The Theory Y Case Against Panopticism:

Toward a Critique of the Economic Theory of Agency

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Introduction

Usually arguments for transparency are concerned with arguing for the transparency of the actions of superiors in the eyes of subordinates. I will present a converse argument for the non-transparency of the actions of the subordinates in the eyes of the superiors.

This paper is part of a larger project to better understand the limitations of the economic theory of agency and incentives.[1] The economic approach focuses on extrinsic incentives whereas a better understanding of human organization requires an understanding of intrinsic motivation and the complementary or substitutive relationships with extrinsic motivation. I will focus on different treatments of informational or "panoptic" questions regarding transparency or non-transparency in the management of firms or other human organizations. This context will give the questions definiteness but the ideas might also be applied in a broader social context.

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[*] The findings, interpretations, and conclusions expressed in this paper are entirely those of the author and should not be attributed in any manner to the World Bank, to its affiliated organizations, or to the members of its Board of Directors or the countries they represent.

[1] See Ross 1973 and Stiglitz 1974 for early work. For surveys and applications, see Pratt and Zeckhauser 1991, Eatwell et al. 1989, or the text Campbell 1995. For earlier critical analysis of agency theory, see Perrow 1972, Hirsh et al. 1987, Pfeffer 1994, and the references contained in Eisenhardt 1989.

As a conceptual framework, I will use the seminal work of Douglas McGregor [1948, 1960, 1966, 1967]. The economic approach to agency and incentives theory is based essentially on what McGregor called the "Theory X" worldview, and the alternative explored here is essentially what he called the "Theory Y" view of individuals in organizations.

The Economic Theory of Agency and Incentives

Agency theory focuses on the common situation wherein one person or group, called the "principal," desires to obtain certain behavior from another person or group called the "agent." The principal-agent language is borrowed from the legal relationship of agency and is used in economics in a much broader context.[2] McGregor writing in 1948 before the principal-agent language was established in the economics and management literature refers to the principal and agent respectively as "*A*" and "*B*": "*A* always refers to the individual (or group) who is attempting to induce a behavior change, and *B* always refers to the individual (or group) whose behavior is affected." [1948; reprinted in 1966, 155]

Agency theory is based on *homo economicus*, or in McGregor's terms, on the Theory X view of people. The individual agents are assumed to dislike work so positive and negatives incentives ("carrots and sticks") must be supplied by the principal to induce the appropriate behavior by the agents. Left to their own devices, agents cannot be trusted to act in the manner desired by the principal so an incentive structure must be applied to redirect the agents in the desired manner.

Information enters the picture because the principal needs to know if the agents are carrying out the desired actions or at least are delivering the desired outcomes or results. The principal's information about the agents is always in fact incomplete so incentive structures must be designed with this information asymmetry in mind. There are two broad types of informational deficiencies. When the principal lacks information about something that is within the discretionary choices of the agent, then it is broadly called a "hidden action" or "moral hazard" situation. If the principal lacks information about something that the agent cannot change by taking different actions, then it is broadly called a "hidden characteristic" or "adverse selection" situation.[3] The concern here is with hidden action problems where, within the penumbra of the principal's ignorance, the agent or agents might act opportunistically to the detriment of the principal's interests.

The economic theory of agency works with variables such as monetary rewards that the principal can affect and change since the goal of the theory is to design incentive structures to elicit the desired results from the agents. By following the incentives provided by the "incentive-compatible" reward scheme, the agents will be led to achieve the results desired by the principal. From the agents' viewpoint, such an incentive structure represents extrinsic or external motivation.

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[2] In the legal relationship, the agent takes on a legal role to act in the interests of the principal, but economists now use the terminology in a broader context where the agent is not necessarily under any legal obligation to act in the interests of the principal.

[3] Thus the economic theory of agency and incentives is an important topic in the economics of information, e.g., Eatwell et al. 1989.

> Money is the most obvious [extrinsic motivator] but promotion, praise, recognition, criticism, social acceptance and rejection, and 'fringe benefits' are other examples.
>
> 'Intrinsic' rewards, on the other hand, are inherent in the activity itself; the reward is the achievement. They cannot be *directly* controlled externally, although characteristics of the environment can enhance or limit the individual's opportunities to obtain them. Thus, achievement of knowledge or skill, of autonomy, of self-respect, of solutions to problems are examples. [McGregor 1966, 203-4]

There is now a considerable body of literature in psychology, sociology, and organizational behavior on intrinsic and extrinsic motivation as well as the closely related notions of autonomy, self-determination, and internal locus of control.[4] Although considerations of intrinsic motivation have figured prominently in the Romantic critique[5] of classical economics, the topic has until recently only received sporadic treatment in economics literature.[6] Bruno Frey's recent *Not Just for the Money* [1997] is the first book-length treatment of the topic of intrinsic motivation in the economics literature.

The important point to notice is that incentive structures devised by the principal to control the agents must rely, by necessity, on extrinsic motivation. Any actions by the agents that were *motivated* by the incentive structure provided by the principal would, *ipso facto*, not be activities done for their *own* sake--as their own reward. Let me repeat this crucial point; actions done for the sake of incentives provided by the principal are not action done for their own sake. That is the crux of the inherent limitation of agency theory; external control and intrinsic motivation (which requires an internal locus of control) do not mix.

External Control and Panopticism

External control by the principal requires information obtained by monitoring the agents, and that, in turn, requires a certain transparency on the part of the agents. Jeremy Bentham was perhaps the strongest advocate of publicity and transparency: "without publicity, no good is permanent; under the auspices of publicity, no evil can continue."[7] His Panopticon [1995 (1787)] prison scheme (cells arranged around the rim of a circular building all visible from a watchtower in the center) represents the apex of this theme in his writings and thus the emphasis on the one-way monitoring and supervision of a controlled group of people (e.g., agents) has been called "Panopticism." [Foucault 1977] Bentham's plan is often thought to be only an

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[4] See Deci and Ryan 1985, Elster 1983, Lane 1991, Candy 1991, Kohn 1993, and Deming 1994.

