ECONOMIC ANALYSIS AND WORKERS' MANAGEMENT, 2, XVII (1983), 123—154

HYPOTHESES COCERNING THE NON-VIABILITY OF LABOUR-DIRECTED FIRMS IN CAPITALIST ECONOMIES

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I. INTRODUCTION

The increasing interest being shown in worker coopratіve forms of business organisation during the current economic recession is similar to that which occurred during earlier periods of crisis. Perhaps not since the later part of the nineteenth century and the Great Depression of the twentieth century has so much attention been focussed on workers creating their own employment, rather than being dependent on being hired by investor owned and directed enterprises. Not only are local, regional, and national governments exploring this area, but also international and trans-national agencies, such as OECD and EEC, are eäamining ways by which the labour-direct edtype of firm may be utilised to tackle the continuing expansion of unemployment. Despite the pressure of economic crises, occasionally substantial interest, and their reputed advantages,[1] the worker cooperative is not the usual, or indeed even a relatively common, form chosen for organising business ventures. A large and wide variety of reasons has been offered at one time or another to explain this situation. In this study we attempt to identify and formalise the more substantial of these (in other words, those that are not simply expressions of prejudice) which have been proposed by economists. The most frequently expressed attitudes of economists to labour- directed enterprises fall broadly into three categories; first, there are hose who favour this type of organisation in principle and think they can or will occur a significant, if not a predominant, scale; second, there are those who likewise favour the idea but think it cannot, or will not, happen; and third there are those who hold the idea in disfavour and also think it cannot, or will

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[1] Vanek (1970: Chapter 13) for example, discusses a number of advantages in the areas of education and training, technical change and innovation, social efficiency etc.

not happen.[2] It is with the latter two categories, i. e. the reasons proposed as to why worker directed enterprises will not or cannot become a standard form of business organisation, that we are concerned. The purpose of this paper is to provide a concise review of the main hypotheses of interest to persons concerned with understanding and facilitating worker cooperatives. We do not attempt at this stage to evaluate the merits or relevance of any of the hypotheses. It is unlikely that a monocausal explanation will be sufficient, if only because the circumstances of a particular time and place have to be taken into account. In this respect, therefore, our survey is only the preliminary stage for deriving general implications from individual case histories.[3]

For present purposes it is useful to make a simple distinction between investor-directed enterprises and worker-directed enterprises. The investor-directed, or capitalist, firm is founded by those who wish to use their funds to their best advantage. In order to do so they exercise ultimate control over, and bear final responsibility for, the running of the firm. In larger firms this may be shared with or delegated to managers who act as agents on their behalf. The labour-directed or worker cooperative firm is organised and run by a group of workers. The fundamental features of this type of business organisation are (i) overall direction of the enterprise is vested in the entire workforce and is based on participation through work and not capital ownership; and (ii) income after payment of contractual expenses accrues to the members. Thus, the *business* but not (necessarily) the capital is owned by the workforce. The notion of worker direction or control has in the past given rise to much confusion. According to Oakeshott (1978: 22, 23) the source of this confusion can be traced to the Webbs. They regarded worker control as existing when an enterprise was controlled by a working class institution. This usage of the term suggests that enterprises owned and controlled by trade unions are worker — controlled. In this study, such enterprises are not classified as worker-directed. Rather, labour-directed firms are business organisations wherein overall direction rests with those actually working in the enterprise on the basis of their participation in work. Vanek (1975a: 14) makes a distinction between enterprises where control is based on work and those where control derives from capital ownership. In some respects this is an idealistic distinction. That is, worker-directed firms where control is based on ownership can be structured in such a way as to ensure that the entire workforce and only the workforce is involved. However, as will be seen, there may be difficulties involved, and attempts to design these structures have not always been successful. Therefore, the simplicity of Vanek's distinction may be practically useful. Further, once this distinction is made, the source of capital is a second-level problem, since capital

[2] As Jones (1976) shows for example, many of the most important British economists — Mill, Marshall, Keynes, Robertson, Meade — while holding reservations about their likelihood were positively disposed towards' associations of labourers' and worker cooperatives.

[3] Also, while we hope to represent the major hypotheses proposed, we do not attempt to be comprehensive in citing literature either as to precedence or simply statement of an hypothesis.

ownership cannot yield control in the firm and becomes one of financing operations. However, that in itself gives rise to severe difficulties, and to characterise it as a second-level problem does not deny its practical importance.

Based on a review of historical experience, Jones (1980) distinguished three general types of labour-directed enterprises:

(i) Firms where overall control is vested in the membership on an equal basis. Membership in turn is restricted to, and reüuired of, all the current workforce (Jones, 1980: 142). The only current and significant example of this type is the Mondragon group of firms in Spain.

(ii) Enterprises wherein majority control is held by workers. It is mainly due to the Rochdale definition of membership that these enterprises are not controlled solely by their workforce. According to the Rochdale principles, membership of a cooperative is open to anyone purchasing a nominal share. This means that non-workers can acquire control in the firm through capital contribution. Further, membership is not required of all workers. Consequently, it is possible for the firm to hire labour in the same way as capitalist firms. For example, membership of the British footwear cooperatives included former workers, trade unions and consumer cooperatives, as well as workers. Control in American plywood cooperatives was based on share ownership. Although they are distinguished from outside investor-owned plywood firms by the fact that their owners work in them (Gunn, 1980: 393), the total workforce is not composed of owners only. Managers and casual workers are usually hired employees.

(iii) Enterprises where workers have minority control. British producer cooperatives in which outside shareholders eventually exceeded working members are an example of this type of worker cooperative.

According to Jones (1978: 150) a 'traditional' producer cooperative sector exists or has existed in most industrialised western economies, whereby 'traditional' he means enterprises such as the nineteenth century British producer cooperatives.[4]

In identifying hypotheses of inclusion in the survey we are obviously only concerned with those that relate to a differential, in terms

[4] Although these type of enterprises were quite numerous at one stage in, for example, the United States and the United Kingdom, this has never been the case in Ireland where the main concentration of cooperative activity has been on suppliers cooperatives in the agricultural sector. These enterprises, which are now large-scale operations, do not make provision for worker direction and are run by managers on behalf of the farmer-owners.

of viability, between investor-directed and worker-directed firms.[5] The necessary requirement for the viability of any type of business organisation is that the enterpreneurial functions can be carried out. The business organisation must be suitable for conducting these functions not only at the outset but on a continuing basis. The essential elements of entrepreneurship are:

(i) knowledge of the market and the perception of profitable opportunities;
(ii) the ability to attract finance on suitable terms which is necessary to purchase the stock or services of the necessary factors of production as they are required; and
(iii) the identification and organisation of a suitable combination of complementary factors.[6]

In the following three sections the main hypotheses proposed are grouped under three headings: founding, finance and administration.

II. HYPOTHESES CONCERNING FOUNDING

Business firms are established in order to exploit perceived opportunities in a market. The motivation to act is the prospect of achieving some object, that is profit in the investor-directed firm and, perhaps, employment security and reasonable remuneration in the labour-directed firm. The performance of this entrepreneurial role requires an alertness to market information. This does not imply an accumulation of knowledge but rather an ability to know where to look for knowledge (Kirzner, 1973: 68). Alertness involves the perception of opportunities that exist already and are waiting to be noticed (Kirzner, 1973: 74) and not necessarily an ability to formulate innovative ideas. Production always requires the bringing together of an appropriate set of complementary factors, since production with one factor is impossible (O'Mahony 1979: 22). Decisions must be made about which process to use from among a range which use factors in different proportions, that may be available at any given time, as well as the degree of utilisation of these factors. With a firm established, this entrepreneurial activity must be maintained, and it now involves the process of reviewing, updating, and ensuring the implementation of policy if the firm is to survive and achieve the desired objectives. The performance of the firm and consequently its survival, depends on the firm's ability to adapt to change. Adaptive ability in turn may be related to the circumstances of the firm's emergence. Neither a perfect knowledge of the past nor a complete awareness of current conditions is an accurate guide to the uncertain future (Alchian, 1977: 28). It will therefore be difficult to determine appropriate courses of action. In an uncertain world, modes of behaviour evolve as guiding rules of action. These modes take the form of imitation and trial-and-error (Alchian, 1977: 28—31). The elements common to successful enterprises will be associated with survival and, in their pursuit of success, other firms will attempt to imitate these elements. When conditions have changed, it may be necessary to engage in a process of trial-and-error. Under these circumstances, anything that interferes with the firm's ability to experiment is likely to prejudice its chances of success. Therefore, although classified as referring to founding an enterprise, the alertness to opportunities and motivation to respond to them are activities that must be carried out continuously as part of the process of directing a business venture. With this qualification we now turn to review a number of explanations suggested as to why (individual) entrepreneurs or groups of workers do not choose the worker-directed form of business organisation.

