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No. 11

THE ECONOMICS OF PARTICIPATION

ISLAMIC DEVELOPMENT BANK
ISLAMIC RESEARCH AND TRAINING INSTITUTE
JEDDAH, SAUDI ARABIA

ISLAMIC RESEARCH AND TRAINING INSTITUTE (IRTI)

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THE ECONOMICS OF PARTICIPATION

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FOREWORD

As an international financial institution serving the Ummah, Islamic Development Bank (IDB) is aiming at fostering the economic development and social progress of member countries and Muslim communities in non-member countries in accordance with principles of *Shari'ah.* In order to achieve its objectives and to discharge the necessary obligations at an operational level, pertaining to research, training and dissemination of information, IDB established Islamic Research and Training Institute (IRTI) in 1401 H (1981) and it became operational in 1403H (1982).

In fulfillment of its objectives, IRTI undertakes a number of activities within the framework of its Annual Plan which include conducting in-house research, sponsoring research studies by outside scholars, holding seminars and symposia independently as well as in collaboration with sister institutions, etc.

IRTI's lecture series of eminent economists and scholars is thus a part of its Annual Plan. It is designed to promote a multi-disciplinary approach towards our research program. Under this action plan IRTI invited Prof. Domenico Mario Nuti of the University of Rome, Italy, and London Business, School Unviersity, U.K. to deliver a lecture on "Economics of Participation". In his lecture, Prof. Nuti advocated for a participatory enterprise economy. His thought-provoking lecture generated a number of contemporary economic questions and issues involving transformation of dependent labourers into full entrepreneurs through simultaneous changes in power sharing, profit-sharing and job tenure arrangements.

It is hoped that the publication of this valuable lecture would contribute to enlightened discussions and constructive dialogue on the subject, which has bearings for the further development of Islamic economics as an academic discipline.

M.F. Khan

Dr. M. Fahim Khan

Officer -in- Charge, IRTI

PREFACE

Alternative ways of organising production enterprises in a market economy have been long standing interests in my teaching and research especially over the last ten years, involving the exploration of labour participation in both decisions and results of conventional enterprises, and forms of employment tenure, in place of wage employment contracts. I am grateful to Prof. Dr. Abdel Hamid El-Ghazali, Director of IRTI, the Islamic Research and Training Institute of the Islamic Development Bank, Jeddah, for providing an opportunity for me to pull together various aspects of my research on this subject into a monograph, and to present it in a lecture given at his Institute on 20 June 1993. I was pleased to discover interesting connections between this subject and basic principles of Islamic economic theory, such as self-regulation, participation, cooperation, solidarity; I am grateful to Dr. Abdul Mannan for introducing me to the foundations of Islamic economics. This draft has been revised in the light of useful comments received in the discussion that followed my lecture at IRTI.

The stimuli to continued work in this area have been provided, in the first place, by direct personal exposure to the inspiring ideas of Jaroslav Vanek (of the Program on Participation and Labor-Managed Systems, University of Cornell, Ithaca, N.Y.) on self- managed enterprises and of James Meade (of the University of Cambridge, England) on partnerships and participatory firms; by fruitful disagreement - rehearsed in lively private and public discussions - with the provocative proposals of Tibor Liska (Budapest) on "entrepreneurial socialism" and of Martin Weitzman (then at MIT) on profit-sharing.

I have greatly benefitted from collaborative research with Will Bartlett (European University Institute, Florence, then Bristol University), Marcello de Cecco (with whom I have had a long standing association at Siena University, at the EUI and now at the University of Rome "La Sapienza"), Saul Estrin (then at the London School of Economics), Stuart Holland (EUI), Bob Rowthorn (of the University of Cambridge, UK) and Milica Uvalic (EUI). I have had many stimulating theoretical discussions - especially on the history of ideas - and direct collaboration on practical issues with Edwin Morley Fletcher of the Italian League of Cooperatives and Mutual Societies and of the University of Rome "La Sapienza". Guy Standing of ILO, Geneva and Budapest, has provided insights and valuable research opportunities in the "transitional" economies of Central-Eastern Europe. I am also

indebted to many scholars who have visited the EUI, Florence, in the years 1983-1989, among whom I would like to single out Hans Aage (University of Copenhagen), John Cable (Warwick University), Alberto Chilosi (Pisa University), Ernst Fehr (Vienna University of Technology), Mario Ferrero (University of Turin), Felix Fitzroy (then at WZB-IIMV, Berlin) Paul Grout (Bristol University), Benedetto Gui (University of Trieste), Derek Jones (Hamilton College), Janos Kornai (Hungarian Academy of Sciences and Harvard), Michael Keren (University of Jerusalem), Miroljub Labus (Belgrade University) Marie Lavigne (University of Paris), Axel Leijonhufvd (UCLA), Jan Mujzel (Lodz University and INE- PAN, Warsaw), Hans Nutzinger (Gesamthochschule Kassel), Ugo Pagano (Siena University), Laura Pennacchi (CESPE Foundation, Rome), Vladimir Popov (then at ISKAN, Moscow), Stephen Smith (George Washington University), Jan Svejnar (then at Cornell University), Ales Vahcic (ICPEDC, Ljubljana). I have benefitted also from work with research students preparing PhD dissertations on related topics under my supervision at the EUI at Florence, namely Renzo Daviddi, Virginie Perotin, Milica Uvalic and Daniel Vaugham-Whitehead.

Messrs Hermanus van Zonneveld and Johan Ten Geuzendam, of the Commission of European Communities, Directorate General V of Social Affairs, commissioned a report on profit-sharing in Europe, prepared under my direction by Milica Uvalic at the European University Institute in 1988-90 and discussed at a Conference held for that purpose at the EUI in 1990; the final "PEPPER" Report (an acronym for which I am directly responsible, standing for "Promotion of Employee Participation in Profits and Enterprise Results") was published in three European languages in 1991 and is now being used for the implementation of the European Social Charter.

Thanks for financial support for travel, research assistance, visitors and meetings are due (in chronological order) to the EUI, where in 1984-87 I conducted a research project on "The impact of workers' participation schemes on enterprise performance"; the Commission of European Communities, the Italian League of Cooperatives, the British ESRC (Economic and Social Research Committee), the German Marshall Fund of the United States, the CESPE Foundation (Rome), the ILO, the UN-WIDER Institute (Helsinki).

Acknowledgements for useful comments and criticisms are due not only to the persons mentioned above but also to participants in various seminars, workshops and conferences at which the ideas embodied in this study have been presented and discussed; among them I would like to single out Masahiko Aoki, Matti Pohjola and Michael Reich. Thanks are also due to anonymous referees who have commented on published articles of mine utilised here and - last but not least - to students of the European University Institute (1983-1990) and of the Faculty of Economics and Commerce of the University of Rome "La Sapienza" (1991-93) who followed my lectures and seminars on Comparative Economic Systems and forced me to articulate, develop and sharpen my arguments.

Needless to say, responsibility for any remaining errors and omissions, as well as for any opinion expressed here, rests solely with the writer.

Rome, 1 August 1993

I

INTRODUCTION

The purpose of this study is an investigation of alternative institutions for combining labour and capital in productive enterprises in a market economy. First the common and specific features of labour and capital are drawn out. Enterprises are seen as risky ventures producing in anticipation of market demand and prices. The reasons are considered for the very existence of enterprises in the organisation of production, and alter-native types of traditional enterprises are illustrated (Ch. II).

The traditional enterprise, whether owned by a single capitalist owner-entrepreneur, by shareholders delegating production decisions to professional managers, or by the state, is characterised by wage employment, which involves a fixed remuneration per unit of time, the subjection of employees to the employer's authority in the work-place and lack of permanence of the work contract for either the employer or the worker. Wage employment is seen to have considerable advantages but also disadvantages, both in the capitalist and the centrally planned socialist economy. .Possible alternatives to wage employment - both actual and theoretical, including schemes which are literally "utopian" in the sense of never having been tried out in economic practice - are considered and classified (Ch. III). These include: employees sharing in the profits or at least the distributed profits of their enterprise (Ch. IV); various types and degrees of employee participation in decision making, ranging from a say on labour organisation (industrial democracy) to minority participation in entrepreneurial decisions (co-determination) to. majority control over entrepreneurial decisions (self-management); forms of employment security and various combinations of these three measures (Ch. V). By "Economics of Participation" I understand the analysis of the economic implications of this wide range of institutions, when they are present with different intensity and are taken both separately and in various combinations. (While the macroeconomic implications of these schemes are drawn out as far as possible, forms of macroeconomic participation such as work-sharing or generalised stock ownership are not considered here).

It turns out that these departures from wage employment are not necessarily superior to it and, especially when present to a significant degree and combined, can be expected to yield advantages but also cause major inefficiencies and. inequalities well established and investigated in the economic theory of cooperatives and fully self-managed enterprises (Ch.VI). Among the remedies proposed to eliminate these likely occur'ences there are the extension to productive enterprises of the unequal partnership regime typical of professional firms; radical proposals for free access by workers to the enterprise of their choice or capital funds in general and - at the opposite end of the spectrum - for the market trading of jobs; forms of capital-sharing (Ch. VII). For one reason or another, none of these remedies appear to be fully satisfactory.

The thesis put forward here is that the dilemmas of participation can be resolved only if

i. the notions of participation in enterprise results and decisions, and of job tenure, are further refined (Ch. VII, VIII), with contractual incomes of factor suppliers transformed into dividends from temporary shares lasting as long as the underlying contractual relation (Ch. IX, on the fully participatory enterprise, drawn mostly from the work of James Meade).

ii. the changes are made simultaneously in all three directions, transforming dependent labourers into full entrepreneurs;.

iii. the economic environment in which fully participatory enterprises operate is also modified, introducing significant forms of generalised income support in order to reduce the greater exposure 'to risk resulting from the replacement of fixed with participatory incomes (Ch. IX). Otherwise the transformation of wage employment into a fully participatory relation can only take place on a reduced, part-time basis.

These innovatory proposals are compared with current actual trends. The last Chapter (X) summarises arguments and conclusions.

II

CAPITAL, LABOUR AND ENTERPRISES[1]

1. COMMON FEATURES OF CAPITAL AND LABOUR

In much conventional economic theory there is no difference between labour and other commodities: individuals are endowed with given amounts of assets and commodities, including 24 hours a day of the n-th commodity, leisure time, which can be transformed at a 1:1 rate into work time at the cost of some disutility, marginally increasing at least beyond a certain point (see for instance Hirschleifer 1970). Individuals transform part of their leisure endowment into work, which they use to obtain other commodities either directly through its employment in their own production activities or indirectly through its sale to enterprises; the rest is consumed by individuals for their survival and pleasure (with involuntary unemployment possibly occurring, as forced consumption of leisure, if the labour market does not clear labour excess supply).

There are, indeed, many similarities between fixed capital goods (like machines or buildings) and labourers, being both, strictly speaking, durable assets whose services are used in the production process. Both are produced, and according to the Malthusian approach to population theory the reproduction of labourers is regulated by the wage rate, similarly to the reproduction of fixed capital responding to the rate of return which can be obtained on new investment (relatively to the interest rate). Both fixed capital and labourers embody technical specifications which depend on the cost of processing capital and of training labourers; such a cost represents an investment, and the rate of return on such an investment (which in the case of investment in human capital may include a non-monetary return) regulates the supply of specific machines and workers. Such technical specifications are costly to modify after a machine is produced or a labourer is trained; [2] therefore both are subject to technical obsolescence when progress occurs, or are made redundant when demand changes in directions towards which they cannot be profitably redeployed.

The maintenance of the productive capabilities of both fixed assets and laboureres, when unused, involves incurring a cost: a "user cost" of fixed capital, a subsistence consumption by laboureres, without which both perish. Both may exhibit a "reserve price" - rental, wage or other fees for labour services - higher than user cost or labour subsistence, below which they are not offered for lease. Both are demanded when the value of the marginal product (evaluated at its current price in competitive conditions, otherwise at its marginal revenue in monopolistic and oligopolistic conditions) expected from their lease is at least as high as the capital rental or labour price respectively. Both are used jointly in production, mostly together with intermediate goods, inventories of which are working capital, and with non reproducible resources ("land" for short). In all these respects there is no difference between a labourer, a horse or a robot.

2. THE SPECIFIC FEATURES OF LABOUR

Together with similarities, there are also paramount differences between labourers and fixed capital assets, which prevent their assimilation.

First, laboureres - outside a slave economy - own themselves and cannot be owned by other economic agents, whether other individuals or institutions; nor can they - outside a feudal economy - be bound to an asset or a master, like serfs or bondsmen. There are important corollaries deriving from this fundamental difference. Labourers cannot be irrevocably leased in the same way as machines can: in a modern society leaving any occupation instantly at any time is an elementary and irrenounceable civil right. It follows that employers cannot secure the continued services of labour at a prefixed price, and therefore will be reluctant to enter long term contracts for the supply of their products at a fixed price. Investment in human capital is not transferable and therefore is completely illituid. A worker's effort supply will depend among other things on the real wage, and therefore the wage offered will not normally fall below the "efficiency wage" that minimises labour cost per unit of effort (measured by observed output); this is true also of horses but, in the case of workers, efficiency wages will be determined by social as well as physiological factors. When technical progress occurs, workers - unlike robots or horses - will observe it and will naturally seek to appropriate at least part of their productivity increase. Even if the wage rate approached physiological subsistence, and even in an open economy, demand for labour - except for personal services - may be fairly inelastic, unless low wages are confidently expected to remain low for a prolonged period of time, relatively to the length of the economic life of the equipment with which it must be used. Such a confidence is unwarranted, as wages are known to rise when employment rises as a result of their low level.[3]

Second, the productive services of a labourer cannot be "disembodied" from the person that owns them: they are like the services of a machine permanently chained to its single owner4 Thus laboureres cannot diversify the fulltime, continued employment of their labour services by dividing them between different enterprises, as they are not divisible; this applies also to machines but not to capitalist owners, who can fragment their wealth at will, into divisible ownership claims to any number of machines or to financial capital assets. Hence labourers are exposed to unemployment risk, and therefore income risk, to a much greater extent than owners of capital. This income risk, combined with labourers' scant endowment of capital - otherwise they could be capitalists instead of being labourers - bars significant access to credit and to risk capital; it is the main reason why normally capital hires labour instead of laboureres hiring capital in the organisation of production.' Even when they pool their owned resources, laboureres collectively are not in a position to undertake production other than in activities of below average capital intensity, size and risk. Outside such activities, workers do not have enough capital of their own to employ themselves as a group, or to use as collateral to secure loans for that purpose. Ultimately, capital hires labour in the capitalist economy, especially in risky and highly capitalised activities, simply be-cause property is unevenly distributed.'