[5] See, for example, Ruskin 1985 (1862). Lutz 1999 gives an integrated treatment of Sismondi, Carlyle, and Ruskin.

[6] See Titmuss 1970, Arrow 1972, Scitovsky 1976, Hirsch 1976, Sen 1982, Schelling 1984, Akerlof 1984, Hirschman 1992, Kreps 1997, and Prendergast 1999.

[7] From Bentham 1843; quoted in Bok 1982, 174.

eccentric idea for a prison but he was quite explicit about more general applications.[8] Indeed, the long title of the work begins "Panopticon; or, The Inspection House: containing the Idea of a New Principle of Construction Applicable to any sort of Establishment, in which Persons of any Description are to be kept under Inspection; ..." [1995 (1787)] and then he goes on to list "Houses of Industry" "Manufactories," "Hospitals, and Schools" in addition of "Penitentiary-Houses" and "Prisons." The panoptic principle is "a great and new instrument of government...; its great excellence consist in the great strength it is capable of giving to *any* institution it may be thought proper to apply it to." [Bentham quoted in Foucault 1977, 206]

In a factory, the requirements for monitoring would depend on the nature of the incentive scheme.

> Whatever be the manufacture, the utility of the [inspection] principle is obvious and incontestible, in all cases where the workmen are paid according to their *time*. Where they are paid by the *piece*, there the interest which the workman has in the value of his work supersedes the use of coercion, and of every expedient calculated to give force to it. In this case I see no other use to be made of the inspection principle, than in as far as instruction may be wanted, or in the view of preventing any waste or other damage, which would not of itself come home to the workman, in the way of diminishing his earnings, or in any other shape. [Bentham 1995 (1787), 80-1]

Where monitoring and detailed control is quite costly or not feasible (and where the workman will not pay a franchise fee to be an independent franchisee, e.g., taxicabs), then some form of piece rate or performance-related pay is recommended by agency theory.[9] Since the effort expended by the agent is hidden, "any measure of performance that (on the margin) reveals information on the effort level chosen by the agent should be included in the compensation contract." [Prendergast 1999, 12-13] In that manner, the economic results of the effort decisions would "come home to the workman."

In a survey article, Eisenhardt [1989] notes that, in addition to emphasizing considerations of risk, agency theory emphasizes the role of information.

> This gives an important role to formal information systems, such as budgeting, MBO [*sic*][10], and boards of directors, and informal ones, such as managerial supervision, which is unique in organizational research. The implication is that

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[8] Nor was it just a passing fancy. "On the Panopticon, ..., Bentham...centered his attention for over 20 years [between the ages of 20 and 40]. To it he gave up his time, his more ambitious works, and his fortune...." [Everett 1966, 45-6]

[9] Whether such compensation schemes are practical is another matter. Herbert Simon points out that "such reward systems are effective only to the extent that success can be attributed accurately to individual behaviors.... But of course, intense interdependence is precisely what makes it advantageous to organize people instead of depending wholly on market transactions. The measurement difficulties associated with tying rewards to contributions are not superficial, but arise from the very nature and rationale of organizations." [Simon 1991, 33]

[10] See later remarks on the non-vulgarized interpretation of Drucker's "Management by Objectives" or MBO.

> organizations can invest in information systems in order to control agent opportunism. [64]

Information about the actions of the agents allows the principal to more closely specify job performance, to design higher powered incentives, and to better curtail opportunistic behavior. Since information is costly, the principal does not seek full "panoptic" knowledge. Monitoring would in general be pushed to the point where the marginal cost of information equals the marginal return in better control of agent behavior.[11]

Agency theory falls short of recommending full panoptic transparency only because of "agency costs" such as the costs of monitoring and the costs of writing and enforcing more complete contracts. As improving information technologies reduce these agency costs, the recommendations of the economic theory of agency and incentives will more closely approximate the panoptic ideal of full monitoring and control of the agents by the principal.

Intrinsic Motivation and Theory Y

An intrinsically motivated activity is an activity carried out by individuals for its own sake. The activity is an end in itself, not an instrumental means to some other end (such as satisfying biological needs or "tissue deficits"). The factors that determine the meaning of "for its own sake" are usually based on the self-identity of the person or persons carrying out the activity. An intrinsically motivated activity might be accompanied by extrinsic motivators if the latter are not controlling, i.e., if they do not take over the locus of control. For instance, professors typically pursue their professional work for its own sake even though they also receive a salary and other emoluments. Indeed much of the story is concerned with the question of the locus of control for an activity. Autonomous activity has an internal locus of control. A bribe to do what one would not ordinarily do establishes an external locus of control.

The roots of intrinsic motivation such as an individual's self-identity (including the larger social units with which the person identifies) are typically not open to intentional and deliberate choice. One chooses according to who one is, but one does not directly choose who one is. These basic "preferences" can be transformed but more as a "by-product of actions undertaken for other ends" [Elster 1983, 43] than as the result of deliberate actions.[12] For instance, one cannot simply decide to be "in love" and thus one cannot "buy love." This "can't-buy-love" situation limits the domain of the market and the reach of extrinsic motivators. "Carrots and sticks" might buy or

[11] This might involve some subtle points. For instance, Aghion and Tirole [1997] develop a model where increasing monitoring effort by the principal leads to delimiting the agent's scope of action and thus "stifling the initiative" for hidden action. But where the unmonitored activity of the agent still has a net benefit for the principal, the marginal return to more monitoring would have to take account of that indirect cost of stifling the agent's initiative in the determination of the optimal level of monitoring. In a dynamic context, a risk-averse worker might fear that monitoring would uncover hidden characteristics and lead to uncertain future compensation so some current pay might be bargained away in return for less monitoring (somewhat like selling a used item "as is" for a lower price), e.g., see Stiglitz 1975.

[12] In terms of the analytical tools of economics, feasible choices determine the variables in a person's utility function, but the shape of the function itself is not subject to direct choice. Yet preferences or utility functions do shift over time as a by-product of actions taken and other influences.

induce compliant (e.g., "loving") behaviors, but they cannot supply or create intrinsic motivation–although we will see in the next section how "carrots and sticks" can override intrinsic motivation and may eventually cause it to atrophy.

