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NATIONALIZATION, PRIVATIZATION OR SOCIALIZATION: THE EMERGENCE OF THE SOCIAL CORPORATION*

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The idea of "(re)privatization" has become very fashionable in ıe former command economies and also in Yugoslavia. Equally as ıshionable as the idea of "nationalization" after the Second World /ar. When fashions replace argument, scholars mustt become suspicious ı the case of Yugoslavia, the suspicion is doubled, since before the /ar the economy was privately owned, and development was slow nd productivity low. That was precisely the cause of the social rev-lution 1941—1945. After the war the eeconomy was nationalized, de-elopment was accelerated and productivity raised. Yugoslavia de-eloped faster than the other countries: compared with the average f the south European countries, Yugoslav per capita product was round 75% in 1952 and reached 100% in 1980. Since then the economy as been in crisis. Hence the cry for reprivatization. Let us examine ıe problem in detail.

AN INSTITUTIONAL ANALYSIS OF OWNERSHIP

Legal science traditionally distinguishes private and public law. ;ince ownership represents a bundle of rights legally regulated, it /ill be useful to apply the same distinction to ownership rights which etermine the organization of various types of firms.

'rivate ownership:

1. Individual ownership — family firm
2. Collective ownership — cooperative
3. Split ownership — private corporation

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Public ownership:

4. State ownership — state firm
5. Split ownership — social corporation

The firm types enumerated are pure types. Organizational forms as well as ownership types may be mixed. A partnership is a blend of a family firm (owner employs workers) and a cooperative (two or more partners). A public corporation is a blend between the state firm and corporate management. The state may own shares in a private corporation and private individuals may own shares in a social corporation, and so on.

According to the classical definition, ownership rights consist of ius utendi, fruendi et abutendi (the right to use, benefit from and dispose of a thing). Family firms, cooperatives and state firms possess all three rights undivided. Private and social corporations have divided ownership; the usus fructus belongs to the corporation, and the right of disposal to the final owner.

In Western legal theory a corporation is an entity separated from its shareholders. It engages in business contracts on its own behalf, not on behalf of the shareholders. The corporation owns the property (machines, buildings, land) and the shareholders own the corporation. Hence split ownership. The firm is the *primary* or active owner, the shareholders are *secondary* or passive owners. The shareholders can sell their shares or (in theory) appoint the board of directors, but they cannot interfere with management. The corporation is the representative form of the large firms which represent the backbone of a modern economy.

The same considerations apply to the social corporation, the difference being that it does not have a limited number of shareholders; in the pure ownership form the shareholders are all adult citizens. The second difference consists in management organization. The private corporation is hierarchically organized (management directives flow in only one direction, from the top down); the social corporation is a cooperative organization (the sand-glass arrangement of directives). In other words, the former is an undemocratic organization while the latter is a democratic organization. The former belongs to a society which knows only about political democracy. The latter belongs to a society which adds to political democracy economic democracy and in this way represents a more developed democracy.

From system theory we know that the more complex tasks require a differentation of functions which, in economics, is reflected in differentation of institutions. Thus, ownership has been differentiated into two separate functions, primary and secondary, one active and one passive. As a result, the family firm evolved into a private corporation, the state firm into a social corporation. Empirical research in social psychology indicates that democratically organized groups are more effective than hierarchically organized ones (Lippit, 1951). Besides, the trends in modern technology are towards team work, custom-made products and small establishments which all foster self-management as a more efficient organizational form.

It may be of some interest to append a historical note. The joint-stock company appeared in Britain two centuries ago and was met with public criticism and distrust. Hostility was so great that the necessary legislation was delayed for several decades. But the new business organization survived, thrived, proved to be more efficient then its competitors and became dominant in the modern economy. It derives its competitive advantage from three sources: (1) Unlike the family firm, it experiences no difficulty in delegating management power. When a family firm outgrows the size which allows the owner to manage and sueprvise the firm personally, it must be differently organized or cease to grow. (2) As a rule the second generation of owners — occasionally already the first one — is tempted to appoint members of the family to management positions regardless of their capabilities. In a joint-stock company, the selection of managers is more objective and this increases the efficiency, as empirical research has found. (3) The growth of a family firm is limited by its internal accumulation. The corporation may issue shares and so speed up its growth.

Similarly, a social corporation is more efficient than a state firm, for the following reasons: (1) Management of a state firm is bound by bureaucratic rules which limit its initiative and adaptability. On the other hand, the social corporation is independent and self-supporting. (2) The state firm is subject to political control and mixes business with the political interests of the party in power. The social corporation is only concerned with the economic welfare of its employees and therefore tries to maximize economic results. (3) In general, the social corporation can do anything that a private corporation and a state firm can do — and somewhat more.