Third, unlike robots and infinitely more than horses, labourers (including slaves, unless subjected to the risks of severe repression) have a very wide choice of alternative strategies in the work-place, ranging from cooperative and constructive behaviour enhancing production to uncooperative indifference or slack to outright wilful sabotage. Hirschman (1970) characterises the options open to the member of an organisation as loyalty (i.e. cooperative compliance with existing rules), voice (i.e. protest with a view to change those rules) and exit (in this case, ending the wage employment contract). There is, however, a fourth general strategy neglected by Hirschman, which we could call "disloyalty", i.e. individual exploitation of any opportunities - such as always exist, even in a prison - to break to his/her advantage the rules, or at least their spirit, undetected or anyway with impunity or insufficient penalty. Hence the structure of incentives and penalties to which laboureres must be exposed in order to elicit cooperation and effort is much more complex than that applicable to capital rentals.

3. THE SCOPE OF MARKETS

The capitalist economy is the market economy par excellence and is regulated by a whole complex network of markets and exchange transactions. Yet the overwhelming bulk of markets turnover takes place in spot markets for current goods; with the exception of money, and of a handful of primary products over a limited time span, intertemporal exchange is not the rule but the exception. Futures and forward markets and the equivalent markets for options, let alone markets for future "contingent" commodities (contingent, that is, on a specified future "state of the world" as postulated by the full-fledged general equilibrium model, see Hirschleifer 1970) are normally missing. For labour - as we have seen in the previous section - such markets could never exist without introducing elements of coercion compatible only with .slavery and feudalism. Moreover, markets are sequential, i.e. they reopen in future, indeed in today's global economy often hardly ever close: thus, even when such intertemporal markets exist there is no need to transact on them today in order to secure future deliveries. It follows that current economic decisions involving the future are made not on the basis of actual prices of future goods but on the basis of their expected future spot prices.7

This role of expectations is the foundation of Keynesian economics: in the world as we know it a saving decision is not necessarily matched by and normally does not signal a demand for future goods, and therefore does not necessarily lead to parallel investment in their future production; thus investment demand may be insufficient to obtain full employment. This is also the foundation of the specific nature of enterprise, and of the "true" (i.e. non quantifiable) uncertainty that accompanies its operation (as opposed to "risk" in a strict sense, which is measurable uncertainty and therefore can be neutralised by insurance contracts, see Knight, 1921). "True" uncertainty surrounds future market conditions for both inputs and outputs: the enterprise invests and/or produces in anticipation of demands and supplies which are yet to materialise; "true" profit (over and above contractual costs including leases and actual or imputed interest on loans) rewards infra-marginal enterprises or - if negative, i.e. if it is a loss - penalises them.

Such a view of productive activity can be contrasted with much of traditional economics, for instance in standard general equilibrium, in which entrepreneurship is simple organisational capacity and the enterprise is the embodiment of production functions linking inputs and inputs - like a sausage-making machine, or a "black box" (Aoki, 1984); "profit" is due to above average organisational ability of infra-marginal entrepreneurs, without which the rate of profit on' capital could and often is identified with the interest rate. On the contrary, Knight (1921) refer to the "entrepreneur" as "the recognised 'central figure' of the system", exercising not only organisational abilities but also the anticipation of consumers' wants and the forecast of technological change. Schumpeter (1950) also singles out the same two major components of entrepreneurship, namely the ability to organise and to get things done, and the ability to anticipate future market conditions. In a modern economy entrepreneurial functions are exercised by professional managers, but ultimately capital owners are the entrepreneurs, because they determine managerial employment conditions and incentives, hire and fire managers, and control the general and particular criteria to be implemented by "executives" (see Barnard 1938; moreover, shareholders exercise indirect control through the stock exchange, see below, section 7).

4. WHY ENTERPRISES?

For Polanyi (1944) workers' subjection to their employers is the necessary implication of the inseparability of labour services from their owners (see above, footnote 4). In principle, however, it is conceivable that production might be organised not by enterprises, understood as relatively long-lived groupings of labour and capital engaged in recurring production activities under entrepreneurial direction and authority, but through market transactions involving labour services and semi-processed goods. Every labourer would then become an independent external contractor, hired for well specified productive tasks for a pre-fixed fee. While some sub-contracting of production tasks along these lines is not uncommon, its universal generalisation would be prohibitively costly.

Extending the work of Ronald Coase (1937) and others, Oliver Williamson (1985) has argued that a division of labour which relied solely on contracts to perform manufacturing tasks would meet such large scale transaction costs as to be decidedly less efficient than the direct allocation of labour within the enterprise under employer's authority (for a survey of the issues involved, see Aoki 1984, Putterman 1986, Aoki et al. 1990, Archer 1993). In a changing and uncertain world, in fact, the specific tasks to be performed would have to be described in great detail in contingent contracts which, due to human "bounded rationality" (i.e. individuals' limited ability to predict the consequences of their actions) would be extremely expensive to draw and enforce. Alternatively, the terms for the execution of specific productive tasks would , have to be renegotiated repeatedly in sequential contracts, with the danger of "opportunism", i.e.

of contracting parties taking advantage of each other's irrevocable (or costly to revoke) decisions such as investment in specific training or in fixed equipment.

These considerations explain why the production enterprise (including under production also continued trade activities, as opposed to single trade transactions) operates through contracts in its external relations and mostly through "central planning" in its internal organisation, i.e. through direct allocation of production factors, hired for continued use in unspecified ways or, in the case of equipment, possibly purchased outright.

5. TRADITIONAL ENTERPRISES

Traditional enterprises are endowed with financial or real capital by enterprise owners, borrow additional capital funds at a rate normally predetermined regardless of subsequent performance (sometimes there may be a link between interest and performance, but without, lenders being given a voice in entrepreneurial decisions), buy or lease capital goods, employ labour. Owners (as we have already argued above, section 3) are the "entrepreneurs": they control decisions - directly or indirectly through hired managers - and they appropriate operating profits whether distributed or reinvested (or suffer operating losses) as well as any increase (or decrease) in the capital value of the enterprise as a going concern. Such capital gains and losses are realised at the point of disposal of enterprise assets or of all or part of the ownership stake in the enterprise. These seemingly obvious features of enterprises and their ownership regime are singled out here for future reference, because they are an important benchmark for the comparison with alternative types of enterprises which depart from them in one way or another (see Ch. III, section 7).

Differences within this type of enterprise regard exclusively enterprise ownership subjects, whether one or many private owners or the state. These differences, briefly illustrated here, turn out to be smaller than it might appear at first sight, or at any rate reducible by means of specific provisions or accompanying institutions. Beyond minor differences, all of these enterprises have in common the hiring of wage labour; the next chapter will illustrate the specific features of wage employment and the alternative types of enterprises generated by departures from any or more of these features.

6. THE "PURE" CAPITALIST ENTERPRISE

In its "pure" form, the capitalist enterprise has a single owner, who is not necessarily the owner of the capital goods employed by the firm, which could be entirely leased, nor the provider of financial capital, which could be entirely borrowed. The object of ownership is the enterprise itself, which acquires a positive present value - over and above the value of the capital directly invested in the enterprise by its owner - from the profits generated by infra-marginal organisational ability and/or by successful anticipation of market conditions for the enterprise inputs and outputs.

In order to be able to operate, other than as an individual or family producer of services which do not require capital, the single entrepreneur needs sufficient own wealth to purchase capital goods, to secure loans and (for transactions other than those paid in cash on delivery) to win the confidence of input suppliers. Through reinvestment of profits, and by extending their borrowing capacity beyond individual wealth through building a good business reputation, even single-owner firms can grow to a large size and penetrate sectors characterised by high capital intensity (relatively to output or to labour employed). However, the single entrepreneur needs an initial own capital stake considerately greater than average in order to start and - given the undivided burden of enterprise risk - in order to continue operation, since diversification in his/her asset portfolio on top of output diversification is bound to be necessary in order to reduce the variability of return on enterprise capital.

Abstracting from the satisfaction which might be obtained directly from self-assertion and power, the individual owner-entrepreneur is fully exposed to market rewards and penalties and can be presumed to maximise at any time the rate of return on his/her capital, or rather the present value of the enterprise, which is fully appropriated by the owner-entrepreneur. Such a behaviour maximises the wealth, i.e. the purchasing power of the owner-entrepreneur, and therefore commends itself regard-less of his/her individual preferences for the goods or services that can be acquired in the market (see Hirschleifer 1970 for a formal proof of this "separation theorem", i.e. the separation of production decisions by firms and of consumption decisions by individuals).[8]

If the owner-entrepreneur employs professional managers, at any time they can be closely supervised and instructed, directly over-ruled or dismissed, thus never really necessarily separating enterprise ownership from control.

7. THE JOINT-STOCK COMPANY

The joint-stock company presents considerable advantages with respect to the single- owner enterprise: capital can be pooled from many shareholders regardless of the small size of individual capital stakes; liability can be limited to the capital subscribed by shareholders; risk can be reduced through the fragmentation of individual capital into ownership stakes in any number of companies. The company is necessarily managed by professional managers; they can also- be shareholders, but outside hybrid individual/joint-stock companies where a majority shareholder retains or acquires a managerial position, there is a formal separation between ownership and control. In the 1930s the implications of such separation became increasingly the object of attention and study; many believed that company managers enjoy sufficient discretion to pursue their own motives and objectives, other than the maximisation of enterprise rate of return or present value in the interest of shareholders (Berle 1931, Berle and Means 1932, Dodd 1932). The pursuit of such objectives, whether direct or geared to the system of rewards built into managerial contractual incentives, was thought to modify radically the face and substance of the capitalist system to the point of generating a new economic system: "managerial capitalism" (Burnham, 1941).

Enterprise managers must attach some considerable importance to the variables that correspond also to shareholders' interests, such as profitability and stock market assessment of profitability prospects: profits are sought to self-finance and to enhance externally financed growth, to benefit from profit-linked bonuses and from the exercise of stock options (which are frequently offered to managers as part of their remunerations), to protect the company from bankruptcy and managers from the ensuring unemployment. But managers also derive direct and indirect utility from other variables, such as the size of their establishments, as measured by employment or capital or output, and the growth of these measures: apart from direct gratification, these variables affect status, career opportunities.

Robin Marris (1964) develops a model of managerial capitalism and stresses the conflict between profitability and growth in steady state conditions. However, the very development of this model leads to theorising the limits set to managerial discretion by stock market discipline, when financial markets are well developed and operate efficiently. Namely, managerial neglect of company profits depresses the value of shares, and if the ratio between stock market valuation and company net assets falls below unity the opportunity arises for outside "raiders" to acquire cheaply a controlling interest in the company, dismiss managers and redeploy assets in more profitable ways or dispose of ("strip") company assets unprofitably used. Thus the danger of a hostile take-over is bound to limit the range of managerial discretion and keep their policies much more in line with shareholders' interests than they would be otherwise. Indeed, this argument can be generalised to include the possibility of takeover by alternative managerial groups who could benefit from raising profitability also for companies whose valuation ratio is higher than unit: therefore managers could only lower profitability down to the level of the best outside challenger and no further, thus being able to sacrifice profits only within the limits of their own differential managerial ability. Any additional managerial discretion would have to rely on competing managerial teams having limited access to capital, i.e. managerial capitalism would become a synonym for imperfect capital markets.'

The issues of "corporate governance", specifically raised by managers' decisional discretion, are not at all negligible: mutual and collusive determination of each other's salaries; use of inside or asymmetric information to personal advantage; fragmentation of ownership among powerless shareholders; or, conversely, concentration of holdings in myopic institutional investors, like pension funds, unduly concerned with short term yields. But, by and large, the development of the theory of managerial capitalism has led to the identification of the processes which might make it behave very much like the traditional model rather than to the theorisation of a new economic system.

8. THE STATE ENTERPRISE

State enterprises have the state (or local authorities) as a single ultimate owner, whether directly, through state or local agencies or possibly under the control of something like an Agency for State Ownership, or indirectly through one or more layers of State Holding Companies (see Kumar, 1993). Beside profitability, the government will be interested in the direct contribution that state enterprises can make to the implementation of government targets such as containment of inflation or of unemployment, the promotion of investment and growth, regional balance, distributional changes in the desired direction, etcetera.[10] State enterprise managers also have a certain degree of decisional discretion and are interested in size and growth of their establishment like their colleagues managing joint stock companies, but are not subject to the same control by stock markets and by financial markets.

