

Declines in Firms, Organizations & States — Thoughts on Albert O. Hirschman's *Exit, Voice, and Loyalty*

By Kazumasa Kusaka

This short but attractive book was conceived through interdisciplinary chats with colleagues while the author was on leave from Harvard at the Institute for Advanced Study on Einstein Drive near Princeton University. In the mid-1970s I had fortunately been exposed to this treatise and most struck and influenced by it. The news that he passed away last December led me to revisit his insights.

Hirschman argued that people have two different ways of responding to disappointment over the decline in firms, organizations and states. They can leave and attach themselves to a competing firm or organization (“exit”), or stay and complain (“voice” — i.e. take political action). Economic analysis focuses on exit in the market, while “a close look at the interplay between market and non-market forces will reveal the usefulness of certain tools of economic analysis for the understanding of political phenomena, and *vice versa*.”

Deteriorating railways get worse because the most vocal customers shift to the roads (exit) unless the only choice is the railway, where dissatisfaction translates into complaints (voice). Public schools might deliver worse education if the private school option is available to the most quality conscious parents.

In Japan, political representation has been distorted by inequalities in the value of individual votes from different electoral districts. The current arrangement tends to reflect the interests of local farming areas. Also in the context of demography, the graying segment of the population, large in both volume and turnout rate, is naturally well-represented while the interests of the younger generation are not given sufficient attention.

How can we keep the younger generation, especially in the cities, interested and engaged in the political system and willing to exercise their “voice”?

In the economic field, companies are in a position to choose which country to locate their activities in when their home governments or regions cannot secure energy at an affordable price or ensure an appropriate regulatory framework or stable exchange rates. The question to be asked is whether companies should register their voice to change this business environment or silently exit the country they are located in.

Where there is loyalty to the organization, exits may be reduced. “Loyalty” in Japan might have delayed necessary changes by missing the opportunity to have feedback. Japanese households and small investors over the last two decades have remained loyal to local investment opportunities despite a less than 1% interest rate and a disappointing stock market performance. Is this sustainable?

Regionally, East Asia has benefited from the positive feedback from

GATT-WTO liberalizations and competing liberalizations between ASEAN and China, resulting in its becoming one of the most attractive regions for business. But is there a risk that this region could lose its allure, exhausting its energy internally in politico-military conflicts?

The so-called RCEP (ASEAN+6) negotiations have just started. The challenge is whether this will make a difference to the business community, investors, consumers and other users compared to existing bilateral FTAs in addressing domestic policy measures such as regulations and intellectual property rights, in addition to tariffs and other border measures.

Can we mobilize these stakeholders? And can political processes in the region digest these voices and lead to structural reforms?

Without covering fire, i.e. without working on the constituencies, just hoping political leaders will make wise decisions is not practical. Tough and seasoned politicians may not listen. Those who do might lose their seats.

In the past, the G7 summit was the vehicle for creating an “international voice” or consensus for leaders to take back home to persuade domestic stakeholders to swallow a bitter pill. Though the spirit has remained, the combined GDP share of the G7 in the world economy has declined significantly, resulting in the limited effectiveness of any decision it takes. The bigger G20 has yet to learn how to share a common spirit to create so-called international public goods and to accumulate expertise and human resources for global governance.

In Japan, with an upper house election coming up this summer, it is not easy to introduce short-term fiscal austerity, and economically it would undercut the effectiveness of monetary easing. This naturally leads to mid-term fiscal discipline, with an immediate focus on growth strategy. The built-in mechanism for hearing “voices” is FTA negotiations, in addition to the views of the market.

In my talks with the energy industry, which was protected for the nobler purpose of energy security back in early 1990s, I often used the boiling frog anecdote. If a frog is placed in boiling water, it will jump straight out, but if it is placed in cold water which is slowly brought to the boil, it won't sense the danger it is in until it's too late.

We had better listen well and respond appropriately in order to survive.

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