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Employee ownership in the context of globalisation:

a developing country perspective

by

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October 2002

For presentation at

The Capital Ownership Group international policy conference

"Fix Globalization: Make it more inclusive, democratic, accountable and sustainable"

in Washington DC

on 9 – 11 October 2002

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Introduction

1. This paper represents an initial set of ideas focused on employee ownership within the developing country context. The central question being explored is 'To what extent can employee ownership support the broader goal of poverty reduction in South Africa (and, by extension, in the developing country context)?'. This is a rather broad question, and as such this note sets out to begin the discussion on this question, rather than seek to provide a definite set of answers.

2. The critical perspectives put forward in this note draw heavily on experiences and debates in South Africa, and particularly those within the labour movement.

Globalisation's impact on poverty, employment and inequality in the developing world

3. 'Globalisation', in this instance more accurately referred to as neo-liberal globalisation[1], is a multi-dimensional, ambiguous and policy-driven process. Globalisation encompasses dimensions of economics, democracy, culture, technology and communication, and military expansion – to name but a few. It is ambiguous in that contradictions arise between these dimensions, for example, the oft-debated tension between processes of democratisation and economic liberalisation in so-called transition economies. Moreover, as globalisation is a policy-driven process, the outcome of these contradictions is often dependent on the balance of social forces within local, national and global policy environments.

4. Within the multi-dimensional make-up of globalisation, the economic and democratic dimensions are the most important for this discussion on employee ownership. This is because the economic and democratic dimensions have the biggest impact on levels of poverty, and on the ability of the poor to influence economic changes. Moreover, the concept of employee ownership potentially addresses issues of economics (through distributing ownership) and democracy (through promoting forms of economic democracy and participation).

5. On the economic level, globalisation is a process that seeks to create a single global market operating according to universal rules driven primarily by the needs of multinational corporations. This is globalisation's most visible feature, and is reflected in the trade-intensive focus of most globalisation debates. In this regard, the behaviour of rich-country governments seeks to ensure that the rules that govern global trade are 'rigged in favour of the rich'. Developing country exports, for example, face tariff barriers four times higher than those encountered by rich countries. Yet should developing countries increase their exports by just one percent, the resulting gains in income could lift 128 million people out of poverty (Oxfam, 2002).

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1 The term 'neo-liberal globalisation' refers to the profit-centred process to create a common capitalist market, rather than the process focused on creating a common humanity. The term is necessary to avoid the typical but false dichotomy that is often presented between the (allegedly realistic) 'globalisers' and the (allegedly backward) 'anti-globalisation' activists. The term therefore suggests that the debate is between two different types of globalisation, one focused on human development and the other on profit development. For the sake of brevity, however, only the term 'globalisation' is used in the remainder of this paper.

6. Central to economic globalisation has been the increased power of investors (essentially in the form of multinational corporations). The dismantling of capital control mechanisms in much of the world has created a 'race to the bottom' environment whereby corporate tax rates are lowered on a continual basis to attract investment. Due to increasing productivity from rising work intensity and technological advances, the trajectory is one of only 20% of the world's workforce being needed to produce 100% of the output for which there is sufficient aggregate demand. The other 80% of the workforce would, essentially, be surplus to the needs of the global capitalist economy (Martin and Schumann, 1997).

7. This crisis of surplus capacity (or insufficient demand) has contributed to a concentration at the centre of the global economy as multinational corporations seek to consolidate profit rates and reduce costs through mergers and acquisitions. Nonetheless, it is often the case that mergers and acquisitions do not result in long-term benefits for shareholders, with share price increases being short-lived and management getting a disproportionate share of any resulting bonuses.

8. Alongside this rising concentration, there is growing competition at the periphery as multinational corporations seek to compress labour costs mainly through contracting out and promoting the informalisation of the labour market. In South Africa, for example, massive retrenchments through industrial restructuring have resulted in a decline in the income of the poorest 50%. The income of the richest 20%, on the other hand, has increased. While formal employment has declined, informal employment has grown – although three-quarters of the informally employed earn less than $3 a day and one-fifth earn no incomes at all (Taylor Committee, 2002).

9. It is no surprise, then, that there is persistent poverty and rising inequality in developing countries. There are 1,1 billion people struggling to survive on less than $1 a day (the same number as in 1980), and inequalities between rich and poor, both between and within countries, are rising (Oxfam, 2002).