In the applications of agency theory to the workplace, the hidden actions of the workers are typically concerned with the effort level of the work. For instance, there might be quality bonuses that would reward employees for producing at a certain level of monitored quality in the products. Yet what are loosely called "Japanese-style" management techniques (e.g., often associated with W. Edwards Deming) go in quite the opposite direction and achieve world-renowned levels of quality. For instance, Deming's "New Economics" recommends to "Abolish incentive pay and pay based on performance" [1994, 28], e.g., to pay salespeople by salary rather than by commission. Deming recommends replacing a system based on monitoring and quality bonuses with a system using (for the most part) trust based on self-esteem and pride in the quality of one's work. In short, this approach to quality relies not on cleverly constructed pay-for-performance schedules but on switching over to a quality system driven largely by intrinsic motivators such as self-esteem and pride in one's work–in short on quality as a calling.[13]

While Japanese-style management methods and Deming's work has done much to popularize the role of intrinsic motivation in management and to criticize the pay-for-performance schemes, the most sustained development of these themes is McGregor's Theory Y [1948, 1960, 1966, 1967].[14] It is not a matter of choosing extrinsic or intrinsic motivation; it is a matter of background and foreground. When basic physiological and security needs are not satisfied, then such motivations will stay in the foreground. "Man tends to live for bread alone when there is little bread." [1960, 41] But when these needs lower on the Maslovian hierarchy are adequately and equitably satisfied, then the "higher needs" of self-actualization and self-fulfillment move into the foreground.[15] And when extrinsic motivators such as pay are in the background, then the perception of equity may be more important than any purported linkage with performance. Indeed, the detailed linkage of pay to performance, as per agency theory, is pointless when pay is in the background and performance is based on intrinsic motivation.[16]

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[13] The importance of intrinsic motivation has always been evident in the professions where intelligence, creativity, diligence, and empathy are important. For instance, given the patient's very limited ability to monitor a doctor's actions and the knowledge asymmetry between doctor and patient, a medical system based solely on extrinsic motivation would be hardly workable. As long as doctors can "bury their mistakes," even the reputational mechanism is a poor substitute for the intrinsic motivators of empathy and professionalism (e.g., as expressed in the Hippocratic Oath).

[14] Peter Drucker [1954] developed essentially the same "Theory Y" ideas in his "Management by Objectives (MBO)" (also called "management by objectives and self-control") approach as opposed to "management by control" (as noted in McGregor 1966, 15-16 and in Drucker 1973). But the MBO theory was so popularized (indeed, vulgarized) by Drucker and others apparently in order to reach a mass market that it is commonly interpreted to mean "management by results" in a manner quite along the lines of Theory X and agency theory. Hence we will rely more on McGregor's treatment of these ideas.

[15] See Maslow 1954, 1968.

[16] That is why agency theory is not just a harmless "academic toy." It makes misleading recommendations both concerning the pay-performance linkage and the desirability of individual monitoring of agents by principals. The point is not an improved behaviorism or Theory X approach promised by agency theory, but a wholly different approach along Theory Y lines.

> [T]he carrot and stick theory does not work at all once man has reached an adequate subsistence level and is motivated primarily by higher needs. Management cannot provide a man with self-respect, or with the respect of his fellows, or with the satisfaction of needs for self-fulfillment. It can create conditions such that he is encouraged and enabled to seek such satisfactions *for himself*, or it can thwart him by failing to create those conditions. [1960, 41; 1966, 13]

Since the satisfaction of intrinsic motivators is inherently a do-it-yourself project, the principal cannot motivate, direct, or control the agents in those activities. Management has an indirect role:

> The essential task of management is to arrange organizational conditions and methods of operation so that people can achieve their own goals *best* by directing *their own* efforts toward organizational objectives.
>
> This is a process primarily of creating opportunities, releasing potential, removing obstacles, encouraging growth, providing guidance. [1966, 15]

A person's intrinsic motivation is based on the person's own definition of self-identity.[17] Yet through identification, a person's definition of self-identity can extend to broader groups such as family, ethnic or professional group, and organization (e.g., being a "Toyota man" or a "neoclassical economist"). Herbert Simon [1991] has developed a scathing analysis of the explanatory effectiveness and organizational practicality of agency theory and the related new institutional economics.

> Although economic rewards play an important part in securing adherence to organizational goals and management authority, they are limited in their effectiveness. Organizations would be far less effective systems than they actually are if such rewards were the only means, or even the principal means, of motivation available. In fact, observation of behavior in organizations reveals other powerful motivations that induce employees to accept organizational goals and authority as bases for their actions. [The] most important of these mechanisms …[is] organizational identification. [Simon 1991, 34]

He goes on to note specifically that the "attempts of the new institutional economics to explain organizational behavior solely in terms of agency, asymmetric information, transaction costs, opportunism, and other concepts drawn from neoclassical economics ignore key organizational mechanisms like authority, identification, and coordination, and hence are seriously incomplete." [42]

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[17] See Akerlof and Kranton 1999 for some recent modeling using notions of self-identity.

Potential Negative Effects of Management by Carrots and Sticks

Agency theory's neglect of intrinsic motivation would be of less concern if extrinsic and intrinsic motivation were always additive or complementary. While they may be complementary when extrinsic motivators are largely satisfied and in the background, negative effects arise when the extrinsic motivators are brought to center stage as instruments of control.

While management cannot provide intrinsic motivation, it can nevertheless frustrate the satisfaction of those drives by imposing a management structure based on direction and control, i.e., Theory X (and agency theory).[18]

> The philosophy of management by direction and control–*regardless of whether it is hard or soft*–is inadequate to motivate, because the human needs on which this approach relies are relatively unimportant motivators of behavior in our society today....
>
> People, deprived of opportunities to satisfy at work the needs that are now important to them, behave exactly as we might predict–with indolence, passivity, unwillingness to accept responsibility, resistance to change, willingness to follow the demagogue, unreasonable demands for economic benefits. It would seem that we may be caught in a web of our own weaving. [McGregor 1960, 42]

It is not a question of whether Theory X or Theory Y is true. Both theories might be taken as rough descriptions of two different organizational equilibria. Theory X is a low trust and low involvement equilibrium, and Theory Y is a high trust/involvement equilibrium. Distrust breeds distrust and trust breeds trust so both equilibria are self-reinforcing. When McGregor indicates that "we may be caught in a web of our own weaving" he means that when we assume people behave as indicated by Theory X (e.g., distrustful) and thus impose a Theory X managerial structure, we may soon induce the assumed behavior even if it was not initially present. Distrust breeds distrust in the Theory X vicious circle.

