

WHY ARE INEFFICIENCIES OF PRIVATE ENTERPRISES TOLERATED?

Introduction

In the current debate on self-management, considered as a possible alternative for the Swedish social organization, the following question criticism was directed to the advocates of self management: If a workers' managed firm is really more efficient, how is it that it has not outcompeted the private firms on the market and has not become the dominant type of economic organization? Since in a competitive market the more profitable firms are bound to prosper, isn't the fact that workers' managed firms remain rare, a sufficient indication that, on the whole, they are not more efficient but, are possibly, less efficient than other firms?

The question quoted implies several unwarranted assumptions which have not been spelled out explicitly. For the purpose at hand, it will suffice to take up for discussion only one of them. The education that the economist gets from the contemporary neoclassical textbooks conveys an impression that the capitalist framework is conducive to the *maximum* possible efficiency. The celebrated theorem about competitive market resulting in Pareto optimality is an epitome of that impression. Thus, the assumption underlining our question reads as follows: since capitalist arrangements cannot pose a barrier to greater efficiency, the lack of success of a particular social or economic organization is a *prima facie* proof that it is less efficient. If it were more efficient, competition would immediately reveal its superiority in generating higher profits. Suppose, however, that there is a socially determined limit for efficiency in a capitalist setting. Then, only capitalist forms will be able to survive. A possible more efficient organization will either not appear or, if it does, will not be able to exploit its inherent economic superiority.

In order to decide which of the two assumptions is more justified, we have to explore three different problems: the inefficiency of a privately owned economy, the reasons for slow spreading of workers' management and the sources of superior efficiency of workers' management. Since the examination of the last mentioned problem would require a study of its own,^{*1} I shall restrict myself to a brief analysis of the first two problems.

*1) Cf. B. Horvat, M. Marković, R. Supek, eds., *Self-Governing Socialism*, Int. Arts and Sciences Press, New York, 1974.

Inefficiencies of a Privately Owned Economy

Inefficiency can be observed at the micro and the macro level, in the private and in the state sector, in the economic and the social organization. By inefficiency I mean that, given the resources, the desirable effect is smaller than objectively possible.

The Firm. The basic cause of inefficiency is to be found in the fundamental social conflict between the employer and the employees. The same conflict, clearly, exists in state firms as well. This latter case is different only in so far as profits are not used for the accumulation of private riches. The price paid for this positive effect consists in a dangerous concentration of power in the hands of state. The class conflict generates at least five types of inefficiencies.

(a) Since the worker is not working, for himself but for someone else for a master, his work effort is not optimal. He lacks appropriate motivation. A summary of empirical research on that phenomenon is to be found in the book by Paul Blumberg.^{*2)}

(b) In order to extract labour from the worker, the employer must undertake close supervision of his work. There is a natural inclination of people, as Demsetz^{*3)} puts it, to refrain from work when they are not supervised by the master. In the managerial literature, it is considered that one man can closely supervise only ten other men. Even if the requirement of close supervision is relaxed, the supervision costs are still enormous. On the other hand, already a century ago, the English liberal economist John Stuart Mill^{*4)} pointed out that, in a socialist farm or factory, the worker is supervised not by his master but by the entire community whose member he is, Ishak Adizes reports how supervision costs were eliminated in two workers' managed plants.*)

(c) The impulse for innovation is weakened and that for at least three reasons. Since the worker is treated as an operative, the necessary social atmosphere is lacking; innovation is considered to be the business of the staff. Innovation premiums, however, designed, do not prove to be very effective. Next, since the real benefits of innovation go »to them«, why bother? And finally, the foreman, who is the normal intermediary link between the worker and the management, may have — and does have — his own personal careerist reasons to belittle the capacities of the workers under his command.

(d) In a corporation, the link between the managerial behavior and the sanctions for inefficiency has to a large extent, been destroyed. It is the shareholders who are punished for the mistakes that managers make. The process of replacing inefficient management is slow and ineffective. The most radical verdict of the market, bankruptcy, is socially a very costly affair. In a workers' managed enterprise the results of bad management are imme-

^{*2)} P. H. Blumberg, *Industrial Democracy: The Sociology of Participation*, Constable, London, 1968.