[5] Implicit in this is the assumption that state laws, regulations and activities are neutral as between forms of business organisation. This, in practice is unlikely to be the case and indeed taxation and administrative requirements may even hamper all types of production enterprises to the same or varying degrees.

[6] The conduct of these functions in the context of labour-directed firms is discussed by Fanning and O'Mahony (1983).

A. Hypothesis: *Labour-Directed Firms do not emerge in the market economy because workers lack entrepreneurial ability.*

Marshall was sympathetic to the idea of worker control of production, but he was quick to identify its shortcomings. This was due to Marshall's belief that it was the strongest and not the highest motives that formed the basis of society (Robbins, 1976: 142). Marshall suggests that workers' control which is an example of the latter class of motivation, would enhance both the economic and moral condition of the enterprise. For this reason, he explored the idea and advocated change in the direction of worker control of production. Unlike Mill (1848), however, he did not envisage that such a development would bring about a transformation of the existing system. Marshall suggests that the major hindrance to the emergence of worker-directed firms is the lack of entrepreneurial qualities among workers (1920:646). In conventional firms, production is organised and controlled by those with the necessary entrepreneurial aptitude. It is not capital ownership but business ability that controls labour in these enterprises (Marshall, 1889:245). In order to found a firm the entrepreneur does not require capital of his own, for he will be able to acquire the use of capital by virtue of his sense of business purpose. Marshall is confident that workers can gain access to capital and establish their own firms if they possess the necessary entrepreneurial qualities (1925:308). In his own view these qualities are lacking among workers, and he ascribes this deficiency to the low level of workers' education, which leaves them without the practical and mental training and 'habits of mind' necessary to deal with the complex problems of business.

Like Marshall, Walras considers entenpreneurship to be apart from any of the other factors of production. The founding role does not have to be the preserve of capital owners. He criticises English economists for failing to make this distinction (1954:423). For Walras it is perfectly logical that the entrepreneurial function be exercised by the workers. In his role as director of the Caisse d'Escompte des Associations Populaires, however, he observed the inability of workers in producers' cooperatives to behave as entrepreneurs. They were unwilling to accept the prices of products and wages of labour determined by market forces. His advice to these cooperators was "to keep to the economic principles applicable to all firms and regard themselves as fulfilling a dual role, as workers and as entrepreneurs" (Dreze, 1976:1138).

B. Hypothesis: *Labour-Directed Firms do not emerge in the market economy because workers have no desire to participate in the control of their enterprises.*

If workers wished to control the enterprise in which they worked, would their unions not be actively engaged in transforming existing industry to worker control and establishing labour-directed firms among the unemployed? At present, labour unions concern themselves mainly with issues of pay and working conditions. However, this can only be taken as an indicator that workers do not want control of their firms if we accept that unions react to the desires of their members. This is a frequently expressed view. Sirc (1977:56, 74; and 1979:174) suggests that workers are more concerned with the level of wages and the immediate conditions of employment than control of the enterprise. Sociological studies of Yugoslav firms by Rus and Jerovšek have shown that the workers are in no way concerned with the overall problems of business management. These studies sought to determine the aspects of their enterprise that held most interest for workers. Participation in self-management was ranked lowest, with issues such as high earnings, friendly work environment, interesting work and career advancement being ranked higher. Further, Sirc identifies signs in Jerovšek's study which suggest that there is a growing lack of interest in self-management in Yugoslavia, as the earnings motive becomes more dominant.

In a study of British and French worker-controlled firms Bradley (1980) identifies a preference for high earnings when workers are faced with a choice between selfmanagement and high incomes. The Bullock Committee (United Kingdom, 1977), which was primarily investigating the efficacy of worker participation by board-level representation, was presented with submissions which suggested that such representation was not relevant without first having participation at lower levels. The argument in these submissions was that workers' interests lay in shop-floor representation. It was the consensus of these submissions that workers were indifferent to the overall affairs of the enterprise. It was stated that workers were apathetic to experiments in introducing participation at the lower levels, in which they should be most interested. Such would also be the case, it was concluded, for board-level representation (1977:35, 36).

C. Hypothesis: *Labour-Directed Firms will not emerge in the market economy because they are not compatible with this environment. They represent a deviation from the principles of this system and cannot, therefore, be adopted by it. Consequently, worker-controlled firms will not emerge and flourish in the market economy.*

Horvat suggests that the labour-directed firm may not have emerged because it represents a more efficient form than capitalist firms in a society where the latter form determines the social limit for efficiency. Even if the labour-directed firm does emerge, he suggests that it will not be able to exploit its economic superiority in this setting (Horvat, 1975:339 and 344). Garson (1977:216) notes that Lenin did not envisage successful change without a total reform of the system. Lenin observed that even after the revolution in Russia, there was still a need for cultural revolution (1965:220). In other words, there is a basic ethic guiding the system that cannot be changed by the manipulation of minor pieces within it. In reviewing the theoretical literature on the labour-directed firm, Steinherr (1978:129) draws attention to this wider question: that democracy in the firm may not be viable without much wider reforms in the structure of the economy. Jay bases his argument, that labour-directed firms are viable only when *all* firms above a certain size adopt this structure, on this very point. In Jay's words, "there is no private advantage from behaving in the jungle as if the rule of law applied" (1980:20). If labour-directed economy or sector is desirable he suggests that it will have to be brought about by the statutory conversion of all firms above a certain size.

Vanek suggests that there are many legal, institutional and attitudinal forces within Western market economies preventing the emergence and survival of the labour-directed firms, which he calls, "the Mold" (1971:97). In Vanek's view the technological developments that the industrial revolution introducted were poured into a ready-made capitalist mold. That is, the conditions pertaining at the time of the industrial revolution could not have supported any other system but capitalism. At the time of the industrial revolution, the class stratification implicit in capitalism was already the norm: the rights of private property and individual accumulation were guaranteed and the hiring of labour to work with capital assets at fixed wage was accepted while the return from the endeavour accrued to the asset owner, was also considered to be the acceptable price. The evolution of industrial society from this time is portrayed by Vanek as a causal interaction between the political and economic spheres. The initial prosperity that the industrial revolution brought led to demands for political self-determination. This was granted in some measure. The result was that a safety valve was incorporated into the system which served to prevent the development of "explosive revolutionary situations" (Vanek, 1971:93). Therefore, while we see revolutions occurring in the young capitalist countries, such as Russia, where the safety valve was not present, the older capitalist countries avoided such insurrections. However, it also means that economic self-determination was not achieved in the older countries. In effect, the changes that took place ensured that the capitalist mold was strengthened.

A number of authors have drawn attention to the conflict between the institutions of the capitalist system and the labour-directed firm. Carnoy and Shearer (1980:144) state that there is fragmentry evidence to support the supposition that legislation relating to business is unfavourable to the emergence and smooth functioning of the labour-directed firm. Horvat (1975:343) traces the failure of British producer cooperatives to the hostility shown them by the business community. Indeed, Vanek considers such hostility to be a perfectly logical reaction. These firms involved a negation of capitalism in their business relations with the capitalist world and it was, therefore, necessary that they should be discriminated against (Vanek, 1971:99). This discrimination was practiced, according to Horvat, (1975:343) by making it difficult for producer cooperatives to get bank and trade credit, denying them a supply of raw materials, and discrimination in terms of marketing of final products.

Jevons criticises the trade union movement for its failure to propogate worker participation (1968:148, 149). For the most part, unions do not concern themselves with the promotion of labour-directed firms. In this they may reflect the wishes of their members. However, it may be a policy dictated by a desire for self-preservation. Garson (1977:221) suggests that the workers' movement has become "deradicalized by affluence". The development of political self-determination allowed a "democratic self-defence" (Vanek, 1971:94) to emerge. Large unions evolved in order to counter the power of big business. Today, unions have become another part in hierarchical control and no longer serve as a workers' defence against it (Marglin, 1974:42). Economic self-determination may not be sought because it would lessen the influence of labour unions. In fact unions may hinder the development of labour-directed firms, preferring to advocate partial systems of participation, such as board-level representation, which contain a well-defined role for the union. Cornforth (1981) identifies four principal objections to the involvement of labour unions in the promotion of labour-directed firms:

(i) workers will not see the need for unions in firms that they control themselves;

(ii) the involvement of unions in promoting labour-directed firms may undermine their ability to protect workers' interests;

(iii) labour-directed firms may not provide the standard of pay and conditions that workers can achieve in conventional firms; and

(iv) involvement by unions in these firms may be a diversion from their main goals.

