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**Entrepreneurial spirit and the logic of commitment -
A vision for NePAD**

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Entrepreneurial spirit and the logic of commitment **– A vision for NePAD**

by Prof. Dr. Ingo Pies,
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Let me start with a personal remark. I am an economist by training – and a philosopher by heart. So it is not by accident that I have specialized in a field that is called “economic ethics”. From this perspective, I would like to share with you some thoughts on the topic of entrepreneurial spirit and NePAD, the New Partnership for Africa’s Development.

But before reasoning about the future, I would like to draw your attention to the past. Nearly 100 years ago, a remarkable thing happened in the automobile industry in the United States. Henry Ford publicly declared the 5\$ workday. In effect, that doubled the going wage for industrial work. The results were fabulous: Turnover fell; absenteeism fell; productivity rose. Judged in retrospect, the 5\$ workday proved to be one of the most successful moves the Ford company ever made.

How can we understand what had happened? According to our everyday way of thinking, wages are cost. Period. – It was the entrepreneurial spirit of Henry Ford to think outside the box. He had introduced a new production technology: the assembly line. Workers in this line are highly dependent on each other. This means that the new technology was extremely vulnerable to fluctuation and absenteeism. In this context, higher wages are not only higher cost. There are advantages that can be realized by higher wages. Workers become loyal to their employer. They want to stay with the firm. They get an interest in a productive long-term relationship. By this logic, the net effect of the 5\$ workday was to reduce overall cost.

What can we learn from this? Of course, the lesson to be learned is not that it always pays for a firm simply to double wages. Under normal circumstances, it does not. Instead, I think that the lesson to be learned is this: The public declaration to double wages was a commitment that triggered a productive reaction of the workforce. Thus, the initial disadvantage – higher cost – was overcompensated by advantages – lower cost. Now, isn’t this a tremendous example of entrepreneurial spirit, including courage and vision? I think it is. It is an example of how entrepreneurial spirit can set free the logic of commitment, which is in effect a win-win logic, a logic of mutual betterment, a logic of benefiting from providing benefits to others, a logic of doing well by doing good.

The recent Nobel prize winner in economics, Thomas Schelling, provides a very neat formulation for the logic of commitment. He says: Weakness may be strength. – In fact, this logic of commitment is very old. It has an ancient origin. The insight that weakness can be strength dates back to Ulysses and the sirens, when – according to the *Odyssey* by Homer – Ulysses made his comrades tie him to the mast of their ship. Properly understood, this was an early exercise in entrepreneurial spirit. The special commitment allowed Ulysses to enjoy the sirens' song – and survive!

Let me illustrate with a more contemporary example. One of the large international management consultancies publicly declares that they will never hire people from active clients. Now, isn't this a peculiar promise? At first sight, it is easy to see a disadvantage. Management consultancies are dependent upon highly intelligent and knowledgeable employees. From this perspective, the promise is a sacrifice. However, once you think about it, the promise is a commitment that pays off. If the management consultancy did not make this promise, clients would have to be afraid that their best employees might be poached. As a result, they would be reluctant to make their very best people join consultancy projects, which in return would reduce the value of such projects. From an economic point of view, the promise is not a sacrifice, it is an investment. The public declaration never to hire people from active clients is a promise that triggers a productive reaction. By doing so, it sets free the logic of commitment, the win-win logic of mutual betterment. Both parties profit from the promise.

The main point of my argument that entrepreneurial spirit sets free the win-win logic of commitment easily translates into a vision for NePAD. NePAD itself can be interpreted as a commitment device: as an instrument that is intended to trigger productive reactions. What I have in mind is this: The win-win logic of commitment can be set free by political entrepreneurs, too. From this perspective, the central aim of NePAD should be to create and foster trust and credibility. Thus, the public declaration to implement the rule of law as well as sound economic policies can prove to be extremely advantageous. On the one hand, it is true that a government makes itself vulnerable if it does not comply with publicly declared integrity standards. On the other hand, weakness can be strength: There are a huge number of potential investors – both within Africa and from abroad – that reward if promises are kept. In this context, good governance – and the credible commitment to good governance – pays off.