There is yet another historical similarity. The development of the social corporation (labour managed enterprise) began in Yugoslavia in 1952 and resistance (on the part of the state) has been so strong that after four decades the new business form has not yet taken its final shape. The first law on the social corporation has only been drafted and it is not all certain that it will be passed by Parliament.

THE ROLE OF ENTREPRENEURSHIP

A modern economy is extremely complex. Efficient management requires a huge amount of firm specific information. Therefore Firms must enjoy independence in decision-making. The independence of the firm implies a market and the separation of ownership functions.

Economic efficiency depends also on motivation. An autonomous firm, which can make profits but also suffer losses, provides more incentives than any of the imaginable alternatives. Managers are stimulated by high salaries and status. The same incentives may be provided for the employees. That is why profit (and loss) sharing is becoming more and more popular. And there is also a clear trend of involving employees in various managerial functions.

Ever since Schumpeter developed the idea, the role of entrepreneur has been considered crucial for the efficient operations of a firm. The entrepreneur is a man of creative ideas who engages in innovations. In accord with the system's differentiation of functions, he does not own capital (if he does, he is also a capitalist). Consequently, entrepreneurship can work if two preconditions are fulfilled: there is a possibility for free economic initiative and productive ideas have access to capital. Clearly, entrepreneurship can also be collective.

The fundamental precondition for all three elements of economic efficiency is political democracy. This makes possible a legally-based state. A strict legal framework makes the behaviour of economic agents predictable and eliminates the arbitrariness which destroys economic efficiency. Political democracy also makes possible a firm's autonomy and free initiative.

It is now quite clear why the command economy had to collapse and why this was, in fact, predicted (Horvat, 1982). The lack of political democracy made the autonomy of firms and free initiative impossible. Incentives were destroyed and replaced by mass irresponsibility. Since the pervasive influence of the state in all social affairs was also reflected in state enterprises, they came to be considered inherently inefficient. And since the only known alternative were private enterprises, reprivatization came to be thought of as a panacea.

However, wholesale reprivatization is now as much unjustified as wholesale nationalization was forty five years ago. What is necessary is deetatization in general and the deregulation of economic activities in particular. The most efficient ownership and organizational forms cannot be decreed; they can only evolve in a free market on which all agents compete on equal terms. I expect that family-owned firms and partnerships will prove more efficient for small-scale activities while big firms will be organized as corporations. Natural monopolies will remain regulated and production will be organized by state firms.

THE OWNERSHIP TRANSFORMATION

There is no disagreement that the East European command economies are less efficient then the West European market economies. That this is not accidental but a predictable fact — was analysed above. The disagreements begin about the ways and means of how to transform the former into the latter.

Most frequently a reprivatization is suggested, only to find out that it is technically impossible. Namely, it is impossible to sell the entire national capital at once. In England only a couple of enterprises have been denationalized and it has taken a decade to achieve this in an orderly way. In France a hundred-odd firms have been reprivatized. This has created a revenue of 70 billion francs for the treasury, but also incurred a cost of 43 billion francs. Besides, it was estimated that the shares sold to the public were undervalued by 8—20 billions (Andreff, 1990). The resulting capital gains were pocketed by speculat-

ors. This transformation route is thus neither feasible nor very desirable. Clearly some establishments, particularly the small ones, will be sold to the private sector. But that is about all that makes economic sense. And the governmnt cannot count on any large inflow of revenues.

The next solution considered was to distribute shares to workers and so make them private owners. In this way, it was thought, "ownership incentives" will be created. The solution is unjust and the expectations are unwarranted. Due to the extreme differences in capital intensity in different industries, workers would receive very different capital values, and those outside commercial establishments would receive none at all. Also, wherever in the world shares have been distributed to workers, workers sold them in a short while for cash. Attempts are therefore made to compel workers by law to purchase shares by deducting their values from wages. This has provoked furious reactions on the part of workers, and trade unions have threatened to go on general strike. Besides, in various experiments troughout the world in which workers were made shareholders, no improvement in productivity has been observed.

Since no direct privatization proves feasible, the conclusion generally reached is that all firms ought to be transformed into state enterprises in order to sell them gradually to domestic and foreign private interests. That means that the economy would be saddled with state management for years to come — which is exactly the state of affairs one wants to avoid. If state firms are efficient, there is no need for transformation. And if they are inefficient, which seems to be the case in the respective countries, they will remain so and in the meantime, until they are sold — i. e., for many years — the national economy will be operated at a low level of efficiency.