These arguments are valid only if it is considered that the preservation of the union is more important than workers control of production. For instance, the viability of the labour-directed firm is dependent on

workers remuneration being flexible. If unions insist on the standard wage being paid for the job, they will seriously threaten the firm's chances of success and lose one of the major advantages of labour-directed firms for ensuring survival.

D. Hypothesis: *In capitalist societies, wealth is the principal means of achieving such ends as power, prestige and a high standard of living. Wealth is to be found in organising other peoples' production and not one's own. Labour-directed firms will not be established in these economies because such a course of action would diminish the reward that the organiser can reap. On the other hand, business forms wherein the benefit from organising can be privately appropriated, will flourish.*

The basis of this argument rests on the contention that the social function of hierarchical work organisation is not technical efficiency but accumulation (Marglin, 1974:34). Marglin suggests that the minute division of labour and the centralisation of work within the factory — which were the two steps that combined to deprive the worker of control of the product and the work process — evolved in order to gain for the capitalist a "larger share in the pie" at the expense of the worker. The development of the capitalist division of labour under the putting-out system was primarily effective in depriving the worker of control over the product. Specialisation of men to tasks at the sub-product level was the sole means, in the days preceding costly machinery, by which the entrepreneur could ensure for himself an essential role in the production process as integrator of the separate efforts of his workers into a marketable product (Marglin, 1974: 38, 39). He suggests that capitalist integration was artifically created to preserve a role for the capitalist and was not necessarily technologically superior to integration by the producers themselves. The capitalist's role was not undermined by producers integrating the component parts and selling the product at a lower price than the capitalist because there was no profit in such an endeavour. Rewards from organising were gained only if one became a capitalist "putter-outer".

As evidence for this hypothesis, Marglin (1974:40) cites a number of incidences where knowledge of key elements of the work process was withheld from employees and, amongst other evidence, a passage from *The Spectator* magazine of 1866, wherein workers' cooperatives are perceived as a threat "because they do not leave a clear place for the masters". In Marglin's analysis the fact that the capitalist division of labour never took place in the British coal industry offers indirect support for his hypothesis (1974:41). The scarcity of coal seams and the institution of private property ensured that miners could not set up shop for themselves and dispense with the bosses. According to the divide-and-conquer hypothesis there would be no need for specialisation of men to tasks in this situation. As it turns out, except for one period of experimentation, coal was mined by self-integrating, non-specialised work groups.

Control of the work process, when and how much the worker would exert himself, remained with the worker until the coming of the factory (1974: 44). Marglin suggests that the origin and success of the factory lay not in technological superiority but in the substitution of the capitalists for the workers control of the work process. It changed the workers choice from one of how much to work and produce to one of whether or not to work at all (1974: 34). The putting-out system was necessarily a transitional phase because it became necessary to develop a system that ensured worker discipline once a free market in labour was brought into existence. It was for organisational reasons such as this, and not primarily technological superiority, that the factory evolved (1974: 54). Marglin cites two examples as evidence in favour of his hypothesis. First, there was the failure of the Wyatt-Paul machine and the success of Arkwright's. Both were similar in technical details but Arkwright was more successful in ensuring factory discipline. Second, the factory system took hold in the woollen industry, where the same technology was used in both the factory and cottage systems. The ability to organise production, according to Marglin (1975: 4), is a public good. Capitalist institutions allow individuals to monopolise this public good and, consequently, reap a large reward. An entrepreneur who shares this ability with his workers does not reduce his stock of the good. However, his return from the use of the good will be diminished. Consequently, the entrepreneur will not establish a labour-directed firm. Marglin suggests that this distribution of the public good, comprising knowledge and information, through the market, is most likely inefficient (1975: 4, 5).

E. Hypothesis: *The performance of the entrepreneurial function is a prerequiste for the establishment of a firm. Entrepreneurial initiative by its very nature is individualistic. Therefore, this function cannot be exercised collectively to found a labour-directed firm.*

The firm, according to O'Mahony (1979: 23) will be founded by one who is alert to discrepencies in the market and who has the initiative and qualities of leadership necessary to organise the factors of production. He suggests that the capacity to see opportunities to establish a firm is a mental attribute and, as such, highly personal and subjective (1974: 24). Therefore, opportunities will be perceived not as a member of a group but as an individual. Further, he states that the initiative to exploit an opportunity is also likely to be taken by an individual (1979: 31). Because it is held that entrepreneurship is an individualistic function, this role cannot be performed collectively by a group of workers. In order that a labour-directed firm should emerge, it must be promoted in the first instance by an individual (1979: 31). Sirc (1977: 60) also argues along the same lines. In his opinion, workers cannot start an enterprise any larger than an artisan's workshop before the plant has been built. He suggest that the "economic initiative" must rest either with private entrepreneurs or the political authorities.

F. Hypothesis: *An individual entrepreneur seeking to establish a labour-directed firm would be faced with extra costs specific to this type of undertaking. It is more likely, therefore, that he will opt to found a conventional firm wherein a workforce is hired because the costs of this venture are lower.*

This hypothesis follows on from the previous one, wherein O'Mahony suggests that the initiating role must be performed by individuals. Organisational costs would serve to discourage an individual who had decided to use the labour-directed form of business enterprise from doing so (O'Mahony, 1979: 35). These costs, it has been suggested, arise from two sources. First care must be taken in recruiting suitable partners. Unsuitable personnel, because of the difficulty in dismissing them (Wiles, 1977: 128), would impose costs on the firm. Therefore, the entrepreneur would have to assess the ability of partners to cooperate in the governance of the firm as well as their competence to perform the job. Second, the entrepreneur would experience difficulty in attracting partners. This arises because the entrepreneur would be unable to offer monetary incentives greater than could be had elsewhere at less risk and because the worker would not perceive the opportunity to participate in management and his involvement as significant (O'Mahony 1979: 35).

If the labour-directed firm was perceived as an attractive and advantageous form of business organisation it would be expected that a suitable process would emerge and become institutionalised to fulfill the need for bringing together and identifying suitable partners. This points to the specific and fundamental element of transaction costs that appears to underlie the two reasons cited, namely the costs of acquiring information.

Establishing a firm necessitates obtaining information. An investment is necessary in order to receive and decipher this information. An examination of how the costs of this venture affect the decision to found a firm suggests that the failure of the labour-directed firm to emerge, except on a small scale, may be due to the relative costs of information involved in establishing different business forms. To develop this point we first outline a process through which information is acquired and used in acting. According to Arrow (1974: 37), the decision to create non-market organisations, such as firms, is partially determined by the state of knowledge existing at any moment in time and the possibility of acquiring information in the future. He refers to this latter phenomenon as an »information channel«, and the information to be acquired as »signals«. Further, he points out that the existence of information channels is due to choice and is not prescribed exogenously to the system. This choice will be based on a comparison of costs and benefits.

Since information can be used for many purposes, some known, some yet to be discovered, there is little one can say about the benefits of information. It is usually assumed, however, that there are increasing returns to the uses of information (Arrow, 1974: 38; and Aldrich, 1977: 128). The costs of information arise from the effort required to initiate and operationalise an information channel. There are three aspects to these costs. First, the individual's limited capacity for acquiring and using information is a fixed factor in information processing. The second characteristic of information costs is that they are in part a capital cost. That is, it is necessary to have made an investment of time and effort in order to understand the signals thrown up by the information channels. This aspect of information costs implies that it does not pay to invest in acquiring only a small amount of information (Aldrich, 1977: 128). Further, the decision to invest in an information channel is affected by uncertainty. Therefore, we might expect that the demand for information is less than it would be if the value of the information were known with certainty.

Another consequence of uncertainty (held to be most important by Arrow), is that the random accidents of history will play a larger role in the final outcome. Once an investment has been made in acquiring an information channel, it will be easier to continue using it or at any rate channels closely related to it. This is a consequence of the increasing returns to the uses of information. Therefore, present action is affected by decisions made on the acuiuisition of an information channel some time previously. The final characteristic of these costs is that they vary in different directions. This non-symmetrical nature of information costs also effects the choice to acquire an information channel. Above we saw how uncertainty gave rise to a clustering around a narrow range of information channels. This tendency will be accentuated by the fact that information costs vary in different directions. Based on this description of the nature of information costs, the transactions cost hypothesis can be restated more specifically as follows:

The capitalist type firm represents the norm in the market economy. When conditions are stable the norm remains intact. Emerging enterprises will take on the form of the conventional norm. Unconventional enterprise forms, such as the labour-directed firm, will not emerge because of the extra costs of acquiring information.