> The introduction of pay into a task situation, then, moves, or seems to move, the locus of causality from disposition to circumstance, from internal to external; it alters the task from chosen to unchosen, and since people do not work without motives, it transmutes intrinsic motivation into pecuniary motivation. Strangely, it *creates* Skinnerian man where he was missing earlier. [Lane 1991, 379]

Thus agency theory and Theory X management can usually find suitable empirical (pseudo-) verification for the *homo economicus* presuppositions. Money talks–and when it talks loud enough and long enough, people will be able to hear little else.

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[18] This can be illustrated using the ancient neo-Platonic metaphor of an internal "fountain" with its source in the human self. Another person can create conditions and remove obstacles so that the fountain can flow or can effectively shut off the fountain altogether, but the other person cannot supply the *pressure* (motivation) that causes the inner fountain to flow in the first place. Another useful metaphor is biological growth. One can create the conditions to help a plant grow or one can destroy a plant, but one cannot directly force or control the growth (although biotechnology may continually move in that direction).

Let us consider more closely how the use of extrinsic motivation for control purposes drives or crowds out intrinsic motivation. The notions of internal or external loci of control (or causality[19]) are related to intrinsic and extrinsic motivation. When an externally offered reward or punishment is used successfully to redirect a person's behavior, then the behavior is said to have an "external locus of control." When one acts for one's own reasons and is the source of one's actions, then one would be said to have an "internal locus of control." Having an internal locus of control is to act autonomously in contrast to responding to heteronomously imposed rewards or punishments.[20]

External interventions by other people intended to change a person's behavior pose a threat to autonomy. The threat-to-autonomy or reactance [see Brehm 1972] effect results from using extrinsic motivators–carrots and sticks–to shift the locus of control from internal to external.[21] The effect shows itself in a poor quality and low effort performance, in sullen and perfunctory behavior fulfilling the letter but not the spirit of an agreement, and perhaps even in the urge to defiantly do the opposite just to show one's autonomy.

The threat-to-autonomy effect points to a broader complication in accounting for human preferences. An individual's evaluation of an event may be strongly affected by the source of the event (e.g., was a death due to natural causes, an accident, or a murder). A change in a person's choices due to another person's strategic action may give rise to a "reactance" that would be absent if the change had been necessitated by natural events.

The imposition of extrinsic motivation may have untoward long-term "by-product" effects. Intrinsic and extrinsic motivation might not be additive. Indeed it frequently seems to be the case that extrinsic incentives superimposed onto a system involving intrinsic motivation in order to better achieve control will tend to "crowd out"[22] and atrophy the intrinsic motivation.

> It was on the basis of this atrophy dynamic—the less the requirements of the social order for the public spirit, the more the supply of public spirit dries up—that the United States' system for obtaining an adequate supply of human blood for medical purposes, with its only partial reliance on voluntary giving, was criticized by the British sociologist Richard Titmuss. And the British political economist Fred Hirsch generalized the point: once a social system, such as

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[19] See Deci and Ryan 1985 for the notion of locus of causality. They differentiate it from the notion of locus of control [see Lefcourt 1976] as they interpret the latter as dealing with the outcomes rather than sources of action. Nevertheless, one may find the notion of "locus on control" often used to indicate the source of actions. We use the notions of having an internal locus of control, self-determination, and autonomy as being roughly synonymous.

[20] We use autonomy or internal causation broadly to include not only one's 'original' integrated sense of self but norms based on social interactions which are eventually integrated and internalized so following those norms would come to have an internal locus of causality. See Deci and Ryan 1985, Chapter 5.

[21] For example, suppose one buys a townhouse in the middle of Winter and is looking forward to Spring to spruce up the poorly attended front yard. But the Townhouse Association Beautification Committee [a.k.a. "Lawn Nazis"] arrives before Spring to inform the new owners that they must attend to the yard or face certain penalties. Instead of just thinking "Now we have two reasons to spruce up the lawn," the new owners might well resent the attempt to externalize their locus of control.

[22] See Frey 1997 passim.

> capitalism, convinces everyone that it can dispense with morality and public spirit, the universal pursuit of self-interest being all that is needed for satisfactory performance, the system will undermine its own viability, which is in fact premised on civic behavior and on the respect of certain moral norms to a far greater extent than capitalism's official ideology avows. [Hirschman 1992, 155-6]

This crowding-out or atrophy effect might also be amplified by what Frey calls a "motivational spillover effect." The imposition of controlling extrinsic incentives might not only atrophy intrinsic motivators in the given system but in related areas of endeavor where the market-type incentives were not applied.

Frey is also careful to note that intrinsic motivation may be crowded out or overridden not only by extrinsic incentives but also by external interventions in other forms such as compulsory laws and regulations. Frey develops a number of illuminating examples of the crowding-out effect:

- a constitution or other system of laws (e.g., tax laws) designed on the assumption that the citizens are Humean knaves bent on trying to break or evade the law may well lead to civic virtue drying up;[23]
- an environmental control system based on market incentives and penalties may lead to the atrophy of environmental morale;
- a system of military conscription ignores intrinsic motivation to serve, and, moreover, a system allowing conscripts to buy their way out would quickly undermine any residual motivation of the other conscripts; and
- systems of social actions (e.g., putting waste dumps always in someone's "backyard") where the monetized benefits exceed the losses ("Kaldor-Hicks improvements") might operate—without compensating the losers—on the basis of civil virtue if the losers in each case were determined in a fair and transparent manner, but the system might have perverse results if the losers were compensated ("Pareto improvements") as that might dry up the civic virtues and cause adverse spillover effects in other areas (since citizens would then expect to be "compensated" for any adverse effects due to government action).