Thus, reprivatization proves either unfeasible or inefficient or both. The solution must be found elsewhere. The analysis in the preceding sections indicates where. What has to be done is to transform the state firms into independent decision makers, to create an environment for entrepreneurship. This implies that many firms that already earn profits may be *immediately* transformed in self-managed corporations and left to the guidance of the market. That will be particularly easy in Yugoslavia, where self-management and a market of a kind have been in existence since 1952, but it is also possible in other European countries without undue delay. Ownership must be transformed from state ownership into social ownership which is a formal legal operation involving no costs.

The rest of the economy will be handled in the following way. Railways, electricity generation and telecommunications, representing natural monopolies, will be run by state corporations which requires no ownership transformation. Communal services will similarly be entrusted to communal corporations. Perhaps a certain number of other enterprises, specific for each country, will also be included in the category of state corporations. That change can also be made immediately. A great number of small establishments (village shops, restaurants, repair shops, service establishments, apartments), often unprofitable parts of larger firms, will be sold to individuals and co-

operatives, perhaps on the basis of instalment credits. The rest of the firms may be controlled by a certain amount of holding companies. As soon as a firm becomes viable, it will be granted self-management status. The process may be accelerated by proper incentives. Finally, a certain number of the firms will prove to be hopeless cases and will be closed up and the property sold. The entire transformation can be accomplished in about five years (in Yugoslavia in not more than two years). The end result will be a market economy, dominated by autonomous social corporations, with a small number of big state corporations and with a fringe of a large number of small family firms and cooperatives. Joint ventures and foreign owned firms complete the new economic structure.

The financial sector requires a separate analysis which I will refrain from in this paper. It should, perhaps, be pointed out that, e. g., in France 70% of banks are nationalized and the market works well.

BUSINESS CORPORATION IN THE CONTEMPORARY MANAGERIAL CAPITALISM

The existing legal regulation is rather simple. The law provides for annual meetings of shareholders who elect the board of directors (the supervisory board in the continental Europe) who, in turn, appoint the general manager and other senior executives (the management board). The board of directors is supposed to maximize the profits of shareholders. If they happen to be dissatisfied, they are supposed to fire the directors and appoint a new executive (subject to the constraints of possible contracts that the executives may have with the firm). Occasionally the corporation may behave as assumed; in the vast majority of cases it behaves very differently.

Those who make daily decisions and have access to all relevant information — directors-managers and senior executives — are the dominant group in the corporation. The actual practice is well described by Robin Marris (p. 14):

> "It is sometimes supposed that in the corporate sector board of directors may be regarded as trustees for shareholders, that they are ... akin to watchdog committees set up to keep management in place. This view ... is not supported by legal authorities and in any case the managers have themselves considerably assimilated the directorial system. Legally, the function of the board is to operate the company. For the purpose it employs the executives who may ... themselves be directors. But board members who are also full-time employees command the power of organization and hence must in general dominate: In the U. S. the majority of all directors are in this position. Thus, by combining the functions of employee and employer, the management body is considerably freed from direct external restraints, a condition which is emphasised by the fact that the vast majority of board

nominations are proposed by existing directors. In practice, in many firms, the board itself recedes into the background and operations are taken over by committees of senior executives not all of whom are necessarily directors."

In other words, the managers manage without asking either the board or the shareholders for clearance. Managers are empowered to take decisions and in this way they behave like traditional owners. They are not appointed, they practice self-appointment. In the same way they themselves decide on their own salaries, bonuses and stock options.

In principle all the directors in a corporation can be removed by simple majority at a meeting of shareholders. This legal possibility is practically never used — except in take-over raids — since the shareholders practice the diversification of risks and so do not own the majority of shares. In 1951 in the largest British and American corporations the median percentage of votes held by 20 largest shareholders was 20 resp. 28% (Marris, p. 312). The management holds 1—3% of votes, but effectively controls the corporation. R. A. Gordon notes:

"Wholesale purges of executive ranks are rare, and top management, usually securely in control of the proxy machinery, seldom has to worry about retaining its position" (p. 311).

In spite of the absence of any direct control of private owners, the managers work relatively satisfactorily. Why? Because of the inducements and deterrents provided by the market. The mobility of executives is extremely low. In a survey it was found that that senior officers had on the average changed less than two employers since the beginning of their career (Marris, p. 67). Thus, they are dependent on their firms and are vitally interested that the firms prosper. The manager tends to identify with *his* firm, feels the approbation of his class if the price of shares is high, rises faster within his company if the vacancies become available faster by its expansion, his power increases with the size of the company. Besides, good share prices make the access to financial markets easier and increase the borrowing power.