At any moment in time there exists a certain stock of knowledge. There are also in existence certain information channels that can augment this stock. The »capitalist« firm is the dominant form of business enterprise in the market economy, and this predominance amounts to this type of enterprise being regarded as the standard form. Thus, information channels are designed to suit the needs of this firm. An evolution in the form of business enterprise will take place within this framework. The mode in which business activity is carried out supports the norm. Investors monitor stock price changes, workers monitor the job market, entrepreneurs monitor profit opportunities and when they find them, establish capitalist-type enterprises. So why are enterpreneurs unlikely to establish labour-directed firms and why do workers not set-up their own firms?

Creating an entity such as the labour-directed firm requires an investment in new information channels. The entrepreneur will find it cheaper to use the information channels already in existence due to the increasing returns to their use. Creating new channels would involve a capital cost that the profit-maximising entrepreneur would surely avoid. *Ex ante* the labour-directed firm would appear to offer lower profits than a similar capitalist enterprise. The additional benefits of the labour-directed firm are not well defined, whereas the additional costs involved in acquiring new information channels are obvious.

The non-symmetrical nature of information costs will be supportive of this behaviour. It is more likely that new information channels, when they develop, will facilitate the evolution of the conventional enterprise and not the development of radically different ones. Learning will not generalise easily in respect of 'special cases'. Arrow (1974: 42) illustrates this behaviour by analogy to a rat being shocked at one point and generalising by staying some distance away. This could also be the case with the labour-directed firm; entrepreneurs stay away from developments such as this because of past 'shocks'. It is not necessary that the entrepreneur himself has been affected in order that this avoidance effect be operative. Received doctrine on the sujbect could influence his behaviour. Jones (1975) has shown how the work of the Webbs has influenced popular thinking on workers' cooperatives. The perceived bad performance of these ventures may be enough to keep worker control off the agenda of labour-oriented organisations and programmes. The reality — that the performance of workers' cooperatives was not as the Webbs claimed — is not taken into account precisely because it is not well known. Perception of poor prospects for worker-controlled firms could also exist on account of the absence of this type of enterprise, in general, in the market economy (Bradley and Gelb, 1981: 212). Together, these perceptions will discourage any entrepreneur from investing in the information channels necessary for the establishment of a labour-directed firm.

There are also a number of factors discouraging workers from founding and governing their own firms. First, the institutions of the welfare state could discourage unemployed workers from pursuing such a course of action. Social security payments increase the cost of acquiring information channels useful in esablishing a labour-directed firm. They would represent the opportunity cost to an unemployed worker, without an alternative source of income, of founding his own firm. Second, because of the nature of existing industry, the costs to the worker of acquiring information channels is relatively high. Information costs will be influenced by the daily activity of individuals. People can make relatively costless observations in their daily lives that will help them to decipher signals: they learn by doing. However, as Marglin (1974) has shown, the capitalist division of labour has served to reduce the workers' overall knowledge of the production process. He is, therefore, prevented from making gains in terms of the costs of acquiring information channels. This will reduce the likelihood of workers establishing their own firms to produce the products.

The implications of this line of reasoning is that when conditions are stable the norm is taken for granted and hardly questioned. However, a crisis will cause the norm to be questioned and shake faith in received doctrines. In such circumstances alternative structures, such as labour- directed firms, may emerge. The crisis can take many forms. For instance, the closure of a place of employment may lead the workers to consider operating the firm themselves. Economy-wide unemployment could accentuate this force or act as the crisis itself. On another level, the nineteen sixties represented a time of crisis when societal norms were questioned and alternative lifestyles explored. The crisis brings about a situation in which new items are added to the agenda. Because of a change in the pay-offs to present actions, it may be worthwhile to sustain the capital cost of acquiring new information channels.

III. HYPOTHESES CONCERNING FUNDING

Once an opportunity is perceived and its worthiness appraised to be favourable a firm will be established if the promoter(s) is willing and capable of performing the tasks necessary to initiate production. One of these is that suitable arrangements must be made to obtain funding. This finance is necessary to secure plant and equipment, purchase raw materials and provide income to the members of the firm in advance of sales revenue. Because the work of production and sale extends over a future period of time, the outcome cannot be foreseen and in business ventures is subject to many uncertainties. It cannot be known whether the return from an endeavour will be commensurate with the costs involved in the undertaking. Hence, financing arrangements must be based on the possibility that losses may arise and be such that contractual obligations can nevertheless be met.

In investor-directed firms, the major burden of risk is borne by the providers of venture capital. Ordinary shareholders commit their funds to the firm without any guarantee of a return on their investment nor the recoupment of the initial outlay. It is in consequence of this funding that the firm can enter into contractual agreements. All funding has, however, a certain degree of risk attached to it. This risk extends across a spectrum from the high-risk ordinary shareholding to low-risk loan capital. In the event of liquidation, lenders, holders of debentures, preference shareholders and ordinary shareholders will be reimbursed in that order, depending on resources available. Because of the risks to which their funds are subject, ordinary shareholders retain control over the firm. Robertson calls the equalisation of risk with control the »Golden Rule of Capitalism« (Robertson 1923: 88). The basis of this arrangement is that decisions are best made by those that stand to lose most if there is an unfavourable outcome (Marshall, 1920: 645).

Forms of business organisation centre around arrangements for raising capital (Knight, 1921: 253) so that the legal forms which the firm can take are basically different methods of sharing risks among resource owners. At one extreme there is the sole proprietorship in which all risks are borne by one person. There are many forms which

can be used to share these risks, such as partnerships and the various types of companies. The scale of operation and the propensity of individuals to bear risk are some of the factors determining which form will be used. Paish stated that the adaptability of the company form in this regard accounts for its predominance in modern western economies (Paish, 1968: 24).

Once the firm has acquired funding it can undertake production. A firm's ability to remain in existence and fulfil the objectives of its directors is dependent on the effective and efficient use of funds. A necessary condition for the achievement of these objectives is that the firm should survive. One of the principal causes of failure among firms is a lack of liquidity, although the long-term prospects for a firm may be good, it may be unable to meet cash outflow with inflow in the short-term. Therefore, above all else, a firm must remain financially solvent. The central position of the financial structure in any business venture, no matter how organised, has resulted in particular attention being paid to its effects on the emergence and survival of labour-directed firms.

G. Hypothesis: *The labour-directed firm is unable to make suitable arrangements to obtain venture funding. Consequently it will also fail to acquire working capital.*

We have distinguished the labour-directed firm from the investor-directed firm by saying that control arises from participation through work and not from capital ownership. Consequently, the worker-controlled firm cannot offer the providers of venture funding control over the affairs of the enterprise as a 'security' for their risk taking involved in providing unsecured funding. Alternative arrangements need to be made to underwrite contractual commitments. If this can be done, working capital can be raised in similar fashion to the capitalist firm. However, many writers have identified this area as one of particular difficulty for labour-directed firms, and the failure of labour-directed firms to emerge and survive has been accounted for as being due to a lack of capital. The Webbs suggested that worker-controlled firms will have difficulty with initial capitalisation. Funding for this purpose, in their opinion, will have to come from workers savings which are unlikely to be sufficient (Jones, 1976: 32). Buchez recognises that workers are not a homogenous group. He makes a distinction between craftsmen and factory workers. The former would be able to organise firms, he says, by virtue of their human capital. Lacking capital and the means to obtain it, he does not consider this course to be open to factory workers. Even if these workers organised such a firm, they would be prevented from expanding by a lack of credit (Buchez, 1831: 286). Robertson identified the acquisition of venture and working capital as one of the major difficulties experienced by nineteenth century producer cooperatives in Britain (Robertson, 1923: 133, 142).