^{*3)} H. Demsetz, »Information and Efficiency: Another Viewpoint«, *Journal of Law and Economics*, 1969, p. 7.

^{*4)} J. S. Mill, *Principles of Political Economy*, Book IV.

*) I. Adizes, *Industrial Democracy*, Free Press, New York, 1971, p. 192.

diately felt and those responsible for losses can be fired. Since capital is socially owned, it is easy to institutionalize managerial help to firms in difficulty and to avoid bankruptcy.

(e) Finally, bargaining procedures and strikes are costly and absorb time and energy. In order to protect their interests, the workers have to get organized in unions; the upkeep of union machinery involves, of course, real cost. And so does the maintenance of employers' organizations. Instead of spending their time arguing against each other, all these people could engage in more rewarding productive work.

At the level of *national economy*, one can distinguish the following sources of inefficiency.

(a) Since basic decisions about firms' activities are made by a handful of individuals in the Board of Directors, social control is practically impossible. A firm may engage in collusive practices, may evade taxes, may use its international network to hide profits may circumvent regulations about capital export etc. (as multinational corporations do all the time), may remunerate the management in more or less arbitrary way and may engage in various activities which are not strictly illegal but are socially harmful. Untouchable »commercial secrets« provide a cover for all these activities. In a selfmanagement setting, management operates before the watchful eyes of the Workers' Council and the entire working collective. It is both impossible and illegal to keep socially important decisions secret.

(b) A privately owned firm has all incentives to grow beyond the optimal productive size. The bigger a firm, the stronger it is financially. That implies that it can command credit and control market. Thus, oligopoly and monopoly is the natural tendency. In a labour managed economy on the other hand working collectives are stimulated to prevent overexpansion because it would make them loose control over the affairs of the firm. On the other hand, due to different social organization, financial power does not matter any longer. Thus, a labour managed economy is likely to operate much closer to the textbook model of the competitive market.

(c) Private ownership imposes definite constraints on social planning. As a consequence the rate of growth is likely to be lower than otherwise the instability will necessarily be higher and the number of unemployed will exceed the indispensable.

(d) Endemic inflation is the newest consequence of private ownership. In the last three decades, large scale unemployment has become politically intolerable. And in the situation of full employment, unions are strong enough to increase their share in the social pie. For the same reason, employers are strong enough to shift that increase to the general public and preserve the profits more or less unchanged. As a result, prices rise. If profits are reduced, rate of growth diminishes. If wages are kept low — unions are sometimes used as an instrument to achieve exactly that — private wealth increases. Thus, there is a *circulus vitiosus* which is usually resolved in inflation.

The state engages in a complicated, delicate and costly reconciliation of contradictory interests between labour and capital:

(a) Similarly, as an employer incurs supervision costs in the firm in order to save on production costs, the state must incur huge supervision costs at the level of the national economy in order to prevent damage arising from speculation and antisocial behaviour of private capitalist groups.

(b) Since the primary distribution of income in a capitalist setting results in gross inequalities, the state must intervene by means of heavy taxation. The textbook contention that everybody is paid the value of his or her marginal product is, of course, complete nonsense. Largest incomes originate in speculative activities, in ownership of wealth, in managerial salaries and bonuses, in institutional monopolies of various groups and are entirely unrelated to productive contributions. Total taxation, personal and other, absorbs now about one half of Swedish national income. Heavy taxation involves certain real costs, it: (1) brings about disincentives regarding work, (2) invites dishonesty and tax evasion and so affects public morality, (3) makes room for substantial legal loopholes, since, no matter, how complicated, it cannot be perfect. Thus, if in Sweden, eg., a capital owner has four children he can declare $4 \times 4,000 = 16,000$ Skr of tax free capital income which then appears as a sort of children's allowance for the rich. (4) Finally, we have also to take into account the tax administration costs.

