a shorthand for communal, ethnic, tribal, or regional groups of the same origin. Note also use of the lower-case "group" to refer to the communal milieu, while the upper-case "Group" refers to the type of firm under discussion.

[12] Harry Strachan [(1972), pp. 4, 22-25] has also emphasized the "atmosphere of trust" as a key feature of the Groups.

contexts as diverse as eighteenth-century Britain, and nineteenth-century Japan and France.[13]

Initial entrepreneurial success, given scope by resources made available through relations of interpersonal trust, is essential for founding a Group. A subsequent stage is made possible with the growth of managerial experience, and with the development within the Group of a greater degree of competence in modern technology. The latter has often occurred via the accession of Group members (often children of the founders) who have had a technical education. With the growth of its capital and managerial resources, the Group generally directs much of its expansion toward new activities in the economy's advanced sector, often in industry. Pursuing a course of expansion with high reinvestment rates over decades, Groups have developed to their present situation of large capital assets and diversified productive activities.

The Groups' practice of relying on people from their own communal groups for their senior managers fits neatly into our earlier discussion concerning the conditions that make for interpersonal trust. Such communal groups typically involve overlapping patterns of linguistic, social, religious, and cultural domains. Propinquity of residence may also be present. Because of the multiple opportunities for observation,

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[13] Thus note Hugh Patrick's observation (1967, p. 241) that "zaibatsu" literally means a financial clique. The implications of friendship and interpersonal confidence connoted by the word "clique" are also present in the Group. Similarly, in his discussion of international banking firms in nineteenth-century France, David Landes has emphasized the importance of "in-groups" that extended honesty and trustworthiness internally in the midst of environments characterized by substantial risk, including moral hazard. See Landes (1958, pp. 14-40). Likewise, Barry Supple (1974), pp. 84-85] has noted the role of the great Quaker dynasties in the economic development of Britain during the eighteenth-century.

participants in these communal groups have lower information costs for discerning such traits as honesty and reliability in other members. On the basis of such private information, they can trust individuals for whom outsiders -- with the information at <u>their</u> disposal -- would have to be wary. Further, membership in communal groups is usually by ascription, and generally is not easily terminated. Consequently, members are to some extent willy-nilly locked into a repeated game. Regardless of their personal traits and values, participants' optimal strategy may lead to an equilibrium in which they have a reputation for trustworthiness. (In the words of Benjamin Franklin, "Honesty is the best policy.") Finally, the pattern of reciprocal relations in multiple domains increases the possibilities for enforcing sanctions in the event of duplicitous behavior.

As this discussion indicates, more than cultural or linguistic affinity is involved if group members "feel comfortable" with, and communicate relatively easily with each other. The incentives for behavior that rationally merit trust are very different from those present in relations between strangers. The flow of capital and senior management to the Groups exclusively from within their communal milieux is readily understandable in this perspective. In effect, in environments where honesty and trustworthy behavior are not available as public goods, the Groups delimit an area where these virtues are present. James Buchanan's "Economic Theory of Clubs" (1965) comes immediately to mind in this context. His analysis shows the conditions under which private associations will make available public goods to a limited circle of owner-members.

Buchanan's model also derives the socially optimal point of exclusion from (and inclusion within) the club. As might be expected, the limiting condition involves the marginal benefits and costs of extending enjoyment of the public good to additional people. An important part of these incremental costs is the cost of policing the arrangement against "free-riding" on the part of new members. In the present context, this means ensuring that additional would-be members do in fact behave honestly rather than using the club to benefit from the trustworthy behavior of other members, while themselves acting opportunistically. The gradient of the information, monitoring, and sanctions costs to limit free-riding behavior is likely to increase with the social distance from other individuals. And the fact that these costs are markedly lower within the communal group may well determine a discontinuity, such that membership in the free-zone of trust that the Groups constitute is limited to people from the same communal group.

IV. The Groups and Envy

The Groups' investment and production have helped their countries increase output and income in the postwar decades. Hence, standard economic reasoning might lead one to expect that the Groups' investment and production would be valued positively for the income they yield. Further, the Groups' pattern of expansion through investment and entry in a succession of new activities has led to structural change and economic diversification. If structural change and diversification are viewed within the LDC as a national public good, they should generate additional social utility on that account. Consequently, one might expect that the

Groups would be considered very positively in their countries. However, that is often not the case.