Lambert (1963), in his study of the social philosophy of co-operation, says that the lack of funds has been the foremost cause of weakness among worker-controlled firms. He relates the failure of these firms to raise adequate capital to two factors. First, savings for the most part are made on current profits. These funds are then available for use in production to earn more profits. In this way, the ownership of capital is transmitted to the same social class over time. It is only in a small number of exceptions that someone starts from nothing and earns a fortune. Second, those that obtain capital will »play the game of capitalism« (Lambert, 1963: 183). Additional capital will be attracted by offering it a share in directing the enterprise and the prospect of substantial profits. The labour-directed firm cannot do this. Lambert states that the greater ability of consumers' cooperatives to gather capital is due to their large membership. A small sum put aside by each member will leave the society in charge of a large amount of capital. For this reason, he suggests that the most successful worker-controlled firms will be found to depend on consumers' cooperatives. Pointing to the frequency and success of consumer and supplier cooperatives relative to worker cooperatives, Fanning and O'Mahony (1983: 237) suggest that this is due to surpluses generated in the former types of cooperatives being retained in the business, rather than being distributed to members, and thereby fulfilling the role of *venture* capital.

According to O'Mahony (1979), the labour-directed firm will experience difficulty in acquiring funds because the risk for lenders and the obstacles for borrowers are greater than in the capitalist firm. Risk for lenders is increased for two reasons. First, workers will need to pay themselves a wage in advance of the sale of the product. In order to make these wage advances finance must be raised. There is no guarantee, however, that receipts from the sale of the product will cover these wage advances and the other contractural commitments into which the firm has entered. Consequently, *venture labour* cannot take on the role played by venture capital in the conventional firm (1979: 32). Therefore, the risk of loss must be borne by the lenders of capital. Lenders would expose their funds to less risk if they made a loan to a capitalist firm where the final risk of loss is borne by ordinary shareholders.[7] Second, any attempt by the labour-directed firms to raise venture capital by issuing non-voting shares yielding a variable return is unlikely to be successful. This is due not only to the fact that workers must pay themselves a wage advance, but also to the absence of commitment on the part of the workers to the firm. Since the workers are free to leave the firm at any time, they may elect to pay themselves high salaries and leave when the time arrives to pay shareholders. Therefore, capital will not be made available to the labour-directed firm because of the inability of labour to act as the ultimate loss maker and also on account of the absence of commitment to the firm on the workers' part.

[7] In the context of examining the legal-organisational structure of worker cooperatives in Ireland, Fanning and Tomkin (1979) isolate the inability of lenders to place charges to cover interest on loans financing fixed assets and materials, and the wages fund as the source of difficulties in raising loan finance.

That worker-controlled firms are not attractive to lenders is an opinion endorsed by a number of other writers. According to Sirc, worker control lacks a psychological mechanism aligning entrepreneurial activity with individual remuneration. Therefore, there is no mechanism for appropriating responsibility to decision making. This will result in workers abiding by their own sectional interests, thus neglecting market and financial discipline and »the rules of private ownership of capital« (Sirc, 1977: 77; 1979: 246). In Sirc's opinion, workers have a low propensity to save, a tendency which becomes more acute if the savings do not become their own. Consequently, workers will be much less inclined to invest in the firm, instead drawing off the revenue in wages.

The Bullock Committee sought to determine the effect of the introduction of board-level representation on investment in industry (United Kingdom, 1977: 51—54). These results may be even more relevant for an enterprise which is controlled entirely by its workforce. The individual investor, institutional investor and the providers of short and long-term loan facilities have between them been the major source of outside funding for British industry in the last quarter century. These sources have accounted for between fifteen and thirty per cent of funding for new investment in this time. The remainder of the funding has been generated internally by firms. Therefore, it is these outside investors that could provide the equity necessary for the establishment of a labour-directed firm. However, having assessed opinion in financial circles, Bullock concludes that worker-participation in decision-making would damage the confidence of the investor in industry. These investors may be even less likely to become involved with a labour-directed firm.

Borrowing capital on a fixed interest rate basis while setting aside a portion of income as a contingency fund to cover shortfalls is not a realistic option (O'Mahony, 1979: 33). O'Mahony suggests that there is no compelling reason for believing that productivity will be any higher in the labour-directed firm than in the capitalist firm. Consequently, he suggests that the extent to which withdrawals can be made from income for the contingency fund are limited. Such a fund would, therefore, not provide an adequate guarantee for lenders. In Meade's opinion, the burden of risk becomes too concentrated if workers use their own funds in this way. They would stand to lose their savings and their jobs if the venture failed (Meade, 1975: 420; 1980: 93). Clayre suggests that constraining workers to invest in their own firms might result in an inefficient allocation of capital. In effect, workers could be subsidising their own firm (Clayre, 1980: 2, 3).

H. Hypothesis: *Self-extinction of financially successful labour-directed firms arises when the firm adheres to the Rochdale principles of open membership, equal voting rights for all members and membership vested in capital contribution.*

McGregor (1974: 10) refers to this as the »Rochdale hypothesis of self extinction.« The problem arises when non-workers are not excluded from share ownership or when all workers do not have to be shareholders. In the short-term democracy is diluted (Oakeshott, 1978: 31). That is, outsiders can command control in the firm by virtue of capital ownership while working members, who are not shareholders, are excluded from exercising control. In the medium to long term the firm may be taken over by capital owners, and become a de facto capitalist enterprise. This could occur internally or externally. The former case arises when the firm is taken over and managed on conventional lines by shareholder workers. External take-over is most likely to occur when the firm is successful (McGregor, 1974: 9, 10). Outside investors are attracted to buy shares and because of the principle of open membership, they are entitled to do so. Since control is vested in capital contribution, they are thus entitled to a voice in the affairs of the enterprise.

I. Hypothesis: *When the labour-directed firm is funded by collectively owned funds for whose use a scarcity reflecting rent is not paid, a number of forces will be operative that will lead to the demise of the firm.*

The analysis underlying this hypothesis was developed by Vanek (1975 b) who suggests that many worker-controlled firms have, in the past, been internally financed. This was the case, he says, because of hostility in capital markets towards them and because of an unwillingness on the part of the members of the firm to risk their autonomy by accepting outside capital. Self-financing, according to his analysis, causes the firm to produce at an inefficiently low level of output and be under-capitalised. The problem of acquiring outside funding along with the inefficiency implied by internal funding is referred to as the »dilemma of the collateral« (Vanek, 1970: 317).

Vanek's analysis of the effects of self-financing is undertaken within the framework of his model of the labour-directed firm. This firm is assumed to maximise income per worker. When a scarcity reflecting rent is not paid for the use of capital, workers get the share of capital as well as the share of labour. The maximand is therefore reduced to the maximisation of the average value product of labour. Further, when funds are collectively owned, individuals' initial investment cannot be recouped. Vanek suggests that compensation in the form of higher return on investment will be sought. In effect, the firm only operates to the point at which the marginal productivity of capital is equal to a premium level of time preference. Vanek indentifies, (in the case where technology is of the constant returns to scale variety) four »self-extinction forces« causing the degeneration of the firm:

(1) The first 'self-extinction force' is a tendency to reduce the number of members for the given capital stock and consequently increase the income of the remaining mebers. In the limit — membership would be reduced to one. However, in practice, rules are likely to exist to prevent the dismissal of members. Therefore, reduction of membership will probably be achieved through natural wastage. It is possible in this case that retiring members will be replaced by non-member workers. Once the wage rate is less than the average value product of labour the firm's membership can »profit« from this course of action.

(2) The second 'self-extinction force' (which follows on from the first) suggests that the remaining members will engage in capital consumption. Gunn (1980: 398) points to the difficulty that will be experienced in transferring ownership from departing to incoming members. Departing members may insist on recovering a share of the collective funds. If this is allowed a number of scenarios are possible. The member may extract a share of the collective funds directly, in which case the firm will become undercapitalised over time. Transfer of membership to a young worker is another possibility. In this case the recruit would buy out the retiring member. For a number of reasons this course is unlikely to be pursued. If the business has prospered an individual share of the collective funds is likely to be expensive. It would be difficult for a young worker to acquire the means to purchase such a share. The desire to reduce membership is another factor making this course unlikely. If new members are taken on as hired labour and if the retiring member is not allowed to withdraw capital directly, he may opt to sell to a capital investor. Over time, according to the Rochdale hypothesis, this would lead to outside capital interests gaining control in the firm if share ownership and control are linked. In order to avoid the above problems the rules of the firm may be amended to allow for share ownership by past workers. This would, of course, lead to the degeneration of the participatory nature of the firm.

(3) As noted previously, the self-financed labour-directed firm will tend to under-invest when the principal sum invested by members is not redeemable. Meade (1980: 81, 92) states that investment will cause conflict in the firm because the composition of the enterprise will change over time. Workers near retirement age might prefer to see dividends distributed rather than invested to increase income in future periods when they will no longer be members of the firm. On the other hand, younger workers might favour investment. Derrick (1981) predicts that underinvestment will preclude the firm from gaining as high a portion of the market as its rivals.