Let me conclude by stressing a final point. In history, there are numerous examples of the logic of commitment. As a case in point, one can interpret the emergence of the democratic state in Europe – with a constitutional protection of basic rights – along these lines. But we must be careful here. The crucial point is that we must be very precise in asking what it is that can be learned from such examples. To put it as simple as possible, I should say: A good solution always fits the problem at hand. For sure, contemporary problems in Africa are different from historical problems in Europe. But the logic of the problems may be the same. For sure, solutions in contemporary Africa have to be – and certainly will be – different from solutions in historical Europe. But the underlying logic might be the same. It is the logic of commitment. From my point of view, it is not advisa-

ble – and maybe not even possible – simply to copy historical arrangements from abroad. But understanding the logic of commitment might help in finding – in creating! – good solutions to contemporary problems. It needs entrepreneurial spirit to do so. In this respect, NePAD is a very original and promising attempt to institutionalize good governance. My vision for NePAD is that – as a credibility mechanism – it has the potential to set free the win-win logic of commitment for a better future in Africa. And if NePAD proves to be successful, I am sure there will be lessons to be learned for Europe, too.

Appendix

In the discussion several participants raised the question how we can characterize the relationship between market and state and how we can define the role of good governance for economic development. In this context, I think it is useful to distinguish between three different kinds of markets.

((1)) First, there are primitive markets. They can be so robust that they even work if the state tries to suppress them. For contemporary examples, think of all the grey or black markets in the informal sector, markets for illegal drugs or for stolen goods or markets for services where both parties to the exchange want to circumvent paying taxes. The alcohol market during prohibition is a case in point, too.

Primitive markets are very old. They already existed thousands of years ago. Think of subsistence farmers who try to sell their surpluses in times of a good harvest.

Primitive markets usually are spot markets. The trade takes place between partners who exchange their goods and services at the same time, so that they can control each other. They do not need a third-party enforcement of their contract. Informal mechanisms will do. The gains from trade are enough to make sure that – if not at the optimal level, a least to some degree – trade takes place.

((2)) Second, there are precarious markets. They are related to natural resources. Think of oil or gas fields, mines for gold or diamonds, and the like. It is relatively easy to exploit these resources, for example with the help of international companies which provide the necessary technologies. There will be revenues for the natural resources. That is the good news. However, there is also some bad news because these revenues might create disincentives. On the one hand, it is likely that the state tries to nationalize these resources. Here, it is important whether human rights are respected and whether ethnic minorities, for example, are compensated. On the other hand, the economic development of a country depends on how the revenue is spent. It makes a huge difference whether the money is privatized via corruption and put on a Swiss bank account or whether the money is spent to improve the living conditions of the population at large, for example by investing in infrastructure or by investing in human capital via elementary schooling and basic health services. There will be trickle-down effects in favour of the large population only if the government is interested in improving their conditions. Politi-

cal feed-back mechanisms can support this. This is why democracy and good governance can go hand in hand.

((3)) Third, there are sophisticated markets. They depend on an institutional framework that guarantees basic rights and legal processes for exchanging these rights. This framework is needed because exchange takes place anonymously and/or because exchange covers a longer time span. In the first case, the parties do not know each other personally. In the second case, the “quid pro quo” is disintegrated in time, so the goods or services by one party have to be delivered long before the other party delivers her return. Credit markets and insurance markets are a case in point.

Sophisticated markets are of vital importance for growth. That is why law and order in the sense of a reliable legal framework is so important to economic development. The underlying logic is quite simple. People do not seed if they do not expect to be the ones who harvest. Put generally: People will not invest – neither in physical capital nor in human capital nor in social capital – if they must fear to be exploited. Incentives matter.

((4)) Let me conclude with some theses:

- The difference between rich countries and poor countries is not that the former have markets whereas the latter do not. Even very poor countries have markets. The difference is that rich countries are rich because of sophisticated markets, while in poor countries we observe only primitive markets. Sophisticated markets are missing.
- Precarious markets can be a blessing or a curse. They can be a blessing if they lead to investment in people. They are a curse if they invite rent-seeking by political pressure groups and/or corruption by government.
- Good governance is important because finally it is the institutional structure that matters. In order for a society to prosper, it needs an institutional framework to make sophisticated markets work properly and to check the potential abuse of precarious markets. The task is: governance for growth!
- NePAD is a promising initiative as a benchmarking process for good governance.

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