In summary, the principal cannot directly supply or increase the intrinsic motivation of the agent, but the principal can reduce intrinsic motivation (e.g., displace it into the motivational background where it may atrophy) or prevent it from moving into the foreground. Intrinsic motivation can be crudely displaced by threats or subtly displaced by the offer of what economists tellingly call "high powered" incentives (e.g., stock options to focus managers on the stock market and to weaken any conflicting ties with other stakeholders such as the enterprise personnel, the customers, the suppliers, and the local community).[24]

[23] " The first [effect] is the expected deterrent effect: the fear of getting caught and the severity of sanctions motivate taxpayers to comply with the law. However, the retroactive, confrontational, and coercive aspects of a deterrence approach to law enforcement also have an indirect, negative effect by alienating taxpayers and lowering their willingness to comply voluntarily with the law." [Kinsey 1992, 259]

[24] Historically, the "Great Transformation" [Polanyi 1944] from pre-market to market societies and the current process of globalization can be usefully viewed through the lens of using "high powered" market-based incentives to override older identifications.

Theory Y: *Modus Operandi*

It might be useful to see how McGregor developed the Theory Y arguments in his seminal 1948 article on "The Staff Function in Human Relations." McGregor seems to have approached his general theory of management by first analyzing the staff-line relationship and then generalizing the results in his 1960 book "The Human Side of Enterprise." He assumes an organization where there are certain staff departments such as human relations, accounting, finance, and engineering that serve the line managers who carry out the business of the organization. A line manager has a problem, say, in human relations and a staff member ("*A*") from the human relations department is called in to work with the line manager ("*B*") to make a behavior and organizational change that will solve the problem.

The steps in the process can, however, be generalized as essentially the *modus operandi* of Theory Y. This *modus operandi* would be the intrinsic-motivation-oriented alternative to the extrinsic-motivation-oriented compensation schemes and other recommendations of the economic theory of agency and incentives. In other words, it is the Theory Y approach to the situation wherein "*A* always refers to the individual (or group) who is attempting to induce a behavior change, and *B* always refers to the individual (or group) whose behavior is affected." [1948; reprinted in 1966, 155]

McGregor describes Theory Y as being based on the principle of integration and self-control where "integration" refers to the situation where an individual "can achieve his own goals *best* by directing his efforts toward the objectives of the enterprise." [1960, 61] Management's task is not to provide incentives; the "task is to provide an appropriate environment–one that will permit and encourage employees to seek intrinsic rewards *at* work. [1967, 14] The contrasting Theory X is based on the principle or philosophy of direction and control using the type of incentives that management can provide, i.e., extrinsic incentives.

I will outline Theory Y in a broader principal-agent setting where the "principal" or "helper" is trying to help the "agent" or "doer" to accomplish certain tasks. The general purpose is for the helper to help the doer or doers to help themselves. In an organizational setting, the principal (helper) would have a managerial role, the agent (doer) would be a subordinate (or another manager as in McGregor's staff-line example), and the tasks would be in furtherance of organizational goals.

Step 1: Starting from the doer's problem

The helper starts from the doer's engagement with an organizational problem, a problem that the helper is to help the doer solve. The helper is not to start with what the helper as expert thinks is "the problem."

Step 2: Seeing the problem through the doer's eyes

The helper explores with the doer the problem as perceived by the doer. How does the doer perceive and conceptualize the difficulty? If the helper sees the situation differently then this should be explained clearly without trying to manipulate the doer's perceptions or impose the helper's view of the problem.

Step 3: Helping the doer pursue own-ends to best solve the organizational problem

Starting with the doer's problem within the organization and seeing the problem through the doer's eyes, the helper can then offer knowledge and experience to help the doer find the best way to further the doer's own intrinsic ends while addressing the organizational problem. The helper is not to "teach" the doer what the helper considers the best solution.[25] This is particularly difficult for engineers and economists who "know" the "one best (or 'optimal') way" to solve the problem. The helper is to create a learning situation so that the doer can arrive at what the doer considers to be the best solution to the problem in view of his own ends and capabilities.[26]

> *A's* [Helper's] objective is to utilize his skill to create a situation in which *B* [doer] can learn, and to make his knowledge available so that *B* may utilize it to augment his own need satisfaction in ways consistent with the achievement of organizational objectives. [McGregor 1966, 163]
>
> Fundamentally the staff man... must create a situation in which members of management can learn, rather than one in which they are taught. [161]

As the arrived-at solution is the fruits of the doer's own labor, the doer has a natural ownership of it which leads to much more effective implementation (e.g., more effective than the typical partial, half-hearted, and sullen implementation of the expert's imposed "solution").

If the helper's favored approach or solution is sound, then a learning situation should be feasible wherein the doer can arrive at it or something close to it. As may be more likely the case, the helper's favored solution may be incomplete or require adaptation to local circumstances so "perhaps the greatest challenge in the methods outlined above [is that] they offer to [helper and doer] alike a valuable opportunity to learn." [1966, 168]

Step 4: Helping doer to implement, test, and refine the doer's solution

Having worked with the doer to arrive at what the doer considers the best solution, the helper needs to assist the doer in testing it, refining it, and gaining the skill and self-confidence for full implementation of the refined solution. This at the same time builds trust on the part of the helper that the doer will take responsibility for the problem-solving.

Step 5: Helping doer gain autonomy and take responsibility for solution

In this final stage, the helper's goal is to assist the doer to achieve independence ("leave the nest") and to take full responsibility for the solution and its implementation–as well as for finding own-solutions to similar problems that might arise in the future. There are two sides to this

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[25] When the helper facilitates the doer finding a solution and refrains from "teaching" or otherwise imposing a solution, then the helper is perhaps engaging in "action by non-action" (*wu-wei*) of Taoist thought.