(4) The final self-extinction force which Vanek identifies is the »never-employ-force«. Expansion, if it takes place, will take the form of capital acquisition, rather than expansion of membership.[8]

[8] When technology exhibits increasing followed by constant or decreasing returns to scale, the underinvestment force is the only one that will maintain full effect. A muted form of the self-extinction forces contributes to the firms producing in the inefficient increasing returns to scale zone of the production function.

Using a slightly different analytical structure, Furubotn and Pejovich (1970) arrive at the same conclusion as Vanek with regard to underinvestment. They suggest that the incentive for investment in a labour-directed firm is diminished below that of a comparable capitalist firm (Stephen, 1981: 2).

IV. HYPOTHESES CONCERNING ADMINISTRATION

The necessity for the entrepreneurial role to be performed does not end when a firm is established and initial financing arranged. In order for a firm to survive it must be constantly alert to changing market conditions and the internal situation of the enterprise. There is a need for continuous direction and control which, for the want of a more suitable term, we shall refer to as administration.

Coase (1937) has described the firm as a unit which supresses the market system in its internal operation. According to Coase, the existence of the firm is due to the uncertainty involved in dealing in the market. Market behaviour is coordinated through the exchange mechanism of the competitive process. Within the firm however, co-ordination is achieved through command control and decision-making. Knight relates the necessity for authoritative control to uncertainty (Knight, 1921: 267). In the absence of uncertainty, he states, there would be no need for management or control of the productive process. The various stages of the process from raw materials to consumer product would be entirely automatic. With uncertainty present, deciding what to do and how to do it becomes the primary function with the actual execution of activity playing a secondary role. According to Knight, this primary task is undertaken by the entrepreneur. Consequently, the entrepreneur must maintain ultimate authority over the affairs of the enterprise in order to ensure the implementation of his decisions.

The value of authority has been recognised by many writers from Marx to Arrow. They see its value in achieving a coordination of the activities of the members of an organisation (Arrow, 1974: 68). As Marx states:

> "All combined labour on a large scale requires, more or less a directing authority, in order to secure the harmonious working of the individual activities, and to perform the general functions that have their origin in the action of the combined, as distinguished from the action of its separate organs." (Marx, 1867: 313)

Authority, defined as the centralisation of decision-making exists when decisions are made by some individuals and carried out by others (Arrow, 1974: 63 and 69). Broadly speaking, it can take two forms: personal and impersonal. The former involves the giving and taking of orders while the latter prescribes a code of conduct. At the opposite end of the spectrum to authority there is consensus. This is defined by Arrow as "any reasonable and accepted means of aggregating individual interests" (1974: 69). In order for consensus to act as a substitute for authority, the entire membership of an organisation must have identical interests and identical information. It is unlikely that such a situation will arise in a firm. Although the membership of a labour-directed firm may subscribe more strongly to a common interest than those in a conventional firm, interests are unlikely to be identical on all issues. It is even more doubtful that information would be identical among the members. Since information cannot be exchanged without cost, it is necessary to design efficient methods to facilitate the flow of information. This leads us back, according to Arrow, to the superior efficiency of authority (1974: 70). In Arrow's opinion, authority is viable only when it represents the focus of convergent expectations (1974: 72). Further, it is necessary for authority to be responsible. This responsibility may be achieved in a number of ways. For instance, the authority could be subject to a higher active authority or alternatively be monitored by some nonauthoritative group. In capitalist firms a hierarchical command structure exists within the firm. Authority exists at every point on the hierarchy with the ultimate authority resting with executive management and the board of directors. The authority of these personnel is in turn subject to a higher active authority — the shareholders. In the labour-directed firm the overall control of the enterprise rests in the hands of the workers. This does not imply that a hierarchical system of organisation cannot exist within the firm. Just as in the capitalist firm, the various activities of the production process must be coordinated. Management, therefore, must be imbued with authority in order to supervise the day-to-day operation of the firm. In this case, however, the collection of all working participants is the higher active authority to which the management's authority is responsible and so the hierarchical structure is functional, and one based on tasks to be performed rather than on power based on ownership of capital.

J. Hypothesis: *The labour-directed firm will fail to attract and provide motivation for professional management. Consequently, the firm will fail to survive because it will not be properly administered.*

The basis of this hypothesis is that the members of a labour-directed firm, not realising the value of business management, will be unwilling to pay the required price for its use. Consequently, it will operate with inferior personnel and not be able to compete with firms employing such management. Most contributions to this idea rely on the experience of the nineteenth century producer co-operatives in Britain. Marshall stated that the producer co-operatives did not appreciate the important role played by good management. Managers and foreman were treated poorly and did not receive salaries comparable to those being earned in capitalist firms (Marshall, 1925: 305). This resulted in a low standard of management because the best managers were not attracted to the firm. Wiles also observes that pay was too low to attract the best managers from outside (Wiles, 1977: 134).

According to Robertson, management was the area in which the producer cooperative experienced most difficulty. Again he identified low salary as the most apparent indication of the attitude they held towards management. The failure to attract competent personnel from outside necessitated that management be appointed from within. This caused further problems for the producer cooperatives because the most popular and not the most competent men were elected to managerial positions. Moreover, the exercise of the managerial function was restricted because the authority necessary to supervise operations was denied to management (Robertson, 1923: 133). Marshall also says that the selection of the right men to fill the higher and more responsible posts created difficulties for the producer cooperatives (Marshall, 1920: 646). And when appointed, he suggests these men, whose only training had been in the workshop, experienced problems with the complex techniques associated with management (Marshall, 1925: 308).

In Mill's (1848) analysis, worker control of production would experience a number of problems. Principal among these is the effect that such an arrangement would have on the motivation of managers. His observations indicated that managers in producer cooperatives were not personally responsible for the enterprise's performance and did not get compensated as well as their counterparts in capitalist firms. He concludes that the incentive structure in producer cooperatives was unlikely to be as powerful a motivating force to managers as that which existed in capitalist firms. Further he says that the necessity to provide for democratic decision-making would limit the manager's ability to pursue an independent course. Nicholson, who was the last major developer of Mill's analysis, also identified management as the area in which worker control experiences most difficulty:

> "... the method of cooperation, in which, in its full development, the workers provide both the capital and the business management. Cooperation has had an immense success in trade as distinguished from production in the narrow sense. But, although recently there has been some increase of cooperative production, the aggregate amount in the industrial world is of little importance. The great difficulty seems to be in the management. There is a natural reluctance to give either sufficient powers or sufficient wages to the managers." (Nicholson, 1906: 197)

According to the Webb's, managers in producer cooperatives were unable to manage effectively because they attempted to adopt a democratic style of leadership. This had the effect of undermining management's authority and reducing their ability to engage in effective decision-making. Marshall states that producer cooperatives made lower profits, (while paying less for the services of management) than capitalist firms because of the existence of committee management (Marshall, 1920: 293). This system led to inefficiency through the slowing down of the decision-making process and through managerial error of judgement caused by workers interfering with the managers' work (Marshall, 1889: 245). Fanning and O'Mahony suggested that the differential frequency and success of consumer and supplier cooperatives over worker cooperatives may be due to the emergence of a 'managerial wedge', i.e., a strong independent manager or team of managers which may, however, be incomparable with effective worker direction (1983: 257, 238).

K. Hypothesis: *The concept of self-management is self-contradictory and consequently an enterprise organised on this basis is an inherently contradictory form of organisation. Even if a labour-directed firm comes into existence it will lack the entrepreneurial direction necessary for its survival.*

Previously, we outlined an hypothesis (E), which suggested that the entrepreneurial initiative necessary to found a firm must be taken by an individual. If this was true, a group of workers could not act entrepreneurially to establish a labour-directed firm. O'Mahony (1979: 36) also argued that the labour-directed firm is not conducive to the performance of the entrepreneurial role of direction. This is the case because the entrepreneur in this type of firm has the same share in formal control as everyone else. By establishing a worker-controlled firm the entrepreneur "parts with the possibility of directing it towards its goal" (O'Mahony, 1979: 36). Without this direction the firm cannot survive. If, however, the entrepreneur informally appropriates control the firm can survive, but it will only be nominally worker controlled.