10. Growing labour informalisation and lower corporate taxes have resulted in a rise in capital's share of national income relative to that of labour and government revenue (taxes). Thus, in this period of extensive poverty and rising inequality, the fiscal capacity of states to alleviate poverty and inequality (through taxation and redistributive means) is reduced. This is a fundamentally important bind that states, particularly the social democracies, have found themselves in. These states are now under pressure to revise downwards their historic social compacts. They are seeking to cut their social spending by channelling specially identified categories of the 'undeserving' poor through 'workfare'. Further, states are redefining 'employment' to include low-income informal and survivalist activities, thus taking people engaged in such activities off the social protection 'in-need' list.

11. On the democratic level, globalisation is driven by two somewhat contradictory emphases. The first is the emphasis on ensuring political stability and some form of representative democracy. This emphasis is functionally related to the need of investors to have secure property rights and greater degrees of certainty over the repatriation of profits. Despite this narrow functionalism, representative democracy is often an advance on the forms of governance that many developing countries have. The second emphasis is the pressure to insulate public policy (particularly macroeconomic policy)

from societal pressure. This is ostensibly motivated by the need to ensure policy certainty for investors.

12. Many conservative commentators argue that globalisation requires rapid and unpopular decisions that democratic processes cannot generate. This view holds that experts, shielded from political pressures, are best suited to making effective policy. They reject the claim that such technocratic processes are undemocratic by noting that the government is ultimately accountable to the public through electoral competition – essentially seeking shelter behind 'low-intensity democracy'. Thus globalisation is introducing a form of representative democracy, but one that is functionally structured to meet the needs of investors. A contradiction arises, however, as even processes of 'managed democracy' may create opportunities for truly democratic forces to extend those democratic spaces even further.

13. Another contradiction is the growing influence of pension funds, investing approximately $12 trillion of worker savings (Evans, 2002). These funds own large proportions of shares on stock markets around the world. In South Africa, pension funds own approximately 40% - 50% of the shares listed on the JSE (Johannesburg) Securities Exchange (Taylor Committee, 2002). Yet the control that workers exercise over these investments is highly intermediated by the asset management industry, which directly manages the investments. Therefore, it is a common occurrence for these same savings to be invested against the interests of workers as a class. A common example is the manner in which investment strategies promote massive retrenchments in companies to increase labour productivity, apparently to benefit their investors – who are often the very workers being retrenched.

14. The question of where and how pension funds invest is therefore of great importance to union movements. In developing countries such as South Africa, where capital markets are relatively developed and where pension funds represent a considerable share of the gross domestic product, such questions are becoming particularly important. However, it should be noted that the extent to which open scheme pension funds are 'worker owned' is unclear and needs to be further analysed, both quantitatively and qualitatively.

15. Another aspect that is becoming increasing prominent in policy debate is the extent to which 'developing' countries will follow a linear development path, essentially going through similar stages of development as the now developed countries. For example, while developed countries have historically focused their policies on the assumption of formal sector employment being the norm, there is every reason to question whether this will be the case in the development path of the rest of the world. In the developed world it was assumed that most people will find decent formal jobs, and that special measures (such as social security) would assist with income replacement for those who (temporarily) lose their income through frictional unemployment, illness, maternity or the like. The International Labour Organisational (ILO) Convention on social security (No.52) is based on just such an assumption.

16. However, the reality in the developing world is that most people are unemployed, doing low-income or survivalist informal work, and living in conditions of poverty (Moody, 1997). The formal sector is often the smaller of the productive sectors in the economy. With trends even in the developed world favouring growing informalisation

of work, there is less likelihood that we will see the opposite trend taking hold in most less developed countries. Certainly, the evidence points to an entrenchment of the predominance of informal work in the developing countries (Taylor Committee, 2002).

17. In short, strategies centred on the formal sector are unlikely to address the development and poverty reduction needs of developing countries. This conclusion implies that whatever the benefits of employee ownership, it would probably be preferable not to hinge these too heavily on their potential to reduce poverty in developing countries.