[26] In the same spirit, George Bernard Shaw quipped "if you teach a man anything he will never learn it" [1962, 174] and Ortega y Gasset suggested: "He who wants to teach a truth should place us in the position to discover it ourselves." [1961, 67]

"separation" or "leaving the nest" problem: getting the doer to avoid dependency and assume responsibility, and getting the helper to have the trust to "let go" and to avoid trying to take responsibility.[27]

The helper must avoid the benevolent "giving" of a solution to a grateful doer as that develops dependency and the doer does not learn to help himself. Just as the doer needs to take responsibility, the helper needs to avoid trying to "take responsibility." This is particularly difficult since helpers have their own bosses or principals so the helper naturally wants to take ownership of the solution.

> If [the helper's] own need for power is too strong, he will not be able to create or maintain an effective relationship with *B* [the doer]. If he is overanxious for recognition, he is likely to destroy the results of his work with B by seeking credit for *B's* accomplishments. [1966, 167]

This is the classic ownership problem. If the helper takes ownership of the solution in the eyes of the organization, then we are back in the case where the doers are called upon to implement someone else's plan with the aforementioned lack of effectiveness. The helper is never more successful than when the doer finds the *doer's* solution.[28]

The Theory Y Case Against Panopticism

We are now is a position to see that Theory Y has quite different implications for "panoptic" monitoring of the agents than the Theory X approach of the economic theory of agency and incentives. An agency theoretic management system based on monitoring and control may start the dynamics that causes a Theory Y high-trust virtuous circle to decay into a low-trust Theory X vicious circle.

> Intrinsic rewards are largely ignored under these circumstances. Surveillance displaces autonomy, mistrust undermines self-regard, absence of support and help minimizes achievement, likelihood of punishment for noncompliance reduces risk-taking and innovation, rigidity of standards and administrative procedures precludes the individual's use of his own know-how. [McGregor 1967, 126-7]

The close monitoring and supervision of the agent will reveal distrust by the principal and may lead to a negative reaction on the part of the agents and eventually to an atrophy of any intrinsic motivation for the activities.

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[27] One common metaphor is the two-sided problem of the grown-child leaving the parents' "nest." The grown-child needs self-confidence to release the parental hand and the parents need trust (and the willingness to foresake dependency and control) to let go of the grown-child's hand.

[28] "The successful psychotherapist is the one whose patients all believe they cured themselves—they internalized the therapy and it thereby became truly an integral part of them. Consultants suffer much the same dilemma of the psychotherapist—the problem of internalization. If they wish the client to use the right solution with full and lasting commitment then they must let him believe it is *his* solution." [Handy 1993, 145] This echoes the notion of the Taoist ruler who governs in such a way that when the task is accomplished, the people will say "We have done it ourselves." [see Chapter 17 of Lao-Tzu's *Te-Tao Ching*]

McGregor develops this argument in the context of his analysis of the staff-line relationship. [1960, chapters 11 and 12] A staff member, the helper, is called upon to help a line manager, the doer, to address and solve an organizational problem. The line manager also has a manager and the question is how "transparent" should the doer's (line manager's) activities be to the manager. In the course of working with the line manager, the staff member (helper) will compile information and may even set up information monitoring systems (e.g., accounting or finance information) about the line manager's activities. Who should receive this information?

Theory Y is based on the idea of maximizing each person's autonomy and self-control within the organizational framework.

> With respect to data and reports compiled by staff groups, the principle of self-control requires that they be provided to each member of management for controlling *his own*, not his subordinates' jobs. [1960, 160]

Thus the informational feedback about a person's performance should go to that person for the purposes of self-control, not to the person's superior. The system has a built-in "blindness" or non-transparency. In that manner, the informational feedback is enabling to the subordinates rather than controlling.[29] The information that goes back to a division manager should be aggregate, not individuated.

> If such summary data indicate to the manager that something is wrong within the organizational unit for which he is responsible, he will turn not to staff [i.e., not to the accounting or finance staff providing the data], but to his subordinates for help in analyzing the problem and correcting it. He will not assign staff "policemen" the task of locating the "culprit." If his subordinates have data for controlling their own jobs, the likelihood is that they will already have spotted and either corrected the difficulty themselves or sought help in doing so. [1960, 161]

McGregor laments that that there is so much managerial misuse of information by line or staff managers who seem not to understand the non-transparency implications of the principle of self-control or not to be committed to the principle. Managers complain that "delegation" doesn't seem to work–that subordinates "don't want responsibility"–when the same managers maintain surveillance through various performance measures of their subordinates.[30] One of the prerequisites for a person to take responsibility for the job is for the person, not the person's superior, to have necessary information to control the job.

The members of the staff departments should provide information only for the purposes of self-control, not the control of others.

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[29] See Adler and Borys 1996 for a development of this theme.

[30] It should be carefully noted that the principle of self-control is not an argument that managers should "delegate" responsibility and then maintain impersonal surveillance of subordinates through, say, accounting measures–as opposed to maintaining direct personal surveillance. It is an argument against both personal and impersonal surveillance of individual subordinates. "Self-control" is not an euphemism for more subtle external control.

> The same principle–that staff provides help for self-control only–applies to what is usually called "coordination," but which means policing the organization with respect to policy and procedures. Help can consist in informing an individual that he is out of line, or that a contemplated action would be in violation of policy–*but with the full understanding by both parties that the staff member will not report his knowledge or opinion to anyone else.* [1960, 169]

The helper cannot at the same time be a policeman exercising control as that frustrates rather than facilitates the self-control of the doers.

The Panoptic Power of Information Technology

These questions of where there should be transparency in an organization–and where there should not be–will only grow more acute in the future. With the development of modern information technologies, there is the potential both for better informational feedback to enable self-control or for even more abuse by managers of the principle of self-control. In a chapter entitled "The Information Panopticon" of her book *In the Age of the Smart Machine*, Shoshana Zuboff notes that information technology codifies the events and processes of work as a "text" that managers and workers can read.