The primary difference between managers of joint stock companies and those of state enterprises (especially if operating in a centrally planned economy) is not necessarily[11] one of organising ability, drive, initiative, imagination, but in their incentive structure and operational environment. Managers of state enterprises are not dependent on profit for their investment and growth, are safe from takeovers and bankruptcies, their incentives are geared to the degree of fulfillment of government objectives. In addition, in the centrally planned economy, state managers are input-constrained not demand-constrained, and have no control over prices (see Berliner 1957, 1976). Entrepreneurship, in Schumpeter's definition given above (i.e. a combination of organisational skills and the ability to anticipate demand), is not absent in state enterprises, even in centrally planned economies; it is modified, oriented towards the security of supply sources rather than the penetration of market outlets, directed towards playing strategic games with central planners - anticipating their demands - instead of potential competitors and clients. .

Mixed enterprises where the state is a majority shareholder can be assimilated to state enterprises: both are under government control. In its minority shareholdings, managed by a Ministry of State Participation, the government can only assert its own interests - other than enterprise profitability - if they are endorsed by enough private shareholders to obtain a controlling interest, which is unlikely.

In the last decade the inefficiencies and financial losses only too frequently associated with state enterprises (in addition to the need to raise government revenues and to promote the diffusion of share ownership) have led to a widespread reversal of government policies, towards the privatisation of state assets, throughout the world. In principle, however, nothing prevents governments from altering their general policies and the structure of managerial incentives so as to encourage profit-seeking behaviour, especially if control over state enterprises is exercised through State Holding Companies (Kuman, 1993). Recently there have been instances of such "commercialisation" of state enterprises in many capitalist economies, including some "transitional" economies in Central Eastern Europe, especially during the unavoidable delays in the privatisation of state assets. Such "commercialisation" of state enterprises, i.e. a renewed emphasis on profitability, stricter budget constraints, performance-linked managerial salaries, has reduced the differences with private enterprises.

In their general form, all the types of enterprises reviewed here have in common wage employment (see Ch. III): new types of enterprises involve some departure from standard wage employment (Ch. III section 7, Ch. IV and subsequent chapters).

III

WAGE EMPLOYMENT

1. GENERAL FEATURES

The dominant labour contract that emerged with the development of capitalism has three basic characteristics:

i. a fixed wage payment per unit of time, for a "normal" level of effort monitored by the employer.

ii. both parties' ability to end the contract at very short notice, i.e. no employment tenure;

iii. workers' subjection to their employer's authority, both in the organisation of labour and in the overall allocation of labour and other resources.

In these respects the position of dependent workers is exactly opposite to that of the capitalist-entrepreneur, for whom i) income is a variable residual over and above contractual payments including wages; ii) connection with the enterprise is as permanent as he/she wishes, until the natural end of the enterprise or its liquidation or transfer to others; iii) there is full authority - directly or indirectly - over the organisation of labour and over the whole range of decisions over input purchases, output level and mix, sales, stocks and investment.

2. FIXED REMUNERATION

Since most production activities stretch over time and require a pre-fixed flow of labour inputs, their undertaking on a recurrent or continuous basis requires a certain stability in the price of labour in terms of their input/output mix; hence the orderly continuity of production is at odds with spot pricing of labour, and the wage is normally negotiated at intervals, with only quantities (i.e. employment) varying in between.

Piece-rate, i.e. labour earnings related to individual performance, look but basically are not different from wage employment; they replace effort supervision, as effort- equivalence is measured by output. Typically, piece rates are frequently renegotiated; workers may raise their income individually and temporarily - over and above what they would get under a standard wage employment contract - for an effort supply also higher than what would be contractually fixed, and participate automatically in productivity gains due to learning by doing. They are also subject to a ratchet effect on the determination of subsequent rates, i.e. bear the cost of forcing themselves and others to work harder subsequently once norms are raised. Employers save on the cost of recruitment, supervision and contractual enforcement, lose short term productivity gains occurring in between piece rates renegotiations, but can use more fully their contractual power in exacting effort and speeding up progress when rates are reviewed. Under piece rates labour income is bound to be redistributed towards the extra-skilled and the extra-keen but on average, - apart from savings in the cost of monitoring and enforcing effort - average earnings are unlikely to be significantly affected over time with respect to wage employment contracts.

Indexation of money wages to the price of a basket of goods also seems to but does not change the nature of the labour contract sketched above: the numeraire simply changes from monetary to real, and in terms of the chosen basket the wage still remains fixed regardless of enterprise performance and individual effort. An indexed contract is characterised by five parameters: the part of the wage which is indexed, the elasticity of the indexed part with respect to the selected price index, the time lag between price increase and wage increase, the frequency of indexed changes, the frequency of wage contract renegotiation. Such a contract protects the purchasing power of wages only partly (since usually less than 100% of wages are indexed with an elasticity with' respect to prices which is less than unity), intermittently and with a lag, and only within the period in between a wage negotiation and the next, when the new money wage level can be renegotiated independently of the level previously achieved through indexation. At times of expected inflation the wage level in an indexed contract, with respect to that of a non indexed contract covering the same period, will be initially lower and - if the expected inflation materialises - eventually higher. At times of accelerating inflation the arrangement has the advantage of defusing inflationary expectations and thus facilitate the control of inflation; at times of unexpected inflationary shocks it may temporarily amplify the resulting inflation. The inflationary impact of indexation is greater the larger the indexed share of total earnings, the higher its elasticity to the price index, the shorter the adjustment lag, the more frequent the indexed changes; a uniform indexed threshold will flatten differentials in between wage renegotiations; perverse cases are known to have happened, of over-indexed wages rising in real terms thanks to inflation. But, by and large, over time indexation provisions are bound to be offset by lower, and/or less frequent, money wage settlements than would take place without indexation. The nature of the labour contract is not altered at all.

3. NO TENURE

The standard employment contract fixes the wage rate but does not commit either the employer or the employee respectively to continued purchase or sale of labour services. On the part of labourers such a commitment cannot be irrevocable without turning workers into feudal bondsmen; even if advance notice for quitting is required an employer would be ill advised to retain an unwilling employee and will have difficulties in enforcing a penalty clause if it was stipulated. Apparent exceptions, such as footballers or opera singers bound by long-term contracts with significant penalty clauses, are very special categories characterised by a professional interest in good performance and a reputation at stake (and by personal wealth on which penalty clauses can be executed): such exceptions cannot be generalised to ordinary dependent labourers.

On the employer's side, there are common cases of a contractual commitment to continued employment of labourers at least for a pre-fixed period.[12] However, when workers are given full or limited tenure this involves an option to sell their labour in future at a prefixed wage or wage-formula, not an obligation to deliver it at that wage; this employment option is not usually costless but is compensated by a correspondingly lower wage. The arrangement is typical for civil servants and university teachers, and is rare in productive enterprise except for variants of capitalism such as the Japanese model, characterised by de facto life tenure and low inter-enterprise labour mobility (Dore, 1992). Even in all these cases, how-ever, the current tendency is towards the enhancement of labour mobility through the removal of employment tenure, with or without compensatory payments.

4. SUBJECTION TO EMPLOYER'S AUTHORITY

The subjection of employees to their employer's authority is what distinguishes the employment contract from the contractual sale of a specific labour service, in which case the labourer remains arbiter of the organisation and intensity of his/her own work. This proposition is widely accepted: "Employees ... enter the system in two clearly distinct roles. Initially they are owners of a production factor (their own labour) which they sell at a definite price. Having done this they become completely passive production factors, employed by the entrepreneur in such a way as to maximise his 'profit". This passage, which one might be excused from thinking it comes from Marx's Capital (say, Ch. 5 or 6 of Vol. I), is actually from an article by Herbert Simon (1951), which discusses precisely the costs and benefits of the direct sale of labour services and the employment contract for the two parties. The reasons for the almost generalised dominance of the employment contract and the associated subjection to the employer's authority have been discussed in the previous Chapter (section 4), i.e. the high transaction costs of long term sale of labour services and the danger of "opportunistic" behaviour in the recurring negotiation of short term sales of such services.

It has been argued that, given the employee's ability to withdraw instantaneously from the employment contract (see previous section), and the continuous implicit renegotiation of the employment contract, such subjection is purely apparent. Employees, by the very fact of voluntarily accepting continued employment, can be deemed to tacitly consent to the instructions imparted to them by employers.

Alchian and Demsetz (1972) forcefully articulate this objection: "It is common to see the firm characterised by the power to settle issues by fiat, by authority, or by disciplinary action superior to that available in a conventional market. This is a delusion ... To speak of managing, directing, or assigning workers to various tasks is a deceptive way of noting that the employer continually is involved in renegotiation of contracts on terms that must be acceptable to both parties. Telling an employee to type this letter rather than to file that document is like telling my grocer to sell me this brand of tuna rather than that brand of bread. I have no contract to continue to purchase from the grocer and neither the employer nor the employee is bound by any contractual obligations to continue their relation-ship" (1972, p. 778). This comparison is biassed and suggestive:

i) the employment relation, being the sale of a continued flow of services, is different from the occasional sale of this or that brand of a good, which instead is identical to the contractual sale of occasional labour services;

ii) the "exit" option (Hirschman, 1970), i.e. withdrawal from the transaction, for the goods seller restricting the range of goods supplied involves only a fraction of its total revenue, while it can and usually is extremely costly, instead, for a labourer selling his entire, fairly "illiquid" (i.e. highly specific) and "perishable" flow of labour services. The comparison is disingenuous: employees' subjection to the employer's authority is not a delusion, but only too real a feature of the employment relation.

5. ADVANTAGES AND DISADVANTAGES

The three basic features of wage employment singled out above have ensured a number of significant achievements: labour mobility towards its most productive uses, workers' certainty of income while employed thus somewhat offsetting employment uncertainty, the possibility of "central planning" within the enterprise. Thus the standard labour contract has promoted efficient employment and redeployment of labour, high levels of effort for fear of dismissal, productivity gains from large scale and from rational organisation.

These basic features have also some negative implications. First, there is a need for and a cost of supervision for the monitoring and enforcement of individual exercise of "normal" effort and a waste of above normal effort that might be exercised by labourers if the wage was geared to results but which, understandably, is not supplied for a fixed wage.

Second, there is no necessary, direct connection between earnings and enterprise performance and therefore no incentive to raise the effectiveness of collective effort, or to improve labour organisation, or to cooperate in facilitating labour redeployment.

Third, a conflictual, antagonistic relation between "us" and "them" usually prevails between workers and employers, in wage determination and in the employment policy of firms. Employment insecurity, with a permanent pool of unemployed, falls totally on workers; in particular, workers are exposed to unemployment risks due. to enterprise performance, which in turn depends on entrepreneurial decisions in which they have no part; hence the perceived unfairness of exposure to this kind of unemployment risk, as it represents responsibility without power.

Finally, a money wage rate fixed for the period between negotiations, especially if strongly indexed, and fairly inflexible downwards due to workers' reserve pricing of their services and/or strong Trades Unions, is an element of rigidity whenever the maintenance of employment or the achievement of near-full employment requires lower wages. The relationship between wages and unemployment is controversial: neo-classical theory, neglecting the universality of labour usage in production and the repercussions of the wage bill on aggregate demand, regards unemployment as caused by excessively high wages; Keynesian theory attributes unemployment to insufficient aggregate demand and advocates deficit spending, neglecting the impact of demand expansion on external balance and the inflationary and crowding-out effects of deficit finance. By and large, the neoclassical approach reflects the viewpoint of a single open economy with trade elasticities sufficiently large to raise net exports as a result of greater competitiveness, while the Keynesian approach reflects that of the world economy, thus requiring internationally concerted reflation. But there are certainly cases in which a fixed, downwards inflexible wage stands in the way of macroeconomic adjustment in the face of exogenous shocks (such as a major shift in terms of trade as in the oil crisis in the second half of the 1970s, or rapid wage equalisation in unified Germany in 1991-93). In those cases more flexible pay formulas can be advantageous; indeed their permanence makes them preferable to wage flexibility which can be perceived as temporary and therefore be fairly in effective in promoting greater employment.

These acknowledged drawbacks have provided the stimulus for experiments and discussions of alternative formulas of employment contracts, especially towards profit- sharing, decision-making participation (or "power-sharing") and equity sharing by employees - all moves towards the partial transformation of dependent workers into potential entrepreneurs.[13]

6. WAGE EMPLOYMENT UNDER CENTRAL PLANNING

In centrally planned economies with dominant state ownership - now in a process of transition towards the restoration of markets and private ownership and enterprise - the labour contract was basically the same as in the capitalist economy. Thus workers' power, initially exercised through councils ("soviets"), was rapidly curtailed: "Soviet" degenerated from substantive to adjective, turning into a geopolitical designation, and one-man management ("edinonachaliye") was rapidly established.

Fixed wages prevailed, with bonuses largely unimportant and left first to managerial discretion, then made more automatic (in the Soviet Union since the mid-1960s) but still erratic and unrelated to economic performance. In the mid-1930s Stakhanovism appeared, which turned out to be a gimmick (raising the productivity of well supplied and well assisted individual shock-workers) and an instrument to force higher productivity, just like piece rate (see the graphic representation of Stakhanovism in the celebrated Polish film The Man of. Marble). Enterprises had wage guidelines fixed in nation-wide incomes policy but had considerable latitude in wage-fixing (e.g. through job evaluation, labour classification, fringe benefits, promotions) and exercised it, as they were subjected to planned limits only for their total wage fund and could trade-off average wage levels for employment levels and affect the wage structure. Even in the most centrally planned economy at the height of statlinism there was effectively a labour market: enterprises had to match their labour demands with the wages levels and structure necessary to attract labour supply, and that level and structure had to be broadly uniform at least locally, in view of large labour turnover - significantly higher than in capitalist economies (see Holzman 1960 Granick 1987).