For many observers, utility is apparently a function not only of their own income, but also (inversely) of their economic position *vis-à-vis* others in their society.[14] Indeed, the latter argument may dominate the utility function, such that one's happiness is very much a negative function of the economic well-being of others. This is the *invidia*--envy--that anthropologists have noted in observing less-developed (and more-developed) societies. The prevalence of such utility functions has led to a situation where the success of the Groups apparently induces positive disutility on the part of many observers. This unhappiness is exacerbated by the Groups' exclusiveness. As Albert Hirschman and Michael Rothschild (1973) have noted, other people's progress is easier to bear if one can reasonably expect ultimately to enjoy similar success. But by the nature of trust and the Groups' structure, direct participation in Group gains is limited to group members.

Resentment toward the Groups is increased by their oligopolistic market power. However, envy rather than social efficiency losses seems to be the predominant reason behind the hostility. This interpretation is suggested by the positive value with which public opinion in LDC's generally views state enterprises and parastatals -- despite their monopoly power. Resentment towards Group enterprises has been reflected

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[14] This idea has been developed by Robert Frank in his *Choosing the Right Pond* (1984). For a corroborating empirical study based on panel data in The Netherlands, see H. van de Stadt et al., (1985).

in hostile public policy and, in some cases, in violence. As W. Arthur Lewis describes it:[15]

> Many such situations have been allowed to come to boiling point. Armenians and Greeks have been driven out of Turkey...Chinese have been murdered in Java, and Ibos murdered in Northern Nigeria...

To this list, one can add subsequent instances like the expulsion of Asians from Uganda and Tanzania, and the Sinhalese-Tamil violence in Sri Lanka. The list of cases where hostility against the Groups has led to violence would be even longer if, realistically, the perspective is broadened from communal groups to include envy on the part of other economic classes as well.

V. Political Weakness

The development outcome would be different if the Groups had effective control over the political system in their countries. In many cases, they have not achieved such control -- to the point where in some instances, the Groups cannot be assured even of safety of person and property. In other countries, Group investment and production decision-making is seriously constrained by hostile government regulatory policy. Political scientists have noted that failure of the Groups -- or of the bourgeoisie generally -- to dominate the state in many developing countries.[16] This is a phenomenon that requires explanation; one might

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[15] W. Arthur Lewis, Racial Conflict and Economic Development (1985), pp. 89-90.

[16] See, e.g., V. Randall and R. Theobald (1985). Political scientists usually describe this phenomenon in terms of the state possessing "relative autonomy" *vis-à-vis* forces from the broader society.

reasonably expect economic wealth to translate easily into political domination.

In some instances, the Groups derive from "outsider" tribal or communal milieux. The political disability of such immigrant, ethnic or regional minorities vis-à-vis the mainline people who traditionally possess high social status and dominate the political system is straightforward. But even in countries where they are not social outsiders, the Groups generally do not control the state. A key feature here have been the strong social and ideological pressures for rapid economic development that have characterized many LDC's in the postwar period. Coming in conjunction with some other special conditions, these pressures have led to a unique macroeconomic and political constellation.

The pressures for development have induced a large and continuing expansion of government expenditure for public investment and consumption. Moreover, economic aspirations have apparently risen with achievements. In most LDC's, the share of taxation in GDP has risen sharply over the past three decades. However, government spending has increased even more, so that public-sector budget deficits have become a quasi-permanent feature of the macroeconomic scene in many LDC's. Fiscal deficits, in turn, have led to high rates of nominal monetary expansion. Neither taboos against inflation nor concern for the balance-of-payments consequences have effectively restrained such policies in many contemporary LDC's. The result has been continuing fiscal and monetary expansion, at rates that have induced chronic inflation and balance-of-payments imbalance. To complicate things further, governments have often refused to adjust interest rates and exchange rates to market-clearing levels.[17]

The economic effects of this situation have often been noted, but the political consequences are also important. These economies are typically characterized by chronic excess demand for foreign exchange and for credit, while the market is not allowed to allocate those inputs. Instead, the state and its licensing authorities play a key role in the allocational process. The power to accord or to deny firms vital inputs gives the state life and death power over private enterprises, including the largest ones. Likewise, in most LDC's government intervention within the economy is pervasive. Consequently, government decisions with respect to pricing, investment, and taxation determine the welfare of individual firms. Finally, in these volatile economies, the state often acts as ultimate bearer of risk and uncertainty for large firms. Alternative institutions to perform that insurance function would be prohibitively expensive. Accordingly, large firms must cultivate the government's willingness to aid them should they encounter economic adversity. All of these conditions lead firms to a situation in which they become political clients responsive to the carrot-and-stick incentives of the state rather than political participants with an independent economic base.[18]

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[17] See, e.g., Ronald I. McKinnon and Donald J. Mathieson (1981).