> To what extent was it the occasion for organizational members to more fully grasp their own reflections, learn from what they could now see, and increase their opportunities for autonomous actions? To what extent would the text be treated as a technical convenience enabling more assiduous behavior control? Was the text to be the keystone of a new learning environment, or would the increased visibility of behavior be exploited in the service of managerial control as an antidote to the pressures of uncertainty? [Zuboff 1988, 319]

She makes the distinction between information technology that is used to *automate*–increasing the panoptic power and control in the hands of managers–or to "*informate*"–increasing the self-control and learning opportunities of the operators carrying out the tasks. Managers who control how information technology will be used have shown a natural tendency to seek Bentham's "universal transparency"–at least insofar as their subordinates are concerned. Zuboff quotes an ecstatic manager:

> It is beautiful now. I can track my people's work. All I have to do is to type the [subordinate's] initials in and see how he is progressing and see what his total work load was. What is his productivity? Before, we had to judge people more on hearsay. Now we have it in black and white. [1988, 331]

But the managers have an equally natural reticence to have this information in the hands of *their* boss. Another manager notes:

> I don't think my boss should get involved with it....If anything is wrong, he can come and ask me. I don't think he should be involved with the nitty-gritty of running the job on my level. [340]

Thus the power and information dynamics of the new information panopticon are played out. Often any information that *can* be made technologically available to managers *is* made available to them in a renewed dream of panoptic power, a power based not on direct personal observation but on indirect technologically mediated surveillance. The violation of the principle of self-control inevitably brings resistance.

> The resistance to such exposure reflects in part an effort to retain a sense of self-control and to avoid feelings of shame....One way to minimize the risk of shame would be to look for ways to circumvent the observer, to thwart the power of the panopticon. This motivates managers who seek a technological solution that will ensure some measure of shadow, of privacy, and thus of self-control, in the increasing glare of the information panopticon. [Zuboff 1988, 344-5]

While some managers and workers might be able to informationally protect some sphere of autonomy, the whole "non-transparency" issue of managerial non-access to information about subordinates' performance has rarely been faced squarely.

> Not one of the organizations I studied had yet confronted this crucial issue. Rules of access were being constructed ad hoc, as individual managers were motivated to dip into data normally reserved for their subordinates and as subordinates found it in their interests to restrict or impede their superiors' access. Most people said that it would "take a lot of guts" for their organizations to develop a clear policy for data access. [Zuboff 1988, 357]

Some History and Broader Applications of the Ideas

The idea of autonomy and self-control, encapsulated in McGregor's Theory Y, provides an argument for limiting the "transparency" of the agents' activities to the principal–or rather for building a relationship where individuated monitoring of the agent by the principal is not part of the *modus operandi*. This non-transparency argument seems considerably more subtle and nuanced than the traditional arguments for privacy based on preventing inappropriate influence. The argument has nothing to do with the agent's private matters (i.e., outside the workplace). In this context, the principal (e.g., management) has an appropriate influence on the agents (e.g., workers)–albeit indirect by creating the conditions for the agents to promote the goals of the principal (e.g., the organization) by their own intrinsically motivated activities.

If this argument based on the principle of autonomy or self-control can be made in the business enterprise based on the employer-employee relationship, then the argument would find even greater receptivity in a democratic enterprise[31] or in any other organization such as a government

[31] See Dahl 1985 or Ellerman 1992.

based on democratic principles. From ancient times, there has been a contest over the issue of the transparency or legibility of the people's affairs to the state. States need to "read" social realities in order to raise taxes, provisions, and troops. The "high modernist" schemes of technocratic social engineering continue in the panoptic tradition to design organizations and projects to maximize the legibility and controllability of the citizens' activities to the state.[32] The all-seeing Big Brother of the Orwellian vision of *Nineteen Eighty-Four* found its realization in the totalitarian regimes of the Left and Right in the 20th century.

The democratic and liberal (i.e., libertarian) tradition, exemplified by Theory Y in the workplace, has pushed in the opposite direction recommending structures to maximize autonomy and self-activity. Indeed, Drucker traces this point back to the birth of Western democracy in Pericles' Athens.

> The most moving statement of Theory Y antedates behavioral science by thousands of years. It is the funeral oration for the fallen Athenians which Thucydides has Pericles deliver in his great history of the Peloponnesian War. What Pericles said, in effect, was that Athens was a Theory Y society as against the Spartans, who were probably the world's most consistent practitioners of Theory X. [1973, 232]

On our present theme, Pericles notes that the freedom Athenians enjoy in government also extends to ordinary life where citizens do not exercise "a jealous surveillance over each other" [Thucydides 1982, Book II, section 37].[33]

The interplay between intrinsic and extrinsic motivation became a central theme for the later Stoics of ancient Greece and Rome. Virtue was obtained by having one's life controlled by one's mind or soul (intrinsic motivation based on self-identity), not in being a slave to the passions of the body or social reflections ("tissue deficits" and other extrinsic motivations). Their view is that the extrinsic "impulses are not inherently bad but become so only when they are in control." [Patterson 1991, 183] In describing a workplace along Theory Y principles, Harold Laski noted that the worker would have the freedom "which the Stoics understood so well–the provision of avenues through which internal spontaneity may find expression and, where it seems fruitful, response." [1948, 213]

The idea that one's basic identity and convictions (sources of intrinsic motivation) could only be determined by one's own activity and could not be imposed by another (Augustine's "No one can or ought be constrained to believe")–that idea was embedded into Western thought by the Reformation with the notion of liberty of conscience.

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32 See Scott 1998 for an extensive development of this theme.

33 This might be contrasted with B.F. Skinner's description of a behaviorist ideal that is "Beyond Freedom and Dignity": "A state which converts all its citizens into spies or a religion which promotes the concept of an all-seeing God makes escape from the punisher practically impossible, and punitive contingencies are then maximally effective. People behave well although there is no visible supervision." [1971, 67-8]

> Furthermore, every man is responsible for his own faith, and he must see it for himself that he believes rightly. As little as another can go to hell or heaven for me, so little can he believe or disbelieve for me; and as little as he can open or shut heaven or hell for me, so little can he drive me to faith or unbelief. Since, then, belief or unbelief is a matter of every one's conscience, and since this is no lessening of the secular power, the latter should be content and attend to its own affairs and permit men to believe one or another, as they are able and willing, and constrain no one by force. For faith is a free work, to which no one can be forced. [Luther 1942 (1522), 316]

Authorities, secular or religious, who apply extrinsic motivation to try to compel belief can only secure external conformity.