18. The above conclusion, however, does not imply that employee ownership has no role to play in promoting poverty reduction. Rather it implies that employee ownership strategies should be seen in combination with a broader poverty reduction, or alternate globalisation, approach. In particular, it is argued below that employee ownership has an important role to play as part of a broader asset distribution strategy. This role is discussed in the specific context of South Africa.

The economics of ownership dispersion: what role for employee ownership?

19. In order to develop strategies and a vision of how the economic system in South Africa can be transformed so as to reduce poverty, a theory of how the current economy produces and replicates poverty must be developed. Such an understanding must look at the distribution of human and material resources in the workplace, in the household, and in the context of an accumulation of assets and wealth.

20. At the level of economic theory, the understanding of the relationship between poverty and economics remains vehemently contested. Orthodox economics – often called neo-classical economics – is the dominant theory of economics in the developed countries (most notably, Britain and the United States). Orthodox economics connects poverty to productivity, economic growth, prices, and individual choice. Such an approach embraces the *status quo*, in terms of institutions, patterns of ownership, gender dynamics, and productive relationships. This acceptance of the *status quo*, in terms of the environment in which people make choices, clearly risks entrenching and reproducing conditions of poverty.

21. The orthodox theory of income distribution links income received to the 'factor of production' – these include labour, land, capital equipment and skills. Therefore, the income that workers receive is a reflection of the productivity of the workers themselves. In turn, the profits received by capitalist firms, farms and enterprises would be simply a reflection of the assumed productivity of the capital or land used in the production. Therefore this theoretical approach would argue that if an individual receives an extremely low income, it is because that person does not produce enough.

22. Poverty, in the orthodox framework, is tied to low productivity – in an economy, among a group of workers, or within an informal subsistence sector. In order to eliminate poverty and achieve higher standards of living, productivity must increase. Higher productivity, the theory goes, will spur economic growth, which in turn will create more resources to reduce poverty.

23. It is interesting to see how this theory explains, for example, gender dynamics in the economy. According to this theory, women perform labour in the household because they freely choose to do so. Since women earn less in the formal sector than men do it is only rational that women should specialise in reproductive work. But consideration is not given to why do women earn less than men in the formal economy. It is not recognised that the disruptions of raising children and other reproductive duties mean that women are not able to accumulate skills as consistently as men, that their productivity suffers, and they are therefore paid a lower wage. Clearly, the realities of discrimination, oppression, and power dynamics have no place in the orthodox world.

24. The current macroeconomic strategy proposed by the World Bank, the International Monetary Fund and the World Trade Organisation follows this orthodox approach. The debate is clearly central to the politics of South Africa, too. A recent economic policy discussion document of the ruling African National Congress (ANC) claimed that "with growth, poverty decreases…(and therefore that) growth sits at the centre of everything which can make the country better" (ANC, 2002). Also being debated in South Africa is a detailed report on poverty strategies, which argues to the contrary, that due to South Africa's extremely high levels of inequality, very high levels of economic growth are needed to make even a dent in the levels of poverty and, therefore, that redistributive strategies are a pre-condition to growth actually reducing poverty (Taylor Committee, 2002).

25. This focus on distribution mechanisms and redistributive strategies is crucial, not only for developing countries. Highly concentrated ownership of property – land, capital, financial holdings, and real estate – are a primary source of inequality, of both income and wealth. Not only does the distribution of assets deny the excluded access to economic resources, it also facilitates the exploitation of the excluded by perpetuating unequal economic power relations.

26. A skewed distribution of asset ownership creates a socially constructed scarcity that increases the economic power of the asset owners. This scarcity allows the asset holders (for example, home owners) to generate a higher income (such as rent). The same would apply to other forms of assets, such as credit and financial assets, where if people had access to abundant credit, the ability to charge high rates of interest would be compromised. Therefore contrary to orthodox theory, the distribution of income is not related simply to the productivity of the assets, but also to its scarcity.

27. An unequal distribution of assets is an important determinant of the economic attributes of poverty not only because it denies the poor access to factors of production but because it allows a distribution of income away from lower income (asset poor) households to other individuals and institutions. This transfer of income away from poor households can place pressure on household resources; in response these households (and particularly women) compensate by diminishing their own consumption or increasing their workload. Clearly, then, asset distribution must form part of a broader analysis of poverty, and policies of asset redistribution must be considered as a core element of a strategy to reduce poverty.