This is not to say that in centrally planned economies the standard contract yielded the same beneficial effects that wage employment and the labour market had in market economies. Apart from the adverse impact of job security on workers' effort supply, already lowered by endemic shortages reducing the utility of money, there were other adverse effects: dependance on enterprises for social services and housing, normally provided instead by the state or the market in the capitalist economy, led to lower labour mobility; opportunities for labour redeployment were not validated by markets; cheap finance and government subsidies (the "soft budget constraints" well understood and described by Kornai, 1980 and 1986) and emphasis on physical targets induced enterprises to permanently hoard labour.

With the current transition to capitalism, in post-communist economies there has been a tendency everywhere to leave wage labour as it was, simply adding the formerly missing ingredients: the incentives of private property through mass privatisation, and the discipline role of unemployment through mass redundancies. Disenchantment with a discredited socialist model has prevented the exploration of alternative enterprises and labour employment contracts, indeed leading to the elimination of residual forms of self-management as a precondition of privatisation.

7. ALTERNATIVES TO WAGE EMPLOYMENT

Alternatives to wage employment involve the transformation of one or more of its three typical features, namely: forms of labourers' participation in enterprise results, measured by indicators such as sales, value added, profits or distributed profits; the reduction or elimination of workers' subjection to their employers, whether limited to the organisation of labour (industrial democracy) or extended to entrepreneurial decision-making (power- sharing); a degree of permanence of the employment relation, as an entitlement either to continued employment or to the protection of the income levels that would have been associated with it.

There are only eight possible combinations of presence or absence of profit sharing, power sharing and job security; all are actually observed or have been proposed and their main types are illustrated in the following table. Of course each combination contains any number of alternative degrees *of intensity of any of the three features* actually *present.*[14]

		Profit Sharing	Power Sharing	Job Security
1.	Wage Employment	No,	No	No
2.	Civil Service Employment	No	No	Yes
3.	German Type Mitbestimmung	No	Yes	No
4.	Weitzman's Share Economy	Yes	No	No
5.	Vanek's Participatory Economy.	Yes	Yes	No
	Capital Sharing (ESOPs)	Yes	Yes	No
6.	University Teachers	No	Yes	Yes
7.	Japanese Model	Yes	No	Yes
8.	Coops and Yugoslav Firms	Yes limited	Yes 100%	Yes
	Meade Cap/Lab Partnerships	Yes pro-rata +social dividend	Yes pro-rata	Yes or compens ation

Wage Employment (1) has already been discussed in this chapter; Civil Service Employment (2) and Japanese Life-Long Tenure (7), briefly mentioned above (section 3), are special sectoral and national cases which do not lend themselves to generalisation and, anyhow, are on their way out. The same considerations apply to University teachers (6), who traditionally enjoy a high degree of self-determination because of the prevalence of "peer- judgement", their professional involvement in the definition of standards, and the wisdom of delegating to them the development of teaching methods. In the last ten years, however, even their traditional powers have been encroached; and throughout the world they are increasingly subjected to market and market-type verification of their activities, often with forms of performance-related pay: for these reasons, neither their traditional nor their evolving regime can provide a general new model of employment relations and associate type of enterprise.

There remain four major alternative models to be investigated, namely:-

- Combination (4), here named after Weitzman who developed its theory and was its most ardent supporter in the 1980s (see for instance Weitzman 1984) but originally proposed by Jaroslav Vanek (1965). This is the replacement of the fixed wage rate by a participatory formula whereby earnings are made up of a fixed component (lower than the alternative wage, or zero in its extreme form) plus a share of enterprise profits (or, more generally, an amount geared to other indicators of enterprise performance). Neither job tenure nor subjection to employers' authority are affected, except for the possible introduction of mild forms of industrial democracy, i.e. a voice for employee only on minor questions of labour organisation within the enterprise. This combination is considered in the next Chapter (IV).

- Combination (3), i.e. forms of industrial democracy and minority participation in entrepreneurial decisions, on their own, typified by German style Mitbestimmung (co-determination; in French, co-gestion). Stronger, i.e. majority forms of decisional participation (effective power-sharing or self-management), appear to be institutionally unstable and bound to degrade into workers' owned enterprises, with total profit sharing and possibly also employment security (Ch V, which also considers briefly the implications of employment security on its own and in association with profit-sharing and power-sharing).

- Combinations of profit-sharing and power-sharing such as Vanek's self- managed enterprise (the first example listed above under 5; see Vanek 1970, who developed a seminal proposition by Ward 1958), traditional cooperatives and Yugoslav type firms, which can be assimilated to cooperatives (the first example listed above under 8). The tenuous difference between the two is the lower degree of employment (membership) protection usually associated with the Ward-Vanek's self- managed enterprise with respect tot he cooperative or Yugoslav type enterprise (Ch. VI).

Capital sharing (the second of the alternatives listed above under 5) is considered together with a number of alternative institutional arrangements which have been proposed to deal with the inefficiency and inequality generated by these partial modifications of the wage employment contract and of the enterprise regime associated with it.

The basic argument developed here is that, in order to avoid collateral adverse effects on efficiency and/or equality, all aspects of the wage employment contract need to be radically modified simultaneously, and the environment in which participatory enterprises operate also needs to be modified accordingly, in order to achieve the potential transformation of dependent labourers into full entrepreneurs.

IV

PROFIT SHARING

1. PARTICIPATION IN ENTERPRISE RESULTS

In pre-capitalistic systems workers' participation in the results of their enterprises took the forms - now little used - of sharecropping in agriculture and of sliding scales (indexing wage rates to the price of the product), for instance in English coal-mines. In modern capitalism such participation- for which "profit-sharing" is a shorthand label - takes the form of cooperatives' net revenue sharing, production prizes based on group or overall performance, participation in gross/net revenue/profit, share options, participation in investment funds and pay increases graded according to productivity growth.

Indicators of enterprise success other than profit are bound to encourage distortions in the allocation process, of a kind very familiar from the operation of state enterprises under central planning (see for instance Nove 1958). Thus we shall take profits or distributed profits as the variables affecting employee earnings in a profit-sharing enterprise.

Taken by itself, i.e. without changes in either participation in decision making or employment tenure, the replacement of fixed wage by an equivalent mixed pay formula, consisting of a lower fixed component and a share in enterprise profits, has three main beneficial effects, directly or indirectly affecting employment.

2. BENEFITS

First, profit sharing is bound to raise productivity through higher individual motivation of employees. This is not due to workers gaining from the product of individual extra-effort (as in the case of piece-rates) since each of n workers employed will only get 1/n of the product of his/her own extra-effort (Samuelson, 1977) and on the contrary may reduce effort if at all possible, being exposed to only 1/n of the output loss from his/her own lower effort. Instead the productivity gain can be expected from workers, costlessly to themselves, making intelligent and effective use of any given individual level of effort, cooperating with other workers and management and monitoring and supervising each other's effort, efficiency and cooperation (Reich and Devine 1981; Fitzroy and Kraft 1985).

In particular, collective reciprocal monitoring of effort is a possibly disagreeable feature of profit-sharing but no less effective for that. Productivity may also be enhanced by a more cooperative attitude in the resolution of day-to-day problems and conflicts: for example, stricke action is less likely if it is perceived to reduce labour earnings not only through immediate loss of pay from work abstention but also through loss of the profit component of pay over a much longer period. Indirectly, higher labour productivity will promote greater employment.

Second, profit-sharing will automatically make labour earnings more flexible over the cycle, thus stabilising enterprise profit levels and rates and improving the financial viability of firms, especially at times of recession and capacity restructuring.

Third, profit sharing is expected to directly promote higher employment, through the reduction of the marginal cost of labour which, from the viewpoint of the individual enterprise for a given profit sharing formula, is only the fixed component of earnings (Vanek, 1965). Vanek finds that higher employment will be associated with higher aggregate income, lower prices (because of higher output), higher export volume and domestic import substitution (with undetermined effects on the balance of payments depending on price and income elasticities of trade flows), lower after-tax and after-labour-share profits and higher labour-share in national income (Vanek, 1965).

The simplest illustration of this argument is the following. A share of profits paid to workers will have the same effects as an employment subsidy paid out over and above a lower fixed wage, and financed out of a neutral profit tax (neutral in the sense that the same resource allocation and price policy maximise pre- and after-tax profits), leading enterprises to behave as they would if there was no sharing and wages were fixed at that lower level. For example, consider three otherwise identical enterprises A, B and C. Enterprise A paying a wage of $100 will employ fewer workers than enterprise B paying a wage of $40; but enterprise B will employ as many workers as enterprise C which pays a fixed rate of $40 plus a share of profit amounting to $60 per man; a shift from wage contract' A to participatory contract C will raise employment.

This is not, however, the end of the story. Suppose a fixed wage regime was replaced with a profit-sharing formula initially (i.e. for the current employment level) yielding equivalent average labour earnings: additional employment would dilute individual profit shares. If share parameters were then raised to restore earnings to the value of the initial fixed wage, enterprise profits would be lower than for the equivalent fixed wage (as well understood by Vanek 1965). If, after employment expansion, initial share parameters were left unchanged, average labour earnings would be lower (and the necessary additional labour supply might not materialise). One way or another, additional employment would result from either lower profits or lower labour earnings or a combination of both, just as if a subsidy on additional employment was introduced and financed out of a tax on profits or on the wages of those currently employed. Neither arrangement would be introduced contractually and would have to be imposed by legislation; the only advantage of compulsory profit-sharing with respect to explicit equivalent taxes and subsidies is that support of new employment would be financed within the enterprise and thus would be preferable - especially in economies afflicted by fiscal deficits - to open-ended employment subsidies financed out of the state budget.

Moreover, enterprises using profit sharing formulas appear to regard as marginal cost average earnings, rather than their fixed component (Estrin et at., 1987), and for the very good reason that average earnings have to match the supply price of labour.

3. LIMITATIONS

The advantages expected of profit-sharing meet three important limitations. First, such participation usually excludes the most important element of entrepreneurial reward (or penalty), i.e. the growth (or the decline) of the value of the enterprise as a going concern due to its success; moreover often employees share only distributed profits, thus losing also their claim to self-financed investment (see Ch. VIII below, for a more appropriate definition of profits ad dividends plus capital gains).

Second, the parameters of the mixed-pay formula, i.e. the fixed element of pay and the share of profits to be distributed, will not be fixed for all and forever but only for those who remain employed in the enterprise and only for the period that goes from one negotiation of the employment contract to the next. At each renegotiation presumably the average earnings expected from a mixed pay formula will be brought down (or up) to the level of alternative wage employment available elsewhere in the economy. Thus the earnings differentials between wage employment and profit-sharing employment will not be allowed to grow cumulatively over time. Indeed, the benefits of profit-sharing can last for even less than the period in between wage negotiations, for any employee quitting before the end of that period: hence the need for a somewhat more secure employment to accompany profit- sharing provisions (see below Ch. V, section 6)

Third, employment will not be stabilised during the cycle by labour earnings flexibility obtained through profit-sharing because the marginal cost of labour to firms - i.e. the fixed component of pay - does not vary automatically. Workers, who are normally risk- averse and unlike capitalists cannot reduce income through diversification of employment, will be exposed by profit-sharing to greater variability of earnings when employed. This incremental risk may or may not be overcompensated by the likely associated reduction in the risk of unemployment; if not, workers will prefer a fixed sum of money to a profit- sharing formula of equivalent amount. Conversely, the greater stability of profits may or may not be regarded as an improvement by firms owners, who are normally risk-lovers and in any case can reduce risk through product differentiation or portfolio selection, and may be able to do this more "cheaply" than through profit sharing schemes. This is why profit- sharing is favoured primarily in risky ventures; otherwise on this ground alone profit-sharing would be favoured by firms only in a recession (when workers would only accept it as an alternative to a permanent wage cut) and by workers only during a boom (when firms would only accept it as an alternative to a permanent wage increase).[15]

4. OVERCLAIMS

Rediscovering Vanek's macroeconomic benefits from profit-sharing (though not its impact on net profits and relative income shares), Weitzman (1983, 1984,1985a and b, 1986) alleges that there are portentous additional advantages of profit sharing, namely: full employment, indeed over-full employment, of a kind which is claimed to be non-inflationary and resilient to deflationary shocks. Weitzman claims that these benefits are neglected by individual firms, as in other instances of "public goods", "externalities" and "market failures", therefore necessitating public policy measures (Weitzman, 1983, 1984).

In the short run the share economy is supposed to achieve and maintain full employment. For instance: "The share system, ... has a strong built-in mechanism that automatically stabilizes the economy at full employment, even before the long-run tendencies have had the chance to assert their dominance............................... a share economy has the direct 'strong force' of positive excess demand for labor ... pulling it towards full employment. ... the strong force of the share system will maintain full employment" (Weitzman, 1984, p.97).

In the long-run, Weitzman associates full employment equilibrium under profit-sharing with permanent but non-inflationary excess demand for labour, which cushions off the economy from contractionary shocks and gives new dignity and status to labour. In adman's language we are told, for instance:-"A share system has the har[d] boiled property of excessd emand for labor, which turns into a tenacious natural enemy of stagnation and inflation. The share economy possesses a built-in, three-pronged assault on unemployment, stagnant output, and the tendency of prices to rise. This is a hard combination to beat" (Weitzman, 1984, p. 144). Both these claims for the benefits of profit-sharing in the short and the long run, unfortunately, must be dismissed as overclaims.

5. PAINLESS FULL EMPLOYMENT?

For a share economy to "deliver" full employment three necessary conditions must be satisfied simultaneously:

i. the physical marginal productivity of labour at full employment must 'be positive;

ii. the marginal revenue obtained by firms from that physical marginal product of labour must also be positive;

iii. the fixed element of pay in share contracts must be flexible enough to fall down to the level of the marginal revenue product of labour at full employment, positive as it may be.