(c) The inevitable intervention of the state in the productive process are by necessity bureaucratic, i.e., costly and not very effective. In Sweden, France and a number of other countries, public saving amounts to one half of total saving. And public saving implies a commensurate increase in the power of the state.

(d) In the mixed economy, the state undertakes to carry out a number of activities directly. »In my opinion — writes Assar Lindbeck — we have here one of the big efficiency problems... If our government authorities are really bent on increasing the efficiency of the Swedish economy, I should think they could find no better place to start than in the public sector itself.«*) This is easier said than done. A mixed economy requires centralized state. In order to decentralize a country needs pure-selfmanagement-economy which then generates a self-governing society.

Meaningful democracy requires egalitarian distribution of power. Ownership of wealth, parties and unions involve great concentration of power and result in oligarchies. Party chiefs and union presidents are rarely changed. Individuals are lost and powerless in huge bureaucratic organizations. In fact, the situation is worse than that. There can be little disagreement about the fact that a modern factory or office is characterized by a thoroughly authoritarian regime. Since people spend large part of their conscious life working, they spend it under authoritarian conditions. And if one is expected to be a submissive operative of official eight hours a day, how can one become an active and participating citizen over the weekend? Isn't it more natural to expect political apathy, isolation and privatization? And since a man seems to be a creative social being, the observed behavior implies heavy social cost.

*) A. Lindbeck, *Where is Our Economy Heading*, Institute for International Economic Studies, Stockholm, 1972, p. 13—14.

The foregoing was the substance of a talk given to the annual meeting of the Svenska IIRA-föreningen in May 1974. I concluded the talk by asking my audience the same simple question that motivated the present discussion: If a privately owned economy is inefficient, why not replace it by a more efficient alternative? Why not reorganize the society on the basis of selfgovernment? Apart from a justified remark that the alternative should be spelled out in more detail before it can be considered — which then raises an additional question: Why has that not been done already? — no answer was given. After the talk the SAF representative told me privately: there has been no demand for a change!

Why a More Efficient Workers' Managed Enterprise Does Not Prosper (in a capitalist setting)?

Instead of answering the question in the title directly, let us start by considering a historical analogy. A capitalist firm, characterized by management hiring legally free workers for money wages, is clearly more efficient than a feudal estate or an ancient slave factory. After all, that is why capitalism has replaced previous social orders and has become a dominant socio-economic system. Yet these potentially very efficient capitalist enterprises — together with commodity and money markets — had existed in previous societies and had not prospered. The three main ingredients of capitalist entrepreneurship — mobility of factors, contract law and property rights were also present and yet without much avail. Commenting about this fact, Max Weber wrote: »...the specific features of modern capitalism, in contrast to these ancient forms of capitalist acquisition, the strictly rational organization of work embedded in rational technology, nowhere developed in such irrationally constructed states, and could never have arisen within them, because these modern organizations, with their fixed capital and precise calculations, are much too vulnerable to irrationalities of law and administration.«* It remains to find out what are the irrationalities of capitalism which make workers management difficult to install.

Workers' managed firm is similar to a producer cooperative. England is one of the countries with the longest tradition — more than a century — in the producer cooperative experimentation. Most of the producer cooperatives have failed. Studying the problem on the spot and discussing it with English cooperationists, I have identified the following three reasons for the persistent failures of producer cooperatives:

(a) Cooperatives found it difficult to obtain bank and trade credit. They were also discriminated by private firms in terms of supply of necessary raw materials and of marketing of their finished products. **Capitalist economy behaved like a body with an organ transplanted from another body: they spontaneously rejected the alien tissue.**

(b) Cooperative selfmanagement implies a radical reduction of salary spans for managers. Thus, capitalist firms had no difficulty in bribing away

*) M. Weber, *Economy and Society*, Bedminster Press, 1968, 1395.

the most capable business administrators. Particularly because it is easier to issue commands than to treat the workers as your fellow equals.

(c) Once a cooperative begins to expand, new workers must be employed. In a capitalist environment, *that* has been causing social differentiation. The founding members tended to treat the newcomers as hired labour. Very soon, a cooperative would degenerate into an ordinary capitalist enterprise.