28. Flowing from the above analysis, employee ownership can have an important poverty impact in promoting greater economic inclusion and some degree of redistribution of assets, directly benefiting formal sector employees and their direct beneficiaries.

29. The full impact of this gain is, however, related to the proportion and structure of formal employment in the economy. In those developing countries where formal employment is not the leading employment sector, or where formal employment is highly casualised, the full benefit of employee ownership schemes may be limited.

30. Employee ownership could, theoretically, play a role in ameliorating the redistributive conflict between profit share and wage share. Studies of investment in South Africa found a significantly positive correlation between firm investment and profit share (Heintz, 1998). In the debate about increasing firm investment and jobs, a dilemma arises: a shift from remuneration to profits may increase firm investment (and possibly jobs), but will increase inequalities in a society. However, to the extent that these profits could be more equitably shared (possibly through employee ownership), the effects of redistribution towards profit share will have a less pronounced impact on inequality.

Employee ownership share plan (ESOP) debates in South Africa

31. **Increased remuneration to management** – As in many parts of the world, ESOPs in South Africa have been seen as a benefit for management. Distributing company ownership through share options has been a common strategy to increase management remuneration. The argument for this has been to better align management interests with those of shareholders, and avoid the principle-agent problem whereby management utilise their privileged location to promote non-shareholder orientated strategies. A more basic motivation for ESOPS for management has been that capital gains (unlike salary incomes) was not taxed in South Africa, and therefore represented a very lucrative remuneration strategy for management.

32. While ESOPs for management are common in South Africa, ESOPs for low graded employees are generally far less common (Le Grange, 1999).

33. **Shifting remuneration from wages to shares** – As mentioned above, ESOPs could, theoretically, reduce the distributional conflict between profits and wages. It has sometimes been suggested that workers could be given shares instead of wage increases, or in exchange for a wage freeze in difficult corporate periods – that is, giving workers shares as part of a 'sweat equity' deal with the company.

34. There is clearly a limit, however, in terms of the extent to which workers could exchange wage remuneration for share ownership. Share prices fluctuate according to the vagaries of the market. So a worker who sells shares at retirement in one year may achieve a fairly high share price compared to the worker who retires the following year, when the price may have fallen dramatically. In a world where workers have alternate sources of income security such risks may be acceptable. However, in any current reality a significant remuneration-through-shares scheme would be too risky for most workers.

35. Apart from the levels of risk, disposable incomes of workers are also generally too low to support any thought of them sacrificing present incomes (to invest in ESOPs) for future returns. Indeed, the case in South Africa is generally one of dis-saving, whereby workers take new loans to pay off other loans, thereby getting caught in a cycle of debt

and impoverishment.

36. The recent spate of corporate collapses in the United States is a further reminder of the dangers of workers investing their savings in the company that employs them. Should the company fail, you have lost both your job and your savings.

37. **Promoting forms of 'popular capitalism'** – ESOPs have often featured in debates as a strategy to encourage South Africa's socialist-orientated trade union movement to 'buy-into' a popular form of capitalism. This view was relatively common in the early transition years when there was considerable concern over the economic trajectory that South Africa would take, with trade unions closely aligned to the ruling Tripartite Alliance (including the ANC, Communist Party and Congress of South African Trade Unions). However, to the extent that there has not been any attempt by the ANC to develop an alternative to capitalism, this debate has largely become redundant.

38. There remains however some degree of worker resistance to ESOPs on the basis that it would undermine the labour movement's ideological foundations. Internationally, however, there appears no evidence at this point to show that ESOPs negatively affect the desire of workers to join unions (Kruse, 2002).

39. **A sweetener to privatisation deals** – ESOPs have emerged as a strategic tool in getting public sector workers to accept privatisation. Internationally, there is a fairly common association between privatisation and employee ownership (Galgoczi and Hovorka, 1999). In South Africa, there has been a tendency to allocate a significant portion of shares to employees (and particularly union members) as part of privatisation deals (Le Grange, 1999). However, as privatisation has led to massive job losses, and with alternate formal employment hard to come by, worker resistance to privatisation has been intense.

40. Not surprisingly, there is a positive correlation between shares offered to workers and the degree of initial union resistance to the privatisation initiatives (Development Bank of South Africa, 2000). Also not surprisingly trade unions have tended to brand such ESOP strategies as forms of bribery to get workers to accept higher unemployment (COSATU, 2000).