> Besides, the blind, wretched folk do not see how utterly hopeless and impossible a thing they are attempting. For no matter how much they fret and fume, they cannot do more than make people obey them by word or deed; the heart they cannot constrain, though they wear themselves out trying. For the proverb is true, "Thoughts are free." Why then would they constrain people to believe from the heart, when they see that it is impossible? In this way they compel weak consciences to lie, to deny, and to say what they do not believe in their hearts,.... [Luther 1942 (1522), 316]

We saw how a Theory Y manager would not train or teach subordinates the "solution" to a problem but would assist them to discover it themselves. The same is no less true in the state. Wilhelm von Humboldt wrote an essay in the early 1790's translated as *The Limits of State Action* where these points were developed.

> The cultivation of the understanding, as of any of man's other faculties, is generally achieved by his own activity, his own ingenuity, or his own methods of using the discoveries of others. Now, State measures always imply more or less compulsion; and even where this is not directly the case, they accustom men to look for instruction, guidance, and assistance from without, rather than to rely upon their own expedients. The only method of instruction, perhaps, of which the State can avail itself, consists in declaring the best course to be pursued as though it were the results of its investigations. But whether it coerces the citizen by some compulsory arrangement, directly by law or indirectly in some way, or by its authority by rewards, and other encouragements attractive to him, or, lastly, merely by arguments, it will always deviate very far from the best system of instruction. For this unquestionably consists in proposing, as it were, all possible solutions of the problem in question, so that the citizen may select, according to his own judgement, the course which seems to him the most appropriate; or, still better, so as to enable him to discover the solution for himself, from a careful consideration of all the objections [1969, 25]

Conclusion

The themes we have seen developed as "Theory Y" in organizational management are actually quite general. The implications for "Theory Y managers" can be generalized to democratic leaders and other holders of power in organizations where the autonomy of subordinates is to be nourished and supported rather than curtailed and overridden. This general case against Panopticism is part of the general case against the exclusively economic theory of agency and incentives. The "scientific" recommendations of the economic theory of agency are rather one-sided, and organizations that put such schemes in the motivational foreground (rather than the background) will tend not to promote human development and autonomy.

This paper has focused on the ill-founded attempts (given "scientific" expression in agency theory) to override and displace intrinsic motivation with various schemes relying on extrinsic motivation and on direct or indirect monitoring and surveillance. There is a far greater threat that lies beyond the scope of this paper but which should be mentioned to maintain perspective. The drive to externally control people's actions is not limited to attempts to perfect schemes of extrinsic motivation. Far more insidious are the social technologies to more directly mold the determinants of intrinsic motivation–to promote identification with Big Brother–as well as to limit and impair people's cognitive abilities so that decisions are made on the basis of a well-engineered "view" of the world.[34]

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[34] There is a large literature on this topic but I would particularly recommend the stream of thought that runs through Dewey [1939], Lindblom [1990], and Chomsky [1987].

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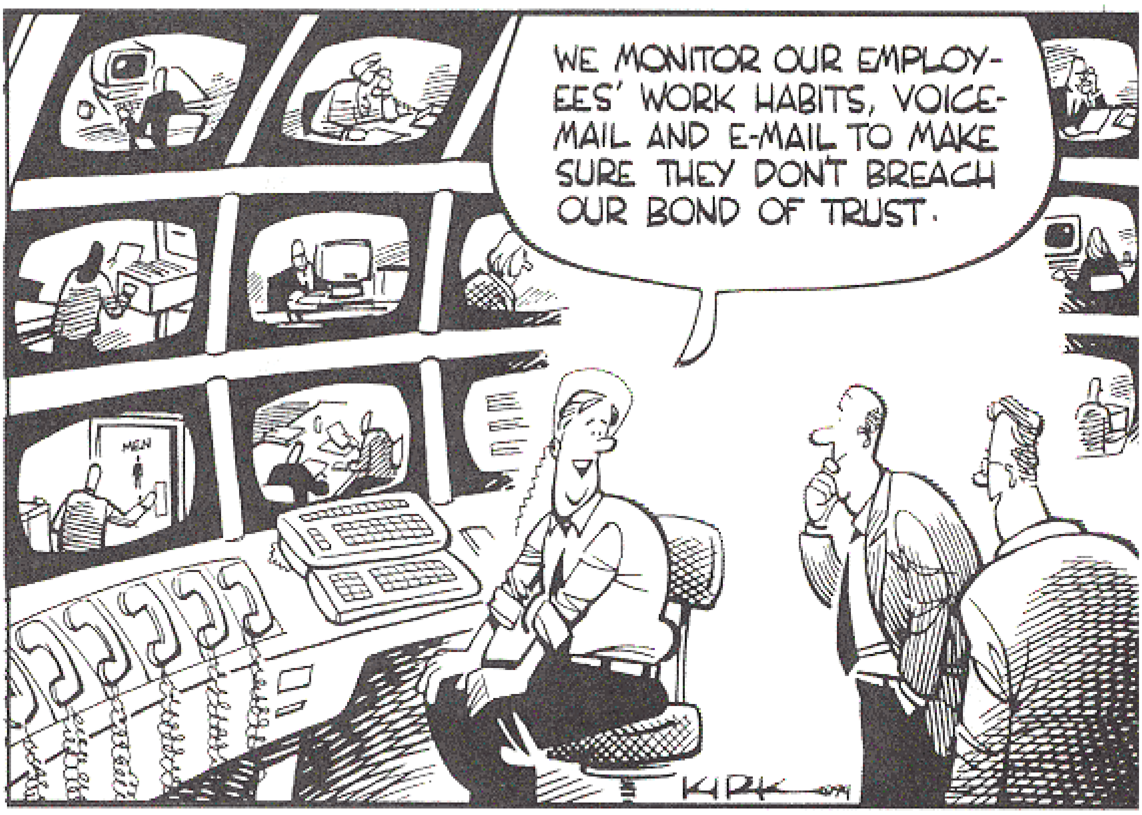
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