[18] This analysis sheds some light on a special type of corruption present in many developing countries. I define corruption as the use of economic incentives to influence political behavior. The preceding discussion suggests that state-operated corruption may be an important feature of political life in LDC's where the conditions discussed in the text apply.

VI. Some Political-Economic Consequences

The Groups' lack of political control has consequences for the economic development of the countries concerned. Group investment and production are likely to be inhibited by hostile regulations. More basically, the conjunction of economic prominence, envy, and political weakness leads to relatively high levels of political risk. The Groups must be concerned with the contingency that their assets may be, to a greater or lesser extent, confiscated. Unfortunately, the responses of individual Group members to this situation tend further to destabilize the country's political-economic equilibrium. In effect, the Groups' successful achievements endogenously increase the system's overall instability.

One possible Group reaction to the possibility of confiscation is to invest a larger share of their portfolio in assets that are relatively liquid, concealable, and transportable, e.g., gold. Such assets do not have a high social productivity. Further, the threat of confiscation constitutes a type of risk from which the Groups cannot diversify in their domestic investment allocations. Basic considerations of portfolio balance therefore indicate the private rationality of accumulating assets overseas. Such "capital flight" is viewed as anti-social behavior, and further weakens the Groups' domestic political position. Another response may be the use of wealth in an effort to buy protection or acquire influence with politicians. In some political systems, such payments may be considered legitimate campaign contributions; but in LDC's, they are typically viewed as corruption. Hence, by reducing the Groups' social acceptability and political legitimacy, political payments increase medium-term vulnerability. Finally, reacting to their situation of social and political insecurity, Group members may seek to demonstrate high social status by conspicuous consumption.[19] Inciting additional envy, such behavior is likely to be perverse from the viewpoint of overall social and political stability.

These responses have negative consequences for the country's economic development. High consumption expenditure diminishes domestic savings and investment. Overseas asset accumulation lowers domestic investment and, at least initially, reduces the foreign exchange available for importing goods and services. Further, empirical evidence indicates that sociopolitical instability lowers domestic savings in LDC's.[20] More generally, the risks and uncertainty inherent in a situation where property rights are insecure can seriously hamper investment and production planning.

Policy solutions likely to be effective and not to impose high social costs are not apparent. For example, discussing the situation where a communal or ethnic minority relies heavily on other members for their employees and suppliers, W. Arthur Lewis suggests:[21]

> The...process creates what is essentially a monopolistic situation, which makes it harder or even impossible for the native businessman to get a foothold.
>
> The appropriate remedy for such a situation is some form of affirmative action...limiting the number of foreigners [_sic_] to be employed in any particular

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[19] Concerning the rationality of such behavior at the individual level, see Robert H. Frank, "The Demand for Unobservable and Other Non-Positional Goods," especially pp. 103-106.

[20] D.B. Stewart and Y.P. Venieris (1985).

[21] W. Arthur Lewis, _Racial Conflict_, pp. 89-90.

> business...thus forcing the firm to hire and train nationals [sic] for positions at all levels...

Two points are noteworthy in this approach. First, Lewis raises the policy problem not in terms of an envy-based utility function but in terms of efficiency losses due to monopoly. Other writers have also adopted that perspective [see, e.g., Bronfenbrenner (1958)], and it may well apply in some cases. In many LDC's, however, Groups from the same communal milieu compete with each other. Competition may also be offered by Group firms from different communal milieux. Hence the main source of unhappiness in the LDC may not be concern about efficiency losses, but rather the disutility engendered by the income-distribution pattern that emerges between different communal groups. Second, if the traits that make for the Groups' entrepreneurial success are not universal or easily impartable, a policy along the lines Lewis suggests will involve costs. In the limit, the capacity of Group firms to function effectively may be destroyed. That outcome is especially likely if interpersonal trust as well as management training is necessary for the firm's effective performance. Lewis continues [ibid.]:

> The case for affirmative action forcing the foreigners to hire nationals and impart their skills is beyond dispute; but the public loses when skilled foreigners are driven out before nationals have been trained to do the work. Affirmative action is better than mass murder...

If that is the choice, few people would quarrel with Lewis' last statement. But the costs over the case where lives and property are not threatened are worth noting.