41. **A strategy to increase company performance** – Similar to the argument regarding management, it is suggested that ESOPs will encourage workers to share the interests of the firm in improving profitability and share price, and stimulate greater worker co-operation with management and worker productivity. Specifically, workers would adopt more self-regulatory systems and effectively monitor each other, and encourage greater effort from other employees to boost profitability (Development Bank of South Africa, 2000).

42. There is considerable evidence in the international literature that firms with ESOPs have better survival rates and higher return on assets than non-ESOP firms (Kruse and Blasi, 2000). Several studies claim to have found a 'causal link' between employee ownership and corporate performance, both in terms of sales growth and employment growth. This has been most prevalent where employee ownership has been combined with forms of worker participation and participatory management (Beatty and Schacther, 2001).

43. Due to the limited degree of ESOPs for low-graded workers in South Africa, there is

less clear evidence of these relationships within the country. It is possibly an area of further study.

44. **Supporting better corporate governance** – More worker participation, and the likelihood of greater corporate transparency that may go with it, may lead to better corporate governance. Improvements in corporate governance may lead to fewer instances of plundering of firms by management, and, hence, less likelihood of bankruptcies and retrenchments.

45. However the case for ESOPs necessarily ensuring good corporate governance must surely be badly shaken following the extensive proof of corporate plundering and fraud in the United States, which has included many firms (ranging from Enron to Xerox) with extensive ESOP programmes. The conclusion, perhaps, is that ESOPs create merely the *potential* for better corporate governance within a particular corporate environment.

46. **Worker participation through employee ownership** – ESOPs often go hand in hand with a greater degree of worker participation within the firm. Management has often regarded this as a negative relationship. At a technical level, some management analysts tend to highlight the 'collective action' problems associated with worker participation, since, they claim, workers acting collectively will not be able to reach agreement on common preferences (Development Bank of South Africa, 2000).

47. The logical extension of this logic implies that employers would seek to get workers to identify with the shareholders' interests, but without having to give up any control over production decision-making to workers. Therefore, there will be the temptation to restrict worker involvement to voting their shares through the trustees of the ESOP trust, with a minimal amount of worker participation within the workplace.

48. As much of corporate strategy, including outsourcing and downsizing, is to reduce workers' claim to profits, strategies that purport to increase worker participation often find resistance from management unless mitigated by other elements of a broad strategy.

49. The dilemma for management is that ESOPs, as mentioned earlier, appear to deliver greater corporate performance gains when linked to worker participation. Indeed it could well be worker participation more than employee share ownership that unlocks improvements in the firm's performance and productivity. In particular, worker participation may bring into play the knowledge and information that workers possess of the organisation and work processes, that would otherwise not be available to management.

50. **Worker buy-outs of troubled firms** – In view of the high rates of unemployment in South Africa, and the limited chances of retrenched workers finding another formal sector job, trade unions have tended to argue in favour of worker buyouts of unprofitable firms rather than allowing these firms to close (National Union of Mineworkers, 2001).

51. While a capitalist investor will require a competitive return of, say, 15 percent above cost, a worker-owned firm would require a lower return sufficient to pay the costs and reinvest in necessary future productive capacity. Therefore, many firms that may be unviable to private investors may be viable to workers who are interested mostly in

keeping their jobs at that firm.

52. Clearly, several issues are important here. Firstly, there needs to be some trustworthy analysis that establishes that the firm can indeed be saved – and that workers are not being led into a greater calamity than the loss of their jobs. Secondly, insolvency procedures need to allow for such options to be considered; in reality the system is structured to promote stripping the assets of the troubled firm to pay corporate creditors rather than allowing workers options to keep their jobs. Thirdly, workers still need to be able to raise the capital to finance the worker buy-out, without putting too much of their pension fund and other retirement savings at risk. Fourthly, there needs to be a sufficient level of worker capacity to manage or participate in the running of the firms

53. **Promote forms of social capital** – As part of promoting a more equitable distribution of resources and facilitating democratic forms of ownership, trade unions have tended to argue in favour of co-operatives. The mineworkers union in South Africa has several years of experience setting up worker-run co-operatives through its Mineworkers Development Agency. Co-operatives are closer to the union movement's ideological preference for developing a powerful, self-reliant and self-managed movement of productive enterprises – along the lines of the Mondragon worker complex in Spain and the Italian 'Red Belt' area of Emilia Romagna (COSATU, 2001).