Sirc expresses a similar opinion when he says that power cannot be transferred to the "mass of employees without destroying the enterprise". (Sirc, 1977: 73). According to Alchian and Demsetz, direction of the enterprise is achieved through vesting control with a central monitor. This individual's remuneration fluctuates with the performance of the firm, as does that of O'Mahony's entrepreneur. The monitor has an incentive not to "shirk" and, moreover, it is in his interest to ensure that the general body of workers do not "shirk". If control of the enterprise is transferred to the workers, their incentive to "shirk" would be reduced. However, any gains from this development would be outweighted by losses due to the increased shirking of the central monitor (Alchian and Demsetz, 1972: 315).

It is conceivable that the work of guidance and direction could be performed on a contract basis, with the contract being framed in such a way as to encourage efficient work from these personnel. Derrick (1981) suggests, however, that these individuals would be constrained in doing their job by a desire to avoid taking decisions (necessary for the efficient operation of the firm) that might prove to be unpopular with the workforce.

A number of writers suggest that self-management is not the means by which industry can be democratised. Sirc states that democracy implies choice among different ends. In the political sphere, this choice can be made between the policies of different political parties. Choice in industry, however, is dependent on expertise. Therefore, this is not a democratic choice. Consequently, he is of the opinion that attempts to initiate democratic worker control of production are ill-conceived (Sirc, 1977: 57).

Clegg suggests that the existence of an opposition is a necessary element for the continuance of a democracy, be it political or industrial. Trade unions, when they act autonomously, provide this opposition in the industrial sphere. If trade unions cooperate in management (this implies in the limit, workers' control) the opposition will cease to exist, and with this there is no guarantee that democracy will survive, (Clegg, 1975: 75). Hannah Arendt also doubts that democracy can be extended to the workplace:

> "It is quite doubtful whether the political principle of equality and self-rule can be applied to the economic sphere as well. It may be that ancient political theory, which held that economics, since it was bound up with the necessities of life, needed the rule of masters to function well, was not wrong after all" (Arendt, 1958: 29).

L. Hypothesis: *The established rules of the labour-directed firm will be broken by those working within the firm. Because these individuals share the control of the enterprise they cannot be sacked. The resulting disharmony will lead to the demise of the labour-directed firm.*

Mill (1848) identified economic and non-economic advantages in the development of worker control. The former, are greater productivity because of greater effort and an increase in national income because of a reduction in class conflict. He also held that the moral fabric of society would improve because of the reduction in conflict. However, the erosion of class conflict, would not mean an end to all forms of conflict according to Mill. Within the firm different sections of the workforce may have conflicting views on the direction of any policy. Because of this strife, the policy-making process might be a drawn out affair if a simple democratic system was used. With regard to firms where all members share equally in returns, Mill suggested the possibility of disenchantment (1848). That is, if benefits are divided equally but the burden of work is not, disharmony will ensue.

In Meade's view it may not be possible to maintain discipline amongst the workforce in a labour-directed firm. This discipline is necessary for the efficient operation of the firm. Consequently, the firm will fail to survive if it does not maintain discipline. (Meade, 1975: 420). The Webbs and Wiles suggest that one of the major reasons for the demise of British producer co-operatives was labour indiscipline. According to Wiles, the worker, when he is the boss, comes in late, leaves early and generally breaks the rules. The problem is compounded, he says, because of the difficulty in getting rid of unsuitable workers.

M. Hypothesis: *Competitiveness, which is dependent on the productivity of labour, is a necessary element for the survival of a productive unit within a capitalist economy. Increased productivity is achieved through the unconditional manipulation of the labour-directed firm, its survival within a capitalist economy necessitates that labour exploit itself: a contradiction that cannot be resolved. Thus, if the interests of the workers predominate, a labour-directed firm will be inefficient and will not survive. If, on the other hand, the firm adheres to the discipline of the market, it will be transformed into a capitalist firm.*

Luxemburg describes worker-controlled firms, operating in otherwise capitalist economies, as being of a hybrid form. That is, the firm operates in the capitalist market while attempting to behave as a socialised work group. She suggests that these twin roles are contradictory. The firm can only achieve one of these ends. If the former is pursued, the worker-controlled firm is transformed into a capitalist enterprise, while pursuit of the latter leads to the dissolution of the firm (Luxemburg, 1970: 69).

Luxemburg's conclusions are based on marxist analysis, which can be outlined as follows. When an enterprise operates in a capitalist economy *exchange dominates production*. That is the desired result in production is to produce a marketable commodity. However, according to Marx, a product does not become a commodity until it can be exchanged. Further, exchange will take place only when the product is valuable to others at its market price. If some of the product goes unsold at the existing price the firm must compete by reducing price in order to survive. In Luxemburg's view the *production process must be dominated by the interests of capital* because of this need to compete (1970: 69). This is the case because price is a function of labour productivity. An increase in productivity enables the firm to reduce price. However, it also leads to an increase in the supply of the product to the market. The result may be an excess supply of the product at the new price level. Therefore, a further reduction in price and hence increase in labour productivity is necessary. A further consequence of higher productivity is that surplus value is augmented. Since the capitalist collects the surplus value, it is in the capitalist's interests to control labour and thus dictate the level of productivity. In order to do this labour is exploited. This might take the form of extending the workday so that more product is produced in a given period of time. However, Marx notes that with legislation enacted to curtail the length of the working day productivity increased. This was due to the intensive use of labour, a use which was achieved by the division of labour. At times the interests of the capitalist may best be served by reducing the workforce. For instance, if labour is used more intensively, the desired level of production, over a given time period may be achieved with a smaller workforce. Competitiveness and the desire to maximise surplus value dictates that some workers be made redundant.

Since they operate in a capitalist economy wherein their product competes for buyers with that of capitalist firms, worker-controlled firms must also use labour intensively (Luxemburg, 1970: 69). If they do, however, they will not be acting in the interests of the entire work group. Therefore, the members of the firm are faced with a dilemma. Either they abide by the discipline of the market and survive, or attempt to satisfy the desires of the entire work group and dissolve. If it is decided to take on the role of the capitalist entrepreneur by following the former course the firm in effect becomes a capitalist enterprise.

According to Luxemburg, worker-controlled firms can survive in the capitalist economy only when they break the link between production and exchange. To do this, they must remove themselves from the free market. In other words, they must find some means of guaranteeing themselves a market for their product. Consumers' cooperatives can provide this service. Thus, Luxemburg suggests that successful worker-controlled firms will be found to be dependent on a consumers' organisation (Luxemburg, 1970: 70). If labour-directed firms must be linked to consumers' cooperatives, then according to Luxemburg, their scope will be limited. They will be excluded from the most important branches of capital production — the textile, mining, metallurgical and petroleum industries, machine construction, locomotive and shipbuilding (Luxemburg, 1970: 70).

Marx held that the starting point of capitalist production is marked by a large body of workers operating in the same place together (Marx, 1867: 305). The basis of this form of production lies in a certain accumulation of capital in the hands of individual producers (Marx, 1867: 585). The need to bring labour together in one place and combine it with fixed capital dictates the necessity of these funds (Marx, 1867: 312). Therefore, because of the large outlays that are necessary for production to commence, the means of production must be concentrated with one whom he calls the »capitalist' (Marx, 1954: 302). Individual workers would not be in possession of such capital. However, the retail cooperative movement had, at the time Marx was writing, accumulated a large stock of capital (Marshall, 1925: 308). Although this was a workingman's movement, Marx was of the opinion that this capital could not be used to establish worker-controlled firms. Evidence of his view can be gleaned from letters written for a Chartist newspaper in 1851/52 by Ernest Jones, a close advocate of Marx's analysis (Marx and Engels, 1979: 573—589). The core of his criticism is identical with that of Luxemburg. Worker-controlled firms would be either unable to survive competition with big business or they would themselves be transformed into capitalist enterprises (Marx and Engels, 1979: 687).

A number of other writers suggest that worker-controlled firms are inefficient and point to their tendency to become transformed into capitalist firms. Wiles (1977: 131) and Jay (1980: 20) state that these firms will be unable to survive in competition with capitalist firms because this form of production is too inefficient. Productivity will be comparatively lower in participatory firms on account of their inclination to carry surplus workers (Jay, 1980: 21). Walras was critical of worker-controlled firms' scant regard for the market. They maintained low selling prices while paying themselves high wages. Consequently they found themselves unable to repay loans. In general, they »showed little regard for their capital, less still for the capital they borrowed« (Dreze, 1976: 113). That nineteenth century producer cooperatives demonstrated a lack of market knowledge is a view echoed also in the writings of Robertson and the Webbs.