The first condition rules out the possibility of classical unemployment, i.e. due to lack of equipment, land or other resources in the quantities necessary to employ all workers efficiently. Yet in the 1990s, after a deep and protracted recession, de-industrialisation and decapitalisation, even advanced industrialised countries such as Britain or France cannot be expected to be able to satisfy this condition as a matter of course, not to speak of Italy or Spain, or of less developed countries. In his formal model Weitzman (1985b) postulates constant physical productivity of labour; this is a plausible assumption up to near-full capacity but Weitzman gives no reason why the capacity should be constrained by labour instead of other resources, or by external balance.

The second condition rules out the possibility of Keynesian unemployment, i.e. aggregate demand constraints making the marginal product of labour valueless or negative before full employment is reached. Even if the first condition was satisfied, imperfect competition - which in all of Weitzman's work provides the environment in which the share contract is to operate - provides an excellent reason why firms might not give to additional physical products a positive value; moreover, the lower marginal cost of labour brought about by sharing - as Weitzman recognises - may have an adverse feedback on investment in the short run, increasing the possibility of Keynesian unemployment. Weitzman can assert that "... a 'pure' sharing system not having any base wage would possess in infinite demand for labor" (1985b, p. 944), which implies positive marginal revenue for any level of output, because of the very special assumption that the elasticity of substitution among all goods if greater than unity (ibidem, p. 938), which makes demand curves absurdly and indefinitely elastic even for imperfectly competitive firms. This proposition cannot have any claim to general validity.

Even if demand for labour were to be infinite in the pure share economy, i.e. with a zero fixed element of pay, it would not necessarily be infinite, or even large enough to reach full employment, for a positive fixed element of pay. Weitzman neglects the determination of the relative weight of the fixed and variable components of the share contract but recognises the impossibility of total dependence of pay on profit; yet he takes for granted that the fixed element of pay can be compressed down to whatever is the full employment marginal revenue product of labour, which we do not even know for sure is positive.

6. NON-INFLATIONARY OVER-FULL EMPLOYMENT?

Suppose that Weitzman's share economy actually does reach a state of full employment. Weitzman maintains the presence and persistence of excess demand for labour in long-run equilibrium on the basis of the following argument:.

1) labour total pay = marginal revenue value of labour productivity at full employment

because long-run equilibrium must be full-employment equilibrium and because of the underlying homo-morphism of profit-sharing and wage contracts in long run equilibrium (Weitzman, 1983). By definition of profit-sharing

2) labour total pay = fixed pay + share of net profits

where fixed pay is' greater than or equal to zero, and the share of net profits is greater than zero. It follows from (1) and (2) that

3) marginal revenue value of labour productivity 'at full employment > fixed pay marginal cost of labour to firms, ,

i.e. firms will wish to employ more workers than are available. A permanent state of excess demand for labour will exist, which will protect full employment from contractionary shocks, as long as shocks do not reduce the marginal revenue value of labour productivity at full employment below the fixed element of pay (otherwise the maintenance of over-full employment would still require a reduction of the fixed element without cutting earnings as much as necessary in the wage regime).

There are three grounds for refuting this syllogism. First, firms should be well aware that, whatever their pay formula, they can only attract workers by offering the going rate for labour total pay and should regard this, and not the fixed element of pay, as marginal cost of labour. If firms behave as they should, excess demand for labour disappears.

Second, if firms regard the fixed element of pay as the marginal cost of labour they should find its being lower than the marginal revenue value of labour productivity disquieting enough to experiment with alternative combinations of pay parameters without raising total pay above labour productivity. Since risk averse workers prefer fixed pay to potentially variable earnings of identical mean, risk-neutral or risk-loving employers can reduce their labour cost by raising the fixed element of pay at the expense of workers' profit share; even without taking into account attitude to risk it is plausible to expect managers to experiment with alternative pay parameters and not to rest until they have equalised their marginal cost and marginal value of labour, i.e.

(3) marginal revenue value of labour productivity at full employment = fixed pay

which can only be reconciled with the definition (2) of a profit-sharing contract if the workers' share of net profit is zero: with the sharing component of earnings the "share economy" also vanishes and reverts to the fixed wage economy without any excess demand for labour.

Third, workers perceiving excess demand for labour are likely to reduce their supply of effort and/or increase job turnover - as they do in the only known instances of permanent excess demand for labour, i.e. Soviet-type economies (see Lane, 1985) - if not right down to the point where their marginal product equals fixed pay at least as close to that level as they are allowed to get by monitoring and supervising arrangements. This is another mechanism which can reduce and eliminate excess demand for labour if it occurred.

On balance, it would seem that the profit-sharing economy would still be prone to unemployment and vulnerable to deflationary shocks.[16]

It is worth noting that if, on the contrary, full and over-full employment could be achieved through generalised profit-sharing, workers would have de factory free access to a job in any firm of their choice, and therefore might as well be given that access as of right, as in forgotten utopias (Hertzka, 1890; Chilosi, 1986, see below, Ch. 7, section 3).

7. IMPLICATIONS

These overclaims, and the weakness of the "lower marginal cost of labour" argument (see above, section 2) do not destroy the case for profit-sharing; but obviously there is a world of difference between higher employment and full employment and another world of difference between full employment and persistent over-full employment. The implausibility of Weitzman's overclaims makes equally implausible the case for treating the sharing contract as a public good: whatever benefits can be obtained from profit sharing can be internalised and appropriated by enterprises and shared with employees. On balance, Samuelson (1977) seems to be right when he argues that the possible productivity increase is in fact the only source of society's net gain resulting from the move to a share economy. In general, profit sharing on its own is not, necessarily, absolutely superior to wage contracts. For workers, profit-sharing transforms the probability distribution of uncertain employment at a fixed and certain income into a probability distribution of employment with a higher mean (because of higher productivity and/or lower marginal cost of labour) but no less variable over the cycle, at a more variable income (both over the cycle and for other factors affecting dispersion of enterprise performance) and at a higher employment mean. For firms it transforms a more into a less variable probability distribution of profit rates around the same mean (or a lower mean if workers are protected from actual losses; the effect on real profit rates depends on accounting conventions and choice of numeraire). In the pursuit of greater employment of course a government
may grant tax relief to shared profits, just as effectively and with just as much reasons as it may subsidise the marginal cost of labour to firms under a wage regime. Otherwise there is no reason why profit-sharing should be forced upon unwilling workers and firms by well-meaning reformers, beyond the extent which they are prepared to consider in their market transactions. There is no reason why a firm should object to granting a given increase in earnings under the guise of a profit share instead of an equivalent fixed amount unless that represents an expensive form of insurance against profit variability; and why workers - at least at the level of nation-wide collective bargaining - should not take into account the

potential reduction of unemployment risk involved in this pay formula and offset this benefit against the greater variability of their earnings in between negotiations, due to both cyclical factors and random factors affecting their firm's performance.

The employment benefits of profit-sharing discussed in this chapter require that workers should have no say on any enterprise decision affecting employment - otherwise the dilution of profits over additional employees will be a consideration restraining employment expansion." Such considerations are discussed in the next Chapter.

8. THE DIFFUSION OF PROFIT-SHARING

The undoubtedly positive net effects of profit-sharing are reflected in their considerable diffusion throughout the industrialised world, and in the deliberate efforts by European Community authorities to encourage their further diffusion in its Member States (see Uvalic 1991 and 1993, which are the sources of the data quoted in this section).

The USA and Japan have a long standing tradition in profit-sharing. It has been estimated that in the USA the number of profit-sharing schemes has risen from 300,000 to 500,000 over the period 1977-87 (Smith, 1988), whereas an alternative estimate puts at 560,000 the number of employee profit-sharing schemes already registered in 1978, covering about 17 million workers (Estrin and Shlomowitz 1988). In Japan profit-sharing is widely diffused, with bonuses usually paid twice a year and are estimated to account for as much as 25 per cent of total employee earnings (Blanchflower and Oswald, 1987); this practice is indeed associated with exceptionally low unemployment and inflation rates.

In France, after intense political debates since the 1950s and in spite of opposition by both employers and Trades Unions, profit-sharing was introduced in 1959, followed by "deferred profit sharing" (i.e. delayed distribution of free shares), with the introduction in 1967 of obligatory participation schemes in all enterprises with over 100 employees. Stronger cash incentives were introduced in 1986. At the end of 1990 there were 10,700 agreements on cash-based profit-sharing, plus roughly as many agreements on deferred profit-sharing,. covering about 6.7 million employees. At any one time, of course, actual enterprise performance determines the number of those actually benefitting from the schemes, and the level of benefits; on the whole, it is estimated that about 20 per cent of French employees directly benefit from financial participation schemes, with average benefits amounting to 3-4 per cent of earnings.

In the UK, tax concessions for profit-sharing schemes were introduced in 1978 by the labour government, and were strengthened in 1987. 1,200 profit-sharing schemes were in operation in 1990, with other forms of financial participation - mostly share-based profit- sharing - being present in other 5,800 schemes; about 13 per cent of employees were eligible to participate and about 8 per cent actually benefitted from such participation. On average, benefits amounted to around 7 per cent of earnings (2-4 per cent in share-based schemes).

In other EC countries, "direct government support has either been limited (as in Belgium, Denmark, Germany, Ireland and the Netherlands), has emerged only in the last few years (as in Greece and Portugal), or has been completely lacking (as in Italy, Luxembourg, Spain)" (Uvalic 1993, p. 9). In Ireland there were 273 schemes registered in January 1991 (of which only 38 per cent were cash-based), covering more than 3 per cent of all employees. In Denmark the overall number of schemes in the mid-1980s was estimated at 200, mostly cash-based. In Germany in 1990 about 5,000 enterprises practiced forms of financial participation (including share distribution), covering around 5 per cent of all employees and accounting for 6.8 per cent of total earnings. In Italy, forms of variable remuneration linked to performance indicators prevail in about one quarter of large firms; there was a rapid increase in the number of employees involved, from 400,000 in 1988 (less than 2 per cent of the total) to almost 700,000 in 1989; benefits range from 3 to 8 per cent of the national minimum wage (see Biagioli, 1989). In the Netherlands, in 1988 about 30 per cent of all firms applied forms of financial participation, mostly cash-based profit-sharing, covering 7.4 per cent of all employees, with benefits amounting to 4.5-6.5 per cent of total earnings. In Belgium, in a 1990 Survey on the top 500 companies, 39 per cent of the 140 respondents had forms of financial participation, of which 15 per cent had profit-sharing (usually not exceeding 5 per cent of profits). In Spain in 1990, as many as 44 per cent of medium and large firms gave employees a variable component of pay linked to performance (averaging about 5 per cent of earnings), but only 6 per cent linked these payments to profit; the link to profit is tenuous also in italy and the Netherlands (Uvalic, 1993).

In 1989 the Commission of European Communities announced its intention to present, as part of its Action Programme for the implementation of the Social Charter (accepted by all Member States except the United Kingdom) a new Community Instrument on employee participation in company results (CEC 1989). This initiative led to the preparation of the PEPPER Report (Uvalic 1991) on Promotion of Employee Participation in Profits and Enterprise Results, on the basis of which a proposal for a Council Recommendation on employee participation in enterprise results was prepared by the Commission (CEC 1991) and was officially adopted by the Council of the European Communities on 27 July 1992 (Council of the EC, 1992).

Traditionally, many Trades Unions in the EC have opposed profit-sharing schemes at the enterprise level, for a variety of reasons: concern about inequalities arising between workers employed in enterprises of different profitability; the use of profit-sharing schemes by employers to discourage unionisation; the frequent unilateral and non-negotiable nature of such schemes; the additional risk of variable income (in spite of expectations of more stable employment); the lack of control over the policies from which profitability actually depends (Uvalic, 1993). Such concerns have prompted Trades Unions to press rather for forms of capital sharing (whether nation-wide schemes such as. employee investment funds, or enterprise-level stock ownership schemes such as those discussed below in Chapter 7, section 5), and/or for forms of participation in decision making (see next Chapter).

V

INDUSTRIAL DEMOCRACY AND POWER-SHARING

1. TYPES OF DECISIONAL PARTICIPATION

Entrepreneurial decisions can be roughly divided into two categories, corresponding to the two components of entrepreneurship singled out by Schumpeter (1950, see above, Ch. 2, section 4), namely organisation of production and allocation of resources in anticipation of market conditions. The first category involves decisions about the organisation of labour, including safety, discipline, the pace of machines, and similar decisions involving the daily operation of plants. The second category includes the level of employment, the quantity and quality of output, price policy, technical choice, investment, financial policy and similar decisions generally affecting the allocation of resources.

To this categorisation there correspond two types of employee participation in enterprise decisions, namely "industrial democracy" in a narrow sense, i.e. participation in decisions about labour organisation, and what we might call "power-sharing" i.e. participation in the full range of entrepreneurial decisions involving resource allocation. Moreover we must distinguish between modest, minority power-sharing, as in German Mitbestimmung (co-determination), and the effective, majority or full power-sharing (or self- management) typical of cooperatives and self-managed enterprises.

2. INDUSTRIAL DEMOCRACY

Industrial democracy takes the form of employee access to information and right to consultation, participation in decisions on work conditions, on internal organisation and redeployment of labour and on social questions, through a workers' council or a similar representative body.