The market deterrents are equally powerful. The larger institutional shareholders may successfully monitor the corporation by threatening to sell their shares. Such sales may inflict a mortal blow on the management. The share price will decline and that makes possible a hostile take-over. In the case of a successful raid, the whole top management is dismissed, losing jobs, prestige and very substantial material remuneration.

It is the administrative independence and market control that make the corporation tick. Clearly, it is not necessarily to slavishly imitate the private institutions in order to achieve the same or better economic effects. All that is necessary is to identify the two crucial preconditions, as just mentioned, and to design the solution in such a way as to exploit the full potentials of the initial position.

THE SOCIAL CORPORATION

The social corporation is a joint stock or limited liability company managed by the employees who elect the workers' council and appoint the general manager. Self-management will require that both the managers and the members of workers' councils pass through an intensive learning process. Courses will be organized and consulting agencies set up.[1] The often-voiced fear, that the nomenclatura managers may simply remain in their positions, is in this setting unfounded (but is very real when the government controls the managerial appointments; even if older personnel are removed, the new appointments will tend to be politically, not economically, motivated). The workers' councils will choose as managers those individuals whom they know from their own experience to be good organizers. Since I wrote on self-management extensively elsewhere (Horvat, 1982), I shall not discuss this aspect of social corporation any longer and shall turn my attention to how the firm is incorporated.

The book value of a firm will usually have only an archaeological interest. The firm's capital must therefore be evaluated anew by applying the same methodology for all firms. Once the real value of capital is known, it is expressed in shares which remain in the company as an undivided fund of social capital. From that moment the social corporation is ready to engage in market operations like any other corporation. It will supplement its working capital by short term loans from the commercial banks. The increase in fixed capital will be financed by issuing bonds and shares and by long-term loans from investment banks.

Shares appear to be internal (social capital) and external (floated on the capital market or sold to the employees at a discount). Whether internal or external, shares earn dividends, and dividends determine the market rating of the firm. In this way market discipline is imposed and any government control becomes superfluous.

Dividends safeguard the minimum profitability and in this way solve the problem of the distribution of income into wages and accumulation without any administrative interference. Internal dividends accrue also to an owner which is society: they are used for investment and are, therefore, added to social capital. If there are also undistributed profits, the share capital will appreciate. In its business policy, the firm will choose the most convenient combination of the raise of dividends and the appreciation of capital.

The firms may merge and combine their capital and management. One firm may invest in another firm on a contractual basis. Or it may invest by buying the shares of another firm. The shares give voting rights. If profitability drops, the value of the shares will drop as well and that may make possible a hostile takeover. This danger will discipline both workers and managers because the takover means suspensions of self-management, reorganization and dismissals.

[1] Experiences from Sweden, England and the United States, where similar activities have been organized, may prove valuable.

A social corporation may also go bankrupt. In this case the law prescribes a standard procedure how its property is to be sold in order to compensate the creditors. The bankruptcy may be prevented if the Development Bank (a counterpart of the National Bank, see Horvat 1969) decides that it is in the social interest to bail the firm out. In this case self-management is also suspended, a new management is appointed by the Bank, and it undertakes to reorganize the firm and effect the necessary dismissals.

Most of the time, social corporations will have mixed ownership with a social capital fund representing the controlling package of shares. Nothing changes if mergers and takeovers occur among social corporations. If a social corporation buys a private corporation, the latter becomes social with self-management introduced and that is the end of the story. If a private corporation buys a social corporation, the latter becomes private, self-management is suspended, and the Development Bank, as the custodian of the social capital, becomes the owner of internal shares. These shares may now be sold on the capital market. Competition on the market will determine all these changes and it would be counter-productive to impose any particular scheme in advance. The government should only take care that the market is not distorted and that everybody enters competition on equal terms. The market will then automatically select the most efficient organizational, financial and ownership forms.

The system described *may work efficiently without any private share ownership.* It, therefore, appears that the great stress laid on reprivatization is determined by *ideological* and *not economic efficiency* considerations. If only social corporations have access to the capital market, the rest of the economy being unincorporated anyway, then the institutional investors are the only ones. This would not make much change from what is happening elsewhere, because *75% of the world stock market is already institutional* and this percentage is increasing. Space does not allow the analysis of why this is so. It suffices to register the fact. Although they are not necessary, private shares may increase the flexibility of the market and for that reason may be used as well.

The main institutional investors are insurance companies, pension funds and investment trusts. That means that a sizeable capital market may be put into operation right away. Thus, the entire transformation from etatist to market economy, if undertaken along the lines suggested, will take no longer then five years (in Yugoslavia two).

Transforming state enterprises into self-managing social corporations means genuine deregulation in the shortest possible time. In this way an etatist economy will be transformed into a more efficient market economy.

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