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LABOUR - MANAGEMENT AND NEOCLASSICAL ECONOMICS: EDITOR'S COMMENT

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The efficiency of labour management has been the subject of debate many times. However, the neoclassical tools of analysis have never or almost never, been questioned. And this is the root of misunderstandings and disagreements. I do not propose to undertake this task here – I indicated the problem in an article published in this journal (1990) and have recently written a book on the subject – but I suggest that the Vanek-Bogetić exchange be taken as an opportunity to engage in such a debate. By way of an illustration, I shall briefly comment on Bogetić's *Rejoinder*.

Evsey Domar of MIT once remarked that MIT had first class students but they were prone to make a dangerous mistake: they took seriously what the teachers taught them. I am reminded of that lucid remark when I read in Bogetić's *Rejoinder* without any reference to data »that a labour-managed economy suffers from behavioral peculiarities which can generate problems not only at the firm level (in partial equilibrium), but also in the economy-wide setting (in general equilibrium).« Is it real-world labour-managed economy or neoclassical assumptions?

Bogetić further writes of »a coup de grace to the idea of labour-management... from government to firm level, particularly in Yugoslavia.« If I understand him correctly, he maintains that the system was inefficient. Let us look at the data. The progressive development of labour management in Yugoslavia falls in the period 1952–1964. This period may be prolonged by another decade until 1974 when the new constitution reversed development towards repressive polycentric etatism. The law of associated labour in 1976 and related laws introduced *ourizacija* at firm level and *dogovorna ekonomija* at national level whereby labour management – more precisely, self-management – while glorified, was effectively destroyed. In the first period, the rate of growth of *global productivity of resources* was among the highest if not the highest in the world (Horvat, 1968; Balassa, Bertrand, 1970; Puljić, 1980). Even in the thirty-five year period 1950–1985, Yugoslavia found itself among the ten fastest growing economies in the world (Pećarević, 1991). So where is the coup de grâce? In the second period, neotatism was established by political repression,

and the economy gradually came to stagnate. Does the author confuse labour-management with polycentric etatism?

The favourite topic of discussion is the negatively sloped output supply function. No-one has ever observed such a behavioral function. Bogetić frankly states that »*it is implied* by a very few, generally accepted, assumptions.« Scientific methodology generally accepts that a theory falsified by facts is a bad theory. Neoclassical economics (like vulgar Marxism) reverses the conclusion and argues that facts – labour-management – falsified by a theory are bad facts.

Bogetić firmly believes in profit-maximizing firms. There is a whole literature which questions the assumption that the modern corporation maximizes profit.

The statement that »in Yugoslavia the entry was extremely sluggish« runs against the fact that the economy was developing extremely fast. Who was responsible for that growth if not new firms? Various market deficiencies can be enumerated, but they have nothing to do with labour-management: for ideological reasons private ownership was severely restricted and so small firms – which by their very nature are usually most efficient as private proprietorships – did not enter the market; for political reasons free initiative, even if not private, was hampered and so a smaller number of labour-managed firms entered the market than would otherwise be the case. Naturally, in the neoetatist period after 1976, the entry was sluggish. Again etatism confused with labour-management?

Elsewhere I pointed out the usual confusion between analytical and historical time (Horvat, 1986 a, b). Analytical time makes full sense only in the long run when all inputs can be adjusted and the appropriate price may be determined. In the short run almost everything is predetermined and two general cases may be distinguished. Either capacity is fully used and then the firm behaves neoclassically: costs are rising and increased demand increases prices. Apart from generating inflation, this case is not particularly interesting. Or the capacity is not fully used and then costs fall as a function of increased demand because of nonpostponable (contractual) payments (Weintraub, 1958, p. 28; Oi 1962; Okun, 1981, p. 162). If demand fluctuations are moderate, price will remain stable and quantities will adjust. Every businessman knows that, but not neoclassical textbooks. Besides, two different maximization rules are suggested. In the short run, marginal cost is equalized to price (marginal revenue); in the long run discounted quasi rents (gross profits) are maximized. The former rule is generally inapplicable because of increasing returns. The latter rule is generally inferior to the one that can be designed for a labour-managed firm, namely the maximization of discounted gross income (gross profits plus wages).

In short, in normal science the real world provides a test for a good theory. In neoclassical theory the real world is rarely examined. If examined at all, it is usually castigated because it does not produce, e.g., Pareto efficiency although it is largely irrelevant since the effects implied represent no more than a fraction of one percent of GNP. What is done instead is to compare two pure models, the profit maximizing and the income maximizing one, *under neoclassical assumptions* and in the *short run*. Since the profit-maximizing model was

developed to appear as efficient (Dubravčić, 1970), the other one must be inefficient. The foregone conclusion. The science is replaced by ideology.

Discussion papers are invited.

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