In his review of the cooperative movement, Cole says that industrial cooperatives exist solely in labour intensive lines of production (Cole, 1944: 395). He suggests that this is where their role lies as they are best suited to producing crafts. The type of worker they attract, he says, would not be suited to the discipline of the production line (1944: 396). Meade (1974: 824) suggests that worker-controlled firms are appropriate only in industries where production on a small scale is efficient and in which there is easy access to the market. The Webbs concluded from their observations that one of the major drawbacks of producer cooperatives was an inability to introduce technical change (Jones, 1976: 32).

In an evaluation of the Bullock Report, Chiplin and Coyne (1977) emphasise the significance of property rights. Property right affect efficiency in production through the structure of rewards and penalties on the decision-maker. When the decision-maker ceases to be the owner of capital, he is not affected by the consequences of his decisions and the role of property rights breaks down. If control is based on work, the individual will not bear the full cost of his actions and consequently the out-put of the firm will be less than it should be (Chiplin and Coyne, 1977: 25).

Mill (1848: 138) draws attention to the tendency of worker-controlled firms to become transformed into capitalist enterprises. He relates this behaviour to deficiencies in education on the part of members. This tendency is also identified by Robertson. The Webbs suggest that there is an inverse relationship between the degree of participation and the success of the labour-directed. Over time successful participatory firms will convert to capitalist-type enterprises. The future Mrs Webb, as early as 1891, dismissed producer cooperatives as being »ill-adapted to survive« (Potter, 1891: 156). She says that the interests of these enterprises are diametrically opposed to the interests of the community at large. In her opinion, self-government in the enterprise, far from being an extension of democracy, fragments the community. The result can either be to engender fierce rivalry among groups of workers, organised in self-governing enterprises, or collusion among the enterprises against the consumer. Firms engage in fierce competition in order to secure a market for their product. This end will only be achieved when the major consideration is the realisation of profits. Successful firms will cast aside notions of participation: failure to do so will lead to the demise of the enterprise (Webb and Webb, 1914: 20). According to Wiles, this transformation occurs through the nucleus of genuine members hiring additional employees and so taking on the role of the capitalist employer (Wiles, 1977: 134).

V. CONCLUSION

Since the review itself has been in the form of a summary, with concise statements of the various hypotheses, there is not a need at this stage for a concluding summary of the various hypotheses identified and categorised. We therefore confine ourselves to three concluding remarks. First, the classification of the hypotheses under the headings of founding, finance, and administration provides just one perspective on the wide variety of reasons offerred for the non-emergence and non-survival of worker cooperatives. An alternative perspective is obtained from a consideration of the hypotheses that refer to the overall environment as distinct from those concerned with the internal organisation of business enterprises. Second, as mentioned earlier, there is no reason to expect any single explanation to be valid across places and through time. Obviously an hypothesis such as that concerned with the inability of worker cooperatives to arrange for venture funding is, quite possibly, complementary to those referring to the environment and these types of firms being outside the norm.

The third and final point is about the purpose for this stock-taking exercise. If the current high, and increasing, level of interest is to result in a sustained development of a labour-directed sector, it is essential that any attempts to promote such enterprises are based on an adequate understanding of the reasons for past difficulties and failures. Otherwise, unless luck is favourable, there is a serious risk that the end result will be, in the manner of the hypothesis on information and the norm, to reinforce the negative impression of worker-directed firms that is still widely held. During the last decade or so there has been a substantial increase in the number of cases of worker cooperatives, in their many variants, and in the number of studies of those cases. To develop an understanding which is useful for policy-making is to generalise from these individual case histories. The usual procedure for generalising from individual observations is to apply econometric techniques to numerical data. This is the approach followed, for example, in examining the effect on productivity of worker participation and worker direction. There are, however, many important questions that are not amenable to analysis by that approach. These questions include the fundamental ones about non-emergence and non-survival. To answer these and derive valid implications and approach based on generalising from analyses of case histories is necessary. A first stage in this approach is to identify and formalise hypotheses which can then be evaluated on the basis of case analyses. This paper has attempted to contribute to this in the area of non-viability hypotheses that have been advanced as explanations for the relative infrequency of labour-directed firms.

Received: 17. 3. 1983.
Revised: 26. 4. 1983.

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HIPOTEZE O NEMOGUĆNOSTI OPSTANKA SAMOUPRAVNOG PREDUZEĆA U KAPITALIZMU

Connell FANNING i Thomas McCARTHY

Rezime

Zajedno sa recesijama praćenim nezaposlenošću velikih razmera, u kapitalističkim društvima se obnavlja i ideja o stvaranju samoupravnih preduzeća koja u takvim situacijama ne bi ostavljala radnika na ulici. Ceo članak posvećen je nabrajanju već postojećih hipoteza koje bi eventualno mogle objasniti neznatnu zastupljenost radničkih kooperativa u kapitalizmu.

U prvoj grupi uzroka vezanih za probleme osnivanja preduzeća, izdvajaju se sledeći: radnike jednostavno ne krasi preduzetnička sposobnost, niti oni sami imaju nekakvu želju za preduzimanjem preduzetničke funkcije; postojeći institucionalni aranžmani ne pogoduju stvaranju kooperativa; njihovo osnivanje iziskuje dodatne troškove (recimo oko prikupljanja informacija o eventualnim budućim partnerima).

Druga grupa hipoteza vezana je za probleme finansiranja. Između njih se ističu sledeće: radnici ne mogu da nabave početni fiksni i opticajni kapital; uslov za kontrolu preduzeća je snošenje rizika a radnici, ukoliko nisu i akcionari, po definiciji to ne mogu učiniti; nezavisno od toga, garantovanje isključivo sopstvenim kapitalom predstavljalo bi suviše veliki rizik za radnike, a tom kapitalu pretilo bi da postane izvor trajnih subvencija kooperativa; neprestano deluju poznati Vanekovi efekti samouništenja samoupravnog preduzeća.

Poslednja grupa hipoteza odnosi se na probleme tekućeg upravljanja. Ovde se navode sledeći momenti: radnici ne cene u dovoljnoj meri iznajmljene menadžere, plaćaju ih slabije nego kapitalističke firme, pa su kooperative trajno osuđene na lošiji upravljački nadzor; savremena tehnologija ne ostavlja prostora za demokratiju na radnom mestu; kooperativa nema načina da se reši neradnika; opstanak preduzeća zahteva stalno povećanje produktivnosti rada koje se, između ostalog, ostvaruje intenziviranjem radnog procesa. Radnici bi se zato našli u dilemi: propast ili uspeh uz povećanu samoeksploataciju. No tu nije i kraj priče. Istorija pokazuje da uspešne kooperative po pravilu prerastaju u klasične kapitalističke firme.

Na kraju, autori veruju da bi zanemarivanje iznetih problema u trenutcima eventualnog osnivanja novih radničkih kooperativa u kapitalističkim privredama, samo ojačalo ionako nepovoljna mišljenja o takvom tipu preduzeća.

ECONOMIC ANALYSIS AND WORKERS' MANAGEMENT, 2, XVIII (1983), 155—175

SOCIAL OWNERSHIP IN THE YUGOSLAV SELF-MANAGEMENT SYSTEM*

*Ivan MAKSIMOVIĆ***

I CONCEPTS, DEVELOPMENT OF INSTITUTIONS AND THE THEORY OF THE SELF-MANAGING OWNERSHIP MODEL***

1. Some introductory remarks

The socio-economic system of the Socialist Federal Republic of Yugoslavia (= SFRY) is based upon two fundamental socio-economic relations and institutions: upon freely associated labour, utilizing and managing the socially-owned means of production, and on self-management (Article 10 of the Constitution of the SFRY of 1974). Social ownership,** one of the foundations of the socio-economic system of the SFRY, represents, at the same time, the material basis of associated labour, as well as of the system of production relationships. Social ownership, together with self-management, also determines the way of utilizing, allocating and distributing (acquiring) the results of the economic activity of the people — of the social product and of the social income. Therefore, social ownership and self-management also determine the socialist character of the socio-economic system of the SFRY.

As socially-owned resources have been the main material basis of the system economic management in the SFRY, from its inception and origins up to the present, the direction of the social and economic policy of the SFRY can be clearly seen by osberving the evolution

* This article was read at the Third International Conference of IAFESM, Mexico City, August 1982.

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*** In the present article the concept of ownership is used instead of the concept of property, although the two concepts semantically are almost identical. The concept of ownership is nonetheless somewhat broader to express legal property rights, system of social relations based on self management and economic assets being socially owned, as well as a system of normative economic ownership (economic appropriation, rules of consumption and accumulation etc.).