(d) The last observation implies that selfmanagement is behaviorally incompatible with private ownership. Thus, we now part with producer cooperatives and consider genuine self-managed firms. Ownership must be made indivisible and social. This means that the right to participate in decision making is derived from employment and not from ownership. And that, in turn, implies a thorough overhaul of the entire legal system. Yugoslavia had to change three constitutions and several thousand laws before the legal system was adjusted to the behavioral patterns of the workers' managed enterprises. Chile is another instructive example, unrecorded in the professional literature. In the Fall of 1972 I happened to be in the country and found the following situation. The spontaneous taking over of enterprises by workers — a phenomenon known as »tomas«, not rare in Latin America — occurred on a scale larger than elsewhere. Between 1968 (when Frey government was in power) and 1972 (when Allende government was in power) one hundred *empresas de trabajadores* were created with about 10,000 workers employed. The workers almost invariably improved the business position of their enterprises. But they had almost no access to the credit facilities either of the private banks (in the first period) or of the state banks (in the second period). They relied on savings out of wages and on the credit extended by the only cooperative bank in the country. Strictly speaking the operations of these enterprises were non-legal under either Frey and Allende's governments because they did not conform to the norms of the established law. Union leaders disliked them. That they have not been enthusiastically accepted by the present military dictatorship — can hardly be doubted. Thus, how could Chilean workers' management prove its efficiency — except by mere survival?

(e) Ideology and vested interests complete our list. In a capitalist setting, a workers' managed firm is a deviant. Even well intended business partners and authorities do not know how to treat it. Does it represent a business or a political risk? What criteria should one apply? Trade union finds its position utterly ambiguous. Isn't it really an employer? Doesn't it destroy working class solidarity? After all, what is the role of a trade union in a workers' managed enterprise? Is there any? Thus, all well intended members of establishment are bound to be highly suspicious. But not everybody is well intended. Those who are not will be openly hostile. Besides, most people have their own prejudices and vested interests. And so the most trivial problems, otherwise solved automatically in the existing institutional setting, will become very complicated and will require a lot of time, energy and ingenuity on the part of workers' management bodies in order to be solved. An alien system generates unnecessary costs. It is a simple fact that *efficiency inherent in a microeconomic organization can be exploited only if the macroeconomic environment is changed appropriately.*

It happens more often than believed that progressive owners hand over their firms to the employees. I happened to be well acquainted with one such case in the United States since I was asked to serve as a consultant. The owner set up an undivisible trust fund for the employees and transferred fifty percent of capital to that fund. Genuine workers' management was established. The salaries of the managers were reduced to one half or one third of their previous level — and none of the managers quit. Private secretaries and offices were abolished — those of general manager included — and everybody was calling everybody else by the first name. The output of the firm was expanding at a rate of 20 to 30 percent per year. It was a clear success in almost every respect. When a year ago I was preparing a *Reader* on selfgovernment, I decided to include the story of the firm in the book. A welcome advertising — would have been the reaction of an establishment firm. But my friends needed several months before they decided — against publication. It was too risky. It could have undermined them.

Such are the efficiency limits of a capitalist society.

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DISPROPORCIJE U RAZVOJU POJEDINI PODRUČJA SR HRVATSKE*)

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1. Uvod

Društveno-ekonomske pojave u osnovi su višedimenzionalnog karaktera, zavisno od pravca iz kojeg se promatraju; jedna ili više njihovih dimenzija se posebno naglašavaju, odnosno od posebne su važnosti.

Najurgentniji problem koji je pokrenuo sve nacije ovog suvremenog svijeta je problem ostvarivanja što bržeg ekonomskog razvoja i podizanja životnog standarda u svim regijama.

Postojanje ogromnih razlika u stupnju razvijenosti između pojedinih regija, promatranih bilo kao kompaktna nacionalna područja ili njihovi dijelovi, predstavlja stvarnost, s kojom se sukobljavaju razne društvene strukture. U tim se stremljenjima progresivnog čovječanstva traže rješenja za

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