This kind of decisional participation is bound to raise employee welfare through the gratification of exercising initiative, and the reduction of boredom and of unnecessary effort. Enterprises may neglect workers' preferences about the specific uses to which their labour is put or at any rate respond to the needs of a hypothetical average worker: if the number of enterprises is not large enough to allow workers' employment in those better responding to their preferences, workers' control is necessary to reduce disutility and alienation.

Such welfare improvements could be appropriated at least partly by employers, who could then offer industrial democracy in lieu of higher wages. However, the impact of industrial democracy on labour productivity has indeterminate sign (Pagano, 1984): possible improvements in the use of all inputs or in the quality of output may be more than offset by productivity losses due to workers avoiding - when they have the choice - disagreeable but more productive labour processes. Employers will have an incentive to grant this kind of participation only if its combined effect on productivity and wage levels is expected to reduce unit labour costs. Moreover employers may be inclined to implement discipline for its own sake, thus requiring significant efficiency improvements before agreeing to industrial democracy. Hence the degree of workers participation in the organisation of labour is just one of the many aspects of wage negotiations.

3. CO-DETERMINATION

A more substantial participation, for instance through membership of workers' representatives in the board of directors of joint-stock companies, involves a broader range of enterprise decisions, affecting employment, output, profits, loans, reinvestment and growth. The best known instance of employee power-sharing is German "Mitbestmmung" (co-determination), involving various degrees of employee representation in different industries (see Nutzinger 1983).

There is an ethical and political case for matching responsibility (i.e. workers' exposure to unemployment risk) with power (i.e. participation in'. the decisions from which unemployment might result as a consequence of entrepreneurial failure). The very fact that workers, unlike capitalists, cannot diversify the sale of their services among different enterprises exposes them to an employment and income risk which induces them to make a claim to control; a claim which up to a point the employer may prefer to accept instead of granting higher wages or longer tenure.

Co-determination is bound to reduce the number and intensity of conflicts between labour and capital in the work-place in general and, in particular, obtain the more likely acceptance by workers of unpopular decisions by management, when workers receive detailed and credible information and participate in decision making. Formal channels are provided for information about objective conditions and prospects, and for the communication and negotiation of respective policy stances. Through this kind of participation workers may achieve greater identity with the enterprise and become more "incorporated" in it; in particular, they are bound to lengthen their time horizon in view of continued participation in decision-making (Aoki 1984; Cable 1984; Fitzroy and Mueller, 1984).

While conflicts within the firm are made more tractable by the introduction of co- determination, afterwards they are bound to reappear over time, possibly in a "ritualised" form which might make them less tractable later on (Furobotn, 1985). Also there remains a basic conflict between employed and unemployed workers which may even be exacerbated by the employment protection policies conceivably encouraged, in their exercise of co- determination, by those who are already employed.

Empirical evidence suggests that co-determination enhances productivity and therefore indirectly also has employment promotion properties (although it may reduce the direct effects of profit-sharing on employment, see below). While the German experience confirms that co-determination if perfectly compatible with a modern market economy and private enterprise, the impact of minority membership in company boards is bound to be effective only in case of a sufficiently divided board. Its actual impact on resource allocation can only be very limited.

Together, industrial democracy and broader co-determination are expected to make a significant contribution to economic efficiency. According to a recent EC document.

"Greater worker participation in corporate decision (for example regarding the improvement of working methods, the introduction of new technologies and innovations in production processes), is vital if the European economy's competitiveness is to be restored and reinforced over the long term. The delays in modernising labour relations in some Member States are one of the reasons for the serious shortage of skilled labour and for firms being unable to meet their requirements, at a time of high unemployment" (comma 3.11.3 of the "Opinion of the Economic and Social Committee on the Annual Economic Report", February 1992).

4. INTERACTION BETWEEN PROFIT- AND POWER-SHARING

The quantification of degrees of "co-determination" and to a lesser extent of "profit- sharing" raises conceptual and practical difficulties (though see Cable, 1985). By and large we can observe a certain correlation between the two: both co-determination and profit- sharing are zero in the pure capitalist enterprises and unity in cooperatives and other forms of partnerships of capital and labour; minor forms of co-determination (or conversely of profit-sharing) tend to go hand in hand with minor forms of profit-sharing (or of co- determination); a high degree of one without the other is virtually unknown.

The respective effects of co-determination and of profit-sharing are not independent: the case for power sharing and profit sharing reinforce each other. The productivity increase expected from profit-sharing can be raised by workers having collective discretion over the organisation of labour; or the productivity fall which might derive from workers' control over labour organisation might be tempered by profit-sharing. Greater variability of earnings - during the cycle and across firms - strengthens under profit-sharing the case for co- determination already present in workers' exposure to employment risk in the wage regime. The income premium required by risk-averse workers to replace some of their fixed wage with a variable profit share can be reduced by their involvement in the decisions which expose them to income variability in the first place. The reduction in conflict frequency and intensity expected from co-determination is enhanced by profit-sharing because for each worker it partly internalises the conflict between "us" and "them" otherwise manifested and enacted externally. Participation in both enterprise decisions and performance is expected to defuse conflicts better than partial participation, and facilitate restructuring and redeployment. In any case it is a requirement of any effective incentive system that power and responsibility should not be separated. Power-sharing is also made more likely by the establishment of profit-sharing: participation in profits leads to access to information and therefore discussions about past enterprise performance and about current plans; formal or informal consultation is only a small step from participation in decision-making and is bound to naturally lead to it.

Paradoxically, the combination of profit-sharing and power-sharing generates - through the understandable temptation of selfish search for the maximisation of earnings-per- man on the part of self-management organs - a tangible risk of inefficient behaviour. Other things being equal, the incentive structure of such an enterprise - unless modified appropriately, or counterbalanced by altruistic behaviour,or disactivated by economic rigidities - leads to additional inefficiencies with respect to the traditional wage employment contract.

The combination of 100 per cent co-determination (= self-determination) and potential 1'00 per cent profit-sharing (= net revenue sharing) obtained in cooperative firms, according to conventional literature, is subject to economic stimuli of a somewhat "perverse" kind (to be discussed in the next chapter). These are primarily: restrictive employment (= membership) policies; destabilising and Pareto-inefficient reactions (or at best inelasticities) to price changes and technical progress; a low propensity towards self-financed investment (Ward 1958; Vanek 1970). In empirical studies of cooperative firms there is no incontrovertible evidence of these phenomena, which are probably partly offset by other economic (job security, growth-mindedness, etcetera) and non-economic stimuli and constraints; but there is a presumption that - albeit in a weak form - the same tendencies and, in particular, employment restrictive policies might be associated with co-determination. We can also presume that workers' eagerness to press and ability to assert demands for co- determination, as in the case of other demands, increase as unemployment diminishes. Hence the employment-generating benefits of profit-sharing can be at least partly offset by the restrictive employment policies possibly associated with co-determination brought about by profit-sharing and by greater proximity to full employment. A number of empirical studies suggest modest but sizeable improvements in economic performance from combined co-determination and profit-sharing (Cable and Fitzroy 1980; Estrin et al. 1984) when and where they occur but there may have been costs that remained unobserved and, in any case, these improvements cannot be generalised.

5. SELF-MANAGEMENT

Suppose workers' participation in entrepreneurial decisions was made truly effective, i.e. determinant, for instance through majority membership of company boards.Co- determination would turn into self-management. Shareholders would then be effectively disenfranchised; now employees could successfully both resist dismissal and award themselves wages higher than compatible with even the maintenance of the value of equity capital, possibly right up to the consumption of the entire equity capital. Shareholders would be dispossessed through the ensuring reduction or even elimination of the enterprise capital value. Fresh risk capital would be made available by investors on a smaller scale, if at all, and fresh loans would be available only if amply secured by enterprise collateral, now dwindling away. Effective, determinant power sharing is incompatible with a guaranteed fixed wage for all employees (just as voting shares cannot have the guaranteed rates of return typical of privileged shares). Any enterprise with effective, determinant employee participation in entrepreneurial decisions would quickly tend to degenerate into a workers' owned enterprise. Thus there is a significant discontinuity in the range of enterprises associated with employee participation in decision making: participation is either nominal and ineffective, or so strong as to lead to potential disenfranchisement of owners and appropriation of all surplus and capital. Therefore when the degree of participation goes beyond industrial democracy and co-determination and turns into majority control and self- management, the enterprise tends to behave in a radically different way (see next chapter).

In principle a similar conflict of interests in the management of enterprises is possible also between shareholders other than employees. This can happen when a large shareholder buys a share of enterprise output (or supplies a share of one of the enterprise inputs) which is substantially greater (or smaller) than the percentage of company shares held by such shareholder. For instance, if the shareholder holds a percentage of total stock smaller than the share of company output which he purchases, but large enough to influence price policy, the shareholder in question will have a vested interest in pushing prices down, thus gaining more as customer than he/she would lose as shareholder. Or, if the shareholder (or group of shareholders) supplies a share of a given input greater than the percentage of total company shares held, such shareholder (or group) will have an interest in pushing up that input price, thus gaining more as supplier than he/she loses as shareholder.

Such cases can be found. For instance, in the 1970s CAPCO, the Central African Power Corporation jointly owned on a 50/50 basis by Zambia and Rhodesia, produced electricity from the jointly owned Kariba Dam installations for sale to Zambian and Rhodesian electricity companies; Rhodesia, which purchased about two thirds of the power and energy, succeeded by obstructionism to hold the price of both unchanged at what soon became an artificially low level, thus gaining more as a customer than it lost as a shareholder from the low price; the conflict had to be resolved by arbitration. Normally such cases are a rarity, as both the share of enterprise output or input, and the percentage equity stake, must be large and yet significantly different. This condition, however, is automatically satisfied when employees have a majority shareholding, as by definition they also supply 100% of the labour employed - hence the conflict of interest with other shareholders and their ability, as majority holders, to manipulate labour earnings to their advantage as they always lose - as less than 100 per cent shareholders - less than what they can gain as labour input suppliers from higher earnings.

6. EMPLOYMENT SECURITY

To the extent that employees have a say in enterprise management, they will naturally press - with uncertain success unless they enjoy self-management - for protected or at least longer employment tenure. Even self-managed enterprises may allow for the dismissal of redundant employees, for instance grading employment protection on the basis of seniority (the so-called LIFO principle, Last In First Out) or other basis. In practice, however, there will be a tendency for employment reductions to take place through natural wastage, i.e. retirements and voluntary quits, with considerably greater employment stability than in traditional enterprises but still with rigidity of employment and output response to price changes.

More generally, long tenure, i.e. the employee's option on continued employment, like all options has a value (for the employee) and a cost (for the employer), which is usually matched by correspondingly lower pay than that associated with shorter-term contracts.

Employment security can be expected to strengthen workers' identification with the interests of the enterprise, reduce risk from participation and amplify the effects of profit participation even when this excludes increases in the capital value of the firm, by lengthening workers' time horizon.

Employment security, however, has also significant drawbacks. Obviously the indiscriminate protection of job-rights eliminates any incentive to exercise above minimum effort, unless significant satisfaction is derived from doing a good job; to cooperate, to raise skill levels, to improve the efficiency of labour organisation. In enterprises and sectors where demand grows more slowly than productivity, to a higher extent than can be accommodated by retirements and voluntary quits (as for instance frequently today in mining, steel, textiles, chemicals), employment tenure involves inefficient overmanning, often to the point of undermining the financial viability of enterprises.

A conspicuous example of these adverse effects is provided by the experience of centrally planned economies, where a labour market always existed and the same kind of wage employment contract prevailed in spite of state ownership and planning (see above, Chapter 3, section 6), but where the protection of job-rights obtained de facto as a result of endemic excess demand for commodities and labour. High rates of employment turnover and low productivity, typical of centrally planned economies, can be attributed to a very great extent to employment tenure.

The net disadvantages of employment tenure on its own can be tempered by profit- sharing and reinforce the benefits of power-sharing; in turn, any form of participation comes to an abrupt end with dismissal and this very possibility must significantly reduce its effectiveness. The best option, however, is the transformation of employment tenure into job-related "income tenure": what really matters is income security, so that job security could and should be replaced by compensatory payments topping up the income of dismissed workers (i.e. their unemployment benefits or their income in new employment if lower than in their former employment in the enterprise) to the level enjoyed prior to dismissal (see below, Ch. IX section 1).

This form of modified tenure, shifted from employment to income, can be expected to reduce the drawbacks of combined profit-sharing and self-management, briefly sketched above and discussed in the next chap-ter, but does not automatically resolve them.

VI

THE COOPERATIVE ENTERPRISE

1. TYPES OF COOPERATIVES

Among participatory enterprises combining profit-sharing and power-sharing the highest degree of both is to be found in old-style Yugoslav enterprises and in traditional cooperatives everywhere, neither having an outside equity holder. Their general model has been dubbed "Illyrian" (Ward 1958).

In these enterprises employee participation in decision-making takes the form of exclusive participation in assemblies on equal terms (one-man one-vote), the election of self- governing bodies and involvement in the appointment and dismissal of managers. The hierarchical structure of the traditional enterprise is replaced by a "circular" flow of authority, managers exercising authority over employees as in the traditional capitalist enterprise, through enterprise executives, but employees in turn exercising their authority on managers through assemblies and self-governing bodies which take strategic decisions, sanctioned by threat of managerial dismissal and negotiation of managerial terms of employment.

Both in the traditional cooperative and in the Yugoslav enterprise employees have the right to use enterprise capital and share out net value added (net of both amortisation and the service of debt) for the duration of their employment (including retirement), i.e. they have the right of "usufruct" on enterprise capital but no rights to transferable ownership.