54. ESOPs that introduce only partial worker ownership in a company are likely to be seen as second best to co-operatives in the social capital stakes. Nonetheless, it would clearly be helpful to explore the ways in which ESOPs can support the objectives of a broader social capital strategy.

55. **Promoting shareholder activism and corporate transparency** – A serious difficulty facing workers, trade unions, communities and even governments is that of getting adequate corporate disclosure. Only publicly listed companies are required to make information publicly available, and even then the levels of disclosure are far from adequate. Importantly, there is growing pressure in South Africa and internationally for more effective corporate reporting – in response to corporate scandals and growing social pressure.

56. Therefore, employee ownership could enable workers, as shareholders, to demand and access information that they could not access as workers. In an era of growing investor and corporate power, such shareholder activist strategies could have an important role to play.

57. With multinational corporations being the drivers of globalisation processes, employee share ownership in multinational corporations could be an especially useful corporate disclosure strategy.

58. **What role should the state play in promoting appropriate forms of employee ownership?** – Changing the distribution mechanisms in a country, which has been argued here as crucial, clearly requires a strong role for the state. The role of the state in furthering appropriate forms of employee share ownership to address the social dimensions of globalisation needs to be conceptualised further – both in terms of promoting better income distribution and participatory governance.

59. In countries where worker share ownership is widespread, governments offer significant

tax incentives to employers to extend share schemes to a wider group of workers than just management (Le Grange, 1999). Currently in South Africa there are no state incentives for employee ownership, or any regulatory frameworks governing employee ownership, either from a worker protection or public policy standpoint.

60. Moreover, as workers in developing countries are risk-averse and liquidity constrained, the fate of ESOPs hinges heavily on a source of affordable finance. The state could therefore play an important role in developing appropriate financing options, probably as part of the overall strategy to transform the financial sector to ensure a source of cheap and accessible credit for low-income and poor people in the country.

Some preliminary conclusions

61. Neo-liberal globalisation is increasing the power of private investors over workers, governments and communities. This is leading to growing inequality and the promotion of 'low-intensity' forms of democracy. Employee ownership, to the extent that it is combined with worker participation, can promote countervailing forms of ownership dispersion and participatory democracy ('high-intensity' democracy).

62. Nonetheless, formal sector employment will not be the norm in developing countries, and therefore employee ownership strategies will have an impact that is limited to the proportion and structure of formal employment in the economy.

63. Employee ownership can empower shareholder activism in these firms, resulting in better corporate governance and information disclosure. Moreover, better disclosure can also assist social movement organisations (including trade unions and other organisations) to engage companies on a range of issues.

64. In taking forward employee ownership, however, there are a number of difficulties that need to be addressed:

- Firstly, **ESOPs are only one potential route** to increase worker influence in companies. Unions in developing countries need to explore other strategies, too – although these need not be mutually exclusive of forms of ESOPs.
- Secondly, while there are no legal restrictions on employee ownership in South Africa, there are also no specific incentives (such as tax incentives) for firms to go the route of employee ownership. **There is room for the introduction of regulations of employee ownership, covering sourcing of finance, tax incentives, employer obligations, worker protection and the building of worker capacity to participate in the participatory management of companies.**
- Thirdly, **efforts should be made to forge a partnership between the state and unions, possibly as part of social capital/ social compact strategy**. Such strategies may be well suited to low-capital intensity industries where the possibility of job creation spin-offs is higher. Aligned to this, of course, is the need to specifically incorporate a role for co-operatives, to which the labour movement is historically committed.
- Finally, trade unions will have to devise education programmes to counteract the ideological assault that will follow increased employee ownership. More importantly,

unions could set standards regarding the appropriate types of employee ownership that their members could enter into – essentially employee ownership that incorporates worker participation, relationships to worker co-operatives, social accountability and ethical firm behaviour as an integral part of the overall formula. Unions could also insist that union members can access shares, and via the union – thus reducing the potential for employee ownership to be created as an instrument to outflank the union.

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