One can also imagine public policy formulated on the basis of a utility function that explicitly includes group-relative incomes as a measure of social welfare. Lester Thurow (1979) has in fact advocated such an approach. Raising the issue of differences in economic outcomes within the United States, he has urged the ethics of income redistribution from economically successful to less successful groups.[22] An approach along those lines has been adopted formally in Malaysia, and informally in other LDC's. Such policies can reduce the pace of economic growth and structural change. They may be justified, even in terms of standard neoclassical welfare functions, if they lead to social and political peace. It remains to be seen whether policies of income redistribution between communal groups in LDC's will actually achieve the objective of socioeconomic stability.

VII. Conditions for A Peaceful Transition

Political circumstances in some LDC's may make it possible to avoid massacre of Group members or throttling of their activities in the medium term. Such a respite raises the question of the possibilities for a longer-term transition, in which market forces lead to an opening of senior management positions within the Groups to people from outside the original communal milieu.

This question pertains to "family-based" firms in any socioeconomic context. In an effort to answer this question in the industrial countries, the conditions that have been associated with the shift from family enterprise to firms whose capital and senior personnel come from

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[22] An interesting effort at modelling the impact of such policies in an LDC context is presented in M. Ali Kahn and T. Datta Chaudhuri (1985). However, that analysis does not include the impact of the threat to the physical and human capital in the industrial sector.

wider sources have been the subject of a social-science literature.[23] Some of that literature is relevant here; but in the special context within which the Groups function, the question has distinctive features. In the economically more-developed countries, discussions of the transition have often focused on whether or not the founders maintain managerial control of the firm. In the LDC's, that is rarely the issue. With its array of credit, foreign-exchange, taxation, and licensing incentives, the state already exerts control over the important investment and production decisions within Group firms. Likewise, in the special capital-market conditions of the LDC's, the issue is usually not whether Group firms will accept outside loan or equity capital. Rather, a key feature of such an opening in developing countries is the inclusion of outsiders in the Groups' senior management. Such inclusion is significant for its political-economic effects, as visible evidence of outside participation and broader social integration.

Groups will not easily accept outsiders as members of their senior management. Their willingness to make the changes (see below) that would make newcomers trustworthy will vary with the returns that can be expected from making such a transition. Of particular importance are: (a) the net gains that accrue from larger firm size; and (b) the enlargement of the senior management team that goes with increased firm size. If we assume linearity in both functions, the returns to the Groups from opening their senior management ranks to outsiders depends on whether the internal supply of personnel who are both technically qualified and

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[23] For a recent survey, see, for example, Roy Church (1986). For studies focusing on the Japanese experience, see T. Kiyonahari and H. Nakamura (1980), and H. Morikawa (1982).

linked by interpersonal trust keeps pace with the Groups' expanding demand for such people. If the demand for able, trustworthy personnel increases more rapidly than the supply, the returns to opening will rise, and Group firms are more likely to attempt the transition.

That much is obvious, but here too conditions differ in the LDC context. On the supply side, the social base from which a Group recruits is larger than the closely delimited family of western societies. Other conditions, however, tend to raise the demand for trustworthy senior personnel per unit of incremental output in developing countries. As discussed elsewhere (Leff, 1978), one reason for the emergence of the Group form of industrial organization is the substitution of factor and product flows within the firm for the poorly functioning markets that characterize LDC's. Because senior management is needed to determine input and output outcomes that are elsewhere decided by markets, the demand for such personnel relative to the scale of investment and production is probably greater in the developing countries.

Little can be said in general terms concerning the likely expansion path over time of the demand for senior personnel in Groups. Increased technical sophistication in production, finance, and marketing are likely to enlarge the demand for senior managers. Company strategies that include a focus on export growth increase intra-firm complexity, and hence would also increase demand. But clearly the pace of the country's aggregate income expansion, and conditions specific to individual industries will be crucial for determining the overall growth in the demand for senior managers within Groups.

Likewise, few generalizations can be proposed about the evolution over time in the supply of able and trustworthy people; specific social conditions are likely to be very important for influencing outcomes. For example, high fertility rates on the part of Group members may permit a continuing large flow of senior managers from traditional sources. In addition, in a pattern similar to one that has occurred elsewhere, Groups have used cooptation -- e.g., through marriage -- to increase the supply of trustworthy personnel from within their communal milieu.[24] Dropping constraints against the accession of female children to top management roles would also increase supply. Much depends on what has been called, after the novel by Thomas Mann, the "Buddenbrooks effect."[25] That is, the second or third generation of Group members may not be suited for, or interested in, managing the Group's enterprises. They may instead choose a profession or a different business career; they may become revolutionaries or playboys. The likelihood of such non-Group career choices depends on family socialization patterns and on the alternative opportunities open, within the country and abroad.

In some cases, the management supply and demand situation we have discussed may provide incentives sufficiently attractive for Groups to recruit outsiders to their senior ranks. Elapsed time for monitoring behavior is an important input in the development of trust. Consequently, one would not expect such a transition to occur quickly or abruptly.. In addition, certain changes would help outsiders function more effectively in Group positions where interpersonal communication and trust are

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[24] Such practices may seem bizarre to American observers. However, it is not a long time since one of the few ways a non-family member could be admitted to a top-management position in some American firms was literally by "marrying the boss's daughter." Such marriages were presumably not random occurrences.

[25] T. C. Barker and Maurice Lévy-Leboyer (1982).

necessary. The experience of the economically more-developed countries suggests that two sets of institutions are particularly important for enabling firms to make this transition. The educational system can aid by providing a shared language and values -- whether of "liberal arts" or of other cultural traditions -- that reduce communications and monitoring costs. Likewise, management practices can facilitate the transition by providing systems of control that do not rely on primary-group loyalty. Patterns of socialization that induce shared behavioral patterns and firm-specific human capital -- the phenomenon of the "company person" -- are also important. So, too, are other incentives that promote long-term managerial commitment to the firm. A bias toward promotion from within the firm is one measure that can enhance long-term management commitment. Compensation structures, including the time profile of salaries and pensions, are obviously also pertinent. Such measures inducing long-term commitment to the firm increase the possibility of repeated interaction, vulnerability to sanctions, and hence inducements to trustworthy behavior.

VIII. Research Implications

This paper has discussed some aspects of trust and envy in economic development, but obviously many important topics remain to be clarified. For example, one would like to know why envy and inter-group hostility have found greater scope in some contexts (e.g., Sri Lanka) than in others (e.g., Thailand). In addition, the paper has implications for other research fields.

First, the analysis suggests a reinterpretation of some of the relations that Max Weber discussed in his celebrated work The Protestant Ethic and The Spirit of Capitalism. As is well-known, Weber focused on the origins of capitalistic behavior in the early Protestant groups. Weber interpreted his findings as reflecting doctrinal pressures that led to individual behavior (such as rationality or methodical activity) conducive to the development of capitalism. Our discussion suggests another, complementary interpretation. What may have happened is that by lowering information and sanctions costs, the new religious groups enlarged the pool of people with whom members could arrange trusting business relations. Increasing the number of such people beyond the immediate family circle opened economic opportunities that were not available to entrepreneurs who lacked the same access to trustworthy personnel and capital. Weber himself proposed this complementary interpretation in a later paper entitled "The Protestant Sects and The Spirit of Capitalism" (1958). Our discussion, based on economic development in other cultures and societies, brings water to his revisionist mill.

Finally, our discussion of trust and the Group pattern of industrial organization has broader research implications. Structures that resemble the Groups are important not only in economic life but also in political activity within many developing countries. Thus writers on LDC politics have noted the role of informal horizontal structures that maintain trust through continuing reciprocal relations.[26] The names vary: "coteries,"

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[26] See, e.g., V. Randall and R. Theobald [(1985), pp. 61-64, 76-77]; Clement Moore Henry [(1980), pp. 121-124, 165, 189-206]. Henry also cites Nicos Poulantzas [(1975), p. 130]. A classic study is Anthony Leeds (1965). Note that I am referring here to reciprocal horizontal exchange, not to vertical patron-client relations.

"networks," "cliques," are often cited. The underlying reality seems to be an effort to use an arrangement similar to a Group in order to reap the gains from trust in political activity. Furthermore, such behavior is not limited to the LDC's, but is frequently observed in the economically more-developed countries as well.[27] Indeed, similar social structures may also exist in the economic life of the more-advanced countries.[28] The ubiquity of such informal structures to facilitate trust suggests that we may be focusing here on a phenomenon of integrative research interest. One would like to know more about how behavior and social arrangements compare as between the economic and the political domains, and how they vary as between the less-developed and the economically more-developed countries. A pioneering effort in this integrative research agenda is a paper (1980) by Yoram Ben-Porath.

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[27] In the United States, see, for example, the so-called "Massachusetts mafia" of the Kennedy administration and the "Georgia mafia" of the Carter administration.

[28] For example, similar monitoring and sanctions effects have been proposed for understanding empirical earnings functions of diverse communal group members in an economically-advanced country like Canada [Nigel Tomes (1985), p. 246].

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