Traditional Yugoslav enterprises were created in the early 1950s with the transfer of usufruct to workers subject to a capital tax which was quickly eroded by inflation then abolished outright; ownership was said to be "social" but could be argued to be still vested in the state, which had never formally relinquished it; the social nature of ownership took the form of an obligation to maintain the value of enterprise capital (with considerable ambiguities as to the determination of the real capital to be maintained in inflationary conditions), limits to the share of value added which could be distributed, limits to individual earnings or punitive taxation on earnings above statutory guidelines (see Uvalic, 1992).

. In traditional cooperatives capital ownership can be regarded as being vested in the cooperative movement, since in case of liquidation any residual net capital has to be devolved to other cooperatives (for instance in British or Italian cooperatives). There are often restrictions even on the interest payable on members' direct capital contributions when they exit. These restrictions originate in the historical roots of cooperatives as mutual societies providing a service to members on more competitive terms than otherwise available: hence the implication that profit should not exceed the interest rate so that if, after members' capital contributions have obtained an interest, there is any internal capital accumulation it should be for the general benefit of future members or for the whole society. The restrictions are also rooted in the works of early 19th century utopians, such as Robert Owen, Charles Fourier, Comte Henri de Saint-Simon and especially Philippe J.-B. Buchez, a catholic Saint- Simonian who regarded a cooperative more like a monastic order than as an enterprise.[18]

There are differences, of course, between different national regimes, on issues such as: whether and on what scale non-member workers can be hired at a fixed wage; statutory limitations on the distribution of net income (more liberal in Ireland and Holland, for instance, than in other countries); extent of members' participation in the capital of cooperative enterprises. A protection of members' capital rights considerably greater than usual is granted in the Basque region of Mondragon (Spain), where reinvested profits are credited to members and accumulated for collection on departure or retirement, together with accumulated profits (see Thomas and Logan, 1982; Wiener and Oakshott, 1986). In the cooperatives that have mushroomed in the former Soviet Union, since 1988, members are free to adopt a capital regime of their choice (see Nuti, 1991 c). However, the general features sketched above, in one form or another, are typical and amount to what could be called a form of micro-socialism, not in a derogatory sense but simply to emphasize the presence at the microeconomic level of the standard socialist premises - democratic planning, egalitarianism, social ownership of the means of production - in an environment which otherwise could be indifferently capitalist, market socialist or centrally planned.[19]

In these respects both cooperatives and Yugoslav type enterprises differ from workers owned enterprises in a strict sense, which are effectively a special case of joint stock companies where employees are also shareholders. Mostly this form of participatory enterprise is found in professional partnerships, where newcomers pay out a capital stake to existing members in order to join and, when members leave or retire, their capital stake is bought by the others or, subject to their agreement, transferred to new members.

2. ADVANTAGES

Cooperative enterprises, beside the non-conflictual implementation of widely shared social-democratic and almost philanthropic values, are expected to provide self-help in the fight against unemployment, enhance downward flexibility of incomes and therefore facilitate adjustment to exogenous shocks, harness entrepreneurship, sharpen competition, improve labour relations, raise work satisfaction and productivity.[20] The early and excessive claims of cooperative enthusiasts such as Charles Gide were sharply rebuked by Maffeo Pantaleoni (1898; encouraged by Vilfredo Pareto, see Morley-Fletcher, 1986, pp. LVI-LVII), who saw no difference between cooperative and conventional enterprises - a view which is now restricted to the comparison of long-run equilibria.[21] Modern economic analysis, on the contrary, while not denying the possibility of non-quantifiable major or minor gains from participation in income and decision-making, has been quick to identify a considerable number of at least potential drawbacks, consisting in various forms of inefficiency, inequality and instability in the short and medium run. Most propositions about the drawbacks of cooperatives are drawn from theoretical analysis, rather than direct observation; indeed the cooperative enterprise is very much like the bumble-bee - in theory it should not be able to fly - but then bumble-bees are not the most successful examples of flying machines; there is a lot of room for improvement in their design, as there is in that of cooperatives.

3. DRAWBACKS

In the last thirty years a vast literature (reviewed by Hill-McGrath-Reyes 1981, Pettman 1978 and Bartlett-Uvalic 1986) has discussed seven main alleged economic drawbacks of cooperative enterprises. These are :

i. The unsuitability of cooperative enterprises outside labour-intensive sectors. This is due to worker-members' lack of substantial own capital (otherwise they would not have to work) to invest or to be used as collateral against loans or rental contracts (for instance, see Meade, 1972).

ii. The unsuitability of cooperative enterprises for risky ventures, for instance in sectors subject to sudden large fluctuations or to fast technical change, in view of their inability - being tied to one or at most a couple of enterprises - to diversify risk (for instance, see Meade, 1972). These two factors reinforce each other: lack of capital makes cooperative workers particularly vulnerable to risk and therefore risk-averse; this vulnerability makes potential lenders all the more unwilling to lend and keeps cooperatives out of capital-intensive sectors. These first two propositions correspond to uncontroversial direct observations: nobody expects car factories, oil refineries or steel mills to be operated by cooperatives.

iii. In competitive conditions, restrictive employment policies on the part of any cooperative enterprise paying out incomes per member higher than the supply price of labour outside the cooperative. This is due to presumed maximisation of net distributable income per member: thus employment will always be equal to or lower than that provided in the same conditions by a capitalist enterprise, since a cooperative enterprise can pay no less than that supply price or members would leave, but it can pay more, in which case it would operate at the (lower) level of employment that the capitalist firm would offer at an equivalent wage. This proposition is one of the set pieces of self-management literature ever since Benjamin Ward (1958) first drew the implications of self-centered behaviour on the part of self-managed firms. Implicitly this analysis rests on labour market clearing: if wage- earners are "rationed" in their ability to sell their labour at the going wage, cooperative enterprises might provide greater employment than their capitalist counterpart because of the greater downward flexibility of their members' incomes and their ability to operate in conditions where a capitalist enterprise would fail (See Meade, 1982). This qualification is demonstrated by employees threatened by plant closure often offering to keep the plant open by taking it over collectively; but if cooperative enterprises were only an instrument for enforcing labour income discipline in a recession they still could not claim general viability. The incentive to behave as predicted by Ward must be there, even if it is resisted or weakened or even overcompensated by other considerations.

iv. In the case of monopoly, more restrictive monopolistic behaviour than in the case of capitalist firms, due to maximisation of monopoly profit per man instead of total profit. In fact, in the neighborhood of minimum profit a small output fall would have no effect on profit but would reduce perceptibly labour inputs, thereby raising profit per man. This tendency makes cooperatives most unsuitable to operate public utilities. More generally cooperatives, while unable to exercise inflationary pressure through wage claims, would naturally exercise inflationary pressure directly on prices, so that they would have to be restrained by competition more than their capitalist counterparts (see Meade, 1982). Jaroslav Vanek thought this condition would be fulfilled given the smaller size expected of cooperatives, but there is no evidence of cooperatives being significantly smaller than other firms in their sector of operation; indeed the contrary is true in Yugoslavia, where firms on average have been larger than their counterparts in capitalist countries (see for instance Sacks 1983).

v. Inefficient allocation of labour in the short run, which rather overshadows the possibility of obtaining the same long term, competitive equilibrium - mutatis mutandis - as any market economy. This Paretian inefficiency is due to perverse response to changes in product price, technology and capital rental. In fact, for a cooperative in membership equilibrium:

$$\frac{\text{Total Revenue - Fixed charges}}{\text{Membership}} = \text{Marginal Revenue Product of Labour}$$

If the left hand side (average earnings) was lower than the right hand side it would pay to expand membership, while in the opposite case an increase in earnings would result from a smaller membership. Now, starting from this equilibrium position, a product price rise will raise average net income per man relatively to its marginal product, because the fixed charge is not indexed to the price of the product. The same effect would follow an equivalent Hicks- neutral rise in labour productivity (i.e. occurring at the same rate regardless of the capital/labour ratio) or a decrease in capital rental. The gap thus arising between average earnings and marginal product of labour provides an incentive to raise further average earnings per member through a reduction of membership size if at all possible, instead of encouraging greater employment and output in the short run, in response to the improved relative conditions of the sector in question; the opposite happens for product price falls and capital rental rise; either way, short-term adjustment leads to Paretian inefficiency. This is another set piece of the Ward-Vanek analysis, illustrating the necessary implications of incomeperman maximisation in the one-product one-input-other-than-labour case; Pareto- inefficient adjustment may but does not necessarily happen in the many-products and/or many-inputs case (Vanek, 1970) but, even if then membership changes are in the right direction, they will be smaller than employment changes in an equivalent capitalist enterprise.

Instability may ensue from this perverse adjustment process if the resulting downward sloping supply curve is less steep than the demand curve, demand increases raising prices and inducing a fall instead of a rise in supply (in which case the reverse would happen for demand falls). In any case any move towards a new equilibrium has to take place through enterprise demography, i.e. the birth of new enterprises in case of an improvement of sectoral conditions, or the closure of old ones in the case of their worsening, instead of taking place through adjustments within existing enterprises.

The macroeconomic implications of this drawback are the ineffective and inflationary nature of aggregate demand management in an economy dominated by cooperative enterprises, and its greater price fluctuations as a result of given fluctuations in monetary expenditure, though this is partly compensated by a greater resilience of full employment if it were to be reached; paradoxically, a minority cooperative sector behaving "perversely" will have beneficial anti-cyclical effects and function as automatic stabiliser of labour employment. Another implication of short-run maximisation of income per man is the likely failure of domestic currency devaluation as a policy instrument for improving the trade balance of a self-managed economy, and its inflationary impact, due to supply rigidities with respect to prices in the short run (Bartlett 1987).

vi. the inefficient use of capital in the medium run, due to bias in project selection, i.e. the possible rejection of investment projects having a positive present value (at the current supply price of labour) if they lower average earnings, and the possible acceptance of negative present value projects if they raise average earnings (Vanek, 1970). Positive value projects may be rejected if pre-investment income per member is greater than the supply price of labour, and the positive present value is obtained only for lower earning levels though no lower than the supply price of labour; this happens when an employment- expanding project involves a membership increase proportionally greater than the associated increase in the present value of expected total earnings. Conversely a negative present value project will be attractive to a cooperative if it involves a membership decrease proportionally greater than the decrease it causes in the present value of expected total earnings. The difference with respect to capitalist firms can be summarised thus (PV = present value of the project at the supply price of labour; L = membership; g = associated growth in the present value of expected total earnings):

PV at the supply price of L	> 0	>0	<0	<0
employment growth	> g	< g	> g	< g
capitalist enterprise	YES	YES	NO	NO
cooperative enterprise	NO	YES	NO	YES

This involves a bias against the generation of new employment through investment in existing firms, contrary to what is usually expected of the growth of the cooperative sector. The most attractive investment for a cooperative enterprise is financial, because it does not generate any employment at all; hence the built-in tendency, or at least temptation, for a cooperative to eventually degenerate into a financial holding. Indeed, in the absence of other constraints, in theory this degeneration process if unimpeded would lead eventually to a one-man financial holding: as income from financial assets replaces income from production further opportunities are created of raising net income per member through a reduction of membership parallel to the disinvestment in production activities.

vii. Even in the absence of such distortions in the selection of investment projects, a bias against the reinvestment of net income can be expected, since a cooperative member is entitled to the current benefits of a project only for the duration of his/her membership and does not participate in subsequent benefits or in the residual capital value of the investment (including its possible appreciation due to success greater than expected, or simply to inflation) at the time of his/her departure for whatever reason.

Comparing the reinvestment of a unit of net income within the enterprise at an internal rate of return r or its distribution to members who can consume it or place it in saving deposits at a lending rate i, the cooperative member of expected tenure T, unless swayed by other considerations will be in equilibrium when

r = (i + the percentage annuity obtainable from investing today an amount equal to today's present value of a monetary unit available in T years);

but then

(i + such an annuity) > i, therefore r > i.

If i is also the cost of credit finance to the cooperative, reinvestment will. fall short of the optimum level corresponding to its opportunity cost to members. Hence the occurrence of underinvestment out of self-finance to an extent governed by the age structure of members, undue preference for borrowed funds and the particular importance of financial intermediaries to avoid the possibility of underinvestment in the whole economy (see for instance Pejovich 1976 and Furbobotn 1985).

These contentions can be weakened, but seldom eliminated, by introducing further qualifications. The restrictive bias in membership recruitment may be offset by solidarity with the unemployed, pressure from local authorities or political interference. Perverse response to output price changes, to technical progress and to capital rental changes is constrained by the tenure of members and (as mentioned above) reduced by substitutability in both output mix and choice of inputs, though rigidities would still result. The birth of new cooperative enterprises competing structural profits away from existing ones, and labour redeployment through mergers (Nuti, 1986a) will reduce the short term inefficiency of the cooperative sector. The anti-reinvestment bias will induce greater inter-firm mobility of funds, though the possibility of capital goods in turn being produced by cooperatives amplifies short term instability (Meade, 1982). Growth-mindedness will induce cooperative managers, like their capitalist counterparts, to push for reinvestment; concern for enterprise safety and employment prospects may induce members to support reinvestment in spite of higher shorter term benefits from paid out income. The possibility of borrowing on cheaper terms if there is own collateral and self-finance will induce at least some reinvestment. Loans to firms are usually more expensive than the interest on households' saving deposits, narrowing or even reversing the gap between interest on individual savings and rate of return requested by members on self-financed enterprise investment; but then the increase in the value of assets if investment is successful is not fully (if at all) distributable and cannot be included in the rate of return.

4. INEQUALITY AND INEFFICIENCY

The theory of economic policy highlights the frequent occurrence of trade-offs between equality and efficiency, which can justify a degree of loss of one for a gain of the other, but this is not the case for the Illyrian enterprise, whose systemic inefficiencies (and instabilities) are associated with additional inequality.

First, the employed as insiders can appropriate part of the quasi rents of their enterprises, excluding not only the unemployed but also less fortunate workers employed in other enterprises. There is an incentive to keep out outsiders even when their marginal product would be greater than their reservation earnings, or greater than their earnings in current employment, for fear of diluting current average earnings when these are higher than such marginal product. Thus - barring altruistic behaviour - there is inequality between the employed and the unemployed and among employees of different enterprises and sectors (see Estrin 1979, 1981, Estrin and Bartlett 1982 and Stellaerts 1984; mergers, or employee subcontracting among enterprises, might contain but cannot eliminate such earnings dispersion, see Nuti 1986a).

Second, there is inequality in the distribution among employees of the burden of past self-financed investment, with less senior members participating equally in the fruits of the past reinvestment of income generated by more senior members.

Given this unholy association of inequality and inefficiency attributable to the combination of power-sharing and profit-sharing, for this type of enterprise to be recommended the direct benefits of participation per se must therefore be thought to be overwhelming.

While there is little empirical evidence of this kind of rigid or inefficient behaviour for participatory enterprises, including cooperatives and Yugoslav firms, it would be facile to dismiss it even as an underlying tendency (for instance, Horvat 1986), since it corresponds to perfectly plausible and sensible economic behaviour. More generally, we can consider as evidence of the limited viability of the "Illyrian" firm the demise of old-style self-managed enterprises now being privatised in most of the ex-Yugoslav successor states; the concentration of traditional cooperatives (including regional areas where they are particularly successful and widespread) in a ghetto of low capital intensity, low risk, mostly small size activities (such as construction, agriculture, food processing, handicraft, transport and other services); their tendency towards financial growth, and difficulties in raising risk capital; the recent evolutionary trends of Italian cooperatives towards the protection of members' capital rights and the association of capital-contributing members; the present degeneration of Israeli kibbutzim into inegalitarian joint-stock companies (Haberman 1993). Oxbridge Colleges, also combining elements of self-management and de facto profit-sharing, seem to partake of the same kind of drawbacks predicted by the Ward-Vanek literature (such as restrictive employment, the maintenance of high living at the expenses of self-financed investment, their tendency to turn into financial institutions). Recently, in transitional economies and especially in Poland, where a considerable degree of self-management has remained in operation in the first years of the transition, there is evidence that enterprises have maintained employment and earning levels regard-less of profitability, tax regimes and even cash flows, building up vast payments arrears between themselves and vis-a-vis the Treasury and banks. Conversely, the outstanding success of Chinese cooperative institutions, the Township and Village Enterprises (TVEs), can be attributed to its being open to local residents, thus lengthening the time horizon of members and avoiding membership adjustments possibly in adverse directions. All in all, the vision of a participatory economy made up of cooperatives or similar self-managed enterprises (Vanek 1971) does not appear to be an economically viable proposition.

5. ALTERNATIVE SOLUTIONS.

At least six main basic approaches have been proposed to reduce or eliminate the inefficiencies and inequalities tendentially associated with self-managed enterprises: Meade's unequal partnerships, the marketability of jobs by enterprises and employees (Schlicht- Weiszacker and Sertel), free access of workers to any enterprise of their choice (Hertzka and Lange-Breit), workers' competitive access to enterprises on the strength of a free capital stake (Tibor Liska's "entrepreneurial socialism"), workers ownership stakes in the enterprise which employs them (through ESOPs or ESOTs, i.e. Employee Stock Ownership plans or Trusts), James Meade's fully participatory enterprise. The first five approaches (Chapter VII) are only partial solutions and raise other problems, whereas a version of James Meade's latest proposal (Chapter IX) seems to provide a satisfactory solution, a pre-condition of which is a re-definition of profits to include capital gains (Ch. 8).

VII

UNEQUAL PARTNERSHIPS, JOB ACCESS AND CAPITAL-SHARING

1. JAMES MEADE'S UNEQUAL PARTNERSHIPS

James Meade (1972) proposes a labour partnership differing from the traditional cooperative in the inequality of members depending on the conditions prevailing at the time of their joining the cooperative. Founders presumably stipulate equal shares, but new members are hired at an income equal not to current average earnings per member but to the value of labour marginal revenue product, i.e. new members are given a number of "shares" such as to guarantee that level of current income, and are exposed to its fluctuations per share for the rest of their membership.

The object of the cooperative now becomes the maximisation of income not per man but per share. At the cost of income inequality between members, and the inequality of voting power involved in unequal shares, most of the drawbacks of cooperatives are eliminated. The proposed institution remains - like the traditional cooperative - unsuitable to capital-intensive and risky ventures, and retains a reinvestment aversion, but the other drawbacks are no longer present. Restrictive employment policies would end; any worker whose supply price is no higher than the marginal revenue product of labour will be offered employment. The over-monopolistic bias of cooperatives also ends, again because total earnings of existing members are maximised, not earnings per man seeing that new men do not get more than their contribution to additional monopoly profits. When a rise in product price lifts average earnings more than labour marginal revenue product, the partnership will recruit new members instead of seeking to reduce its size - offering an income lower than that of existing members but higher than offered before the price rise; hence no perverse or rigid responses ensue. The same will happen with technological change, or rental change. There will be none of the macroeconomic implications of perverse responses; nor any need to rely exclusively on the birth of new firms to move towards a higher output and employment equilibrium.

There will be no labour-saving bias in the selection of investment projects, since lower than average earnings can be offered not just for the current period but for the rest of new members' working life within the unequal partnership (though Meade does not seem to be aware of this implication, asserting instead the equal attraction of credit-financed investment for capitalist firms and cooperatives even in their more traditional form).

Meade advocates provisions for workers leaving the partnership: they may be "bribed" to leave voluntarily to the benefit of all parties, if their marginal revenue product becomes lower than their average earnings (as would result from a product price increase); they may also, however, have to compensate those who remain, if their departure leads to a fall in average earnings per member and jeopardizes the cooperative's ability to repay loans or pay fixed charges 22

The basic drawback of the proposal, apart from the residual limitations of traditional cooperatives indicated above, is the introduction of unequal pay for equal work, a principle generally accepted in professional partnerships but unlikely to be acceptable in industrial enterprises. Inequality now at least is traded off for efficiency, but remains in a different form, internally rather than across enterprises and sectors.

2. MARKETABILITY OF THE LABOUR CONTRACT

Another proposal seeks to eliminate the inefficiency of combined profit-sharing and power sharing also through unequal treatment of members, by making jobs freely marketable at a price by member/employees and by expanding enterprises; here the inequality is not in the income per equal work, as in Meade's unequal partnerships, but in the price that each worker will have paid for his/her job. This institutional set up has been investigated by Schlicht and Weiszacker (1977) in the search for efficient modifications of labour-managed enterprises: "These tradable job rights are the precise analogue of tradeable shares in a capitalist environment" (Schlicht and Weiszacker 1977, p.60). This system may be unpalatable or at any rate unrealistic as a possible arrangement for industrial labour in large scale production, but is not all that absurd: it is, after all, the system prevailing in professional partnerships, and even in conventional cooperatives sometimes there is a de facto, if not de jure, ability to nominate a successor or to transfer one's job to a relative.

Schlicht and Weiszacker presume that "Holders of these job rights will make decisions in accordance with the long run interest of the firm, because they want to maximise the present market value of their tradable job rights" (1977, p.60). This is not so; here the two authors make precisely the kind of mistake carefully avoided by James Meade: maximisation of return per job, i.e. per physical unit of input, is not the same as total profit (or present value) maximisation. The value of a job right must be equal to the present value of expected job differentials over time, with respect to the supply price of labour at the same times; this is maximised by maximising the present value of net income per man, which takes us back to the Ward-Vanek problems, except for the anti-reinvestment bias, which here disappears due to members' time horizon becoming virtually infinite. Any incumbent worker receives the same earnings as the other employees, who cannot appropriate the increase in the net worth of the enterprise deriving from additional employment. Unless newcomers can be paid less than the other employees - in which case we are back to Meade's unequal partnership - or present workers acquire an ownership stake in any increase in the enterprise net worth resulting from investment (see next Chapter), the adverse implications of earnings-per-man maximisation cannot be fully eliminated.

The proposed scheme is only a partial solution to the cooperative problems discussed in the previous Chapter. Namely, it achieves:

i. The elimination of the anti-reinvestment bias, because of the lengthening of the time horizon of cooperative members beyond their own expected tenure;

ii The attenuation and possible reversal of the perverse response to price increases and of the labour-saving bias in project selection. In both cases the expansion of employment, say at the percentage rate z, is associated with a reduction of current members' income, say from y to y'. If y' is greater than the supply price of labour w, however, the enterprise can overcompensate members for their income loss by distributing to them the revenue from the sale of jobs, i.e. an individual bonus equal to the present value of $(y' - w)*z$ (both present values now taken over the whole life of the enterprise, given the indefinite extension of the time horizon achieved under this scheme). Thus the perverse response to price increases and the labour saving bias of investment project selection will be eliminated if $(y' - w)*z > (y - y')$. Since the residual"pure profit" component of members' income $(y' - w)$ after employment expansion is weighed by what must be supposed to be a fairly small magnitude z, this effect is unlikely to be major.

However, the same considerations would also amplify the perverse effect of price falls, as the incentive to raise membership in that case would be similarly amplified by the bonus that the cooperative could distribute to current members out of the sale of additional jobs. Thus the proposed scheme is not the desired solution of the efficiency and distribution problems of cooperative enterprises.

The same proposal, with the same limitations, is put forward by M.R. Sertel (1987), who in addition confuses potential with reality when he claims, in the title of his contribution, that "Labour managed firms are not inefficient".

3. WORKERS' FREE ACCESS TO EMPLOYMENT

The most radical, utopian modification of labour relations is that envisaged by Theodor Hertzka (1981), echoed in Poland by Oskar Lange and Mark Breit (1934): "free access" by workers to employment in any enterprise of their choice (see also Chilosi 1986 and 1992). This would guarantee the elimination of involuntary unemployment, but has a number of devastating drawbacks. First, competition would equalise average instead of marginal product of labour in different enterprises, thus leading to inefficient allocation of labour employment. This could be reduced by mergers between firms with different marginal product of labour, though the process would lead to excess industrial concentration of an artificial kind, as it would not be dictated by economies of scale nor by the internalisation of external economies. Alternatively, additional arrangements would have to be introduced, such as the tradeability of enterprises' obligation to hire workers, an obligation which enterprises characterised by the higher marginal productivity of labour would be able to discharge at a profit (see Nuti, 1983).

Second, the problem arises of measuring both skill and effort, of checking a worker's suitability to a particular job, independently and not by insiders presumably adverse to employment expansion for fear of in-come dilution. This problem, incidentally, arises also in the case of tradable jobs: professional partnerships, as well as cooperatives, usually vet be-forehand the suitability of potential new members - not everybody can join.

Third, if there are private owners they are effectively disenfranchised, losing control over the variables determining their profits; not even employees would have any incentive to reinvest in their enterprises; even in a state ownership economy, investment would have to be centrally funded.

Although unworkable, the Hertzka-Langa-Breit formula is closely associated with, a number of ideas which on the contrary might be useful and practical, such as: i) the idea of work-sharing, of which this formula. is an extreme case;[23] ii) the idea of an obligation to hire (of course limited instead of unlimited as in their model), vested in the ownership of enterprises, as it was done for instance in Italian farms after the last War (the so-called "imponibile di manodopera"), or in some of the state enterprises privatised by Treuhandanstalt in Eastern Germany after German reunification; iii) the idea of a generalised claim, qua citizens, to a basic income or a basic capital endowment if not to basic employment (see below, Chapter 9, section 4); (v) the idea of an Employer of Last Resort, as a state agency which, possibly subject to budgetary constraints set in the state budget. might employ as many workers as it can afford at the going minimum rate and then "lease" them out to enterprises at the highest spot rate that it might be able to obtain, or employ them in public works. These, however, are wider forms of economic democracy, rather than of enterprise democracy; they belong partly to discussions and achievements of the Nordic or Scandinavian model of social corporatism (see Pekkarinen et al., 1992), partly to an uncharted area of institutional engineering.

4. TIBOR LISKA'S "SOCIALIST ENTREPRENEURSHIP"

The Hungarian reformer Tibor Liska (1963) proposes a different form of workers' access to employment, which involves free access to a capital stake and competitive access to specific enterprises. For Liska any individual is entitled, by birthright and for life, to a share of the nation's net capital; he receives a guaranteed minimum income as a return on his share, paid out of the revenue collected by the state budget from tax out of state and private enterprises and from the revenue of state capital leasings. Individuals spend their guaranteed income partly to purchase goods that in other socialist models are provided as public consumption; however, the main purpose of the "Social Dividend" is that individuals can use it to bid competitively for the rental of state owned capital goods.

At the time of transition to this system, and whenever new capital goods are produced, state owned capital goods are leased by state authorities through auctions, starting from a base rental fixed by those authorities. However, at any time anybody can secure the lease of any set of capital goods owned by the state by out-bidding current users, forcing them either to release the capital goods in their possession or to match the higher rental offered by the challenger.

Individuals can bid for rentals on their own account or jointly with other individuals to form a cooperative enterprise. If successful in securing the required capital goods the enterprise (individual or group) organises production freely, may hire additional workers as new members or as wage labour; receives, distributes according to previously agreed rules or retains any value added net of the charge lease and other contractual payments.

Unsuccessful bids are not fruitless. All bids, whether successful or not, reveal an ability to do better than the previous bidder or the present user or, for newly produced goods, to do better than anticipated by the state authority originally setting the starting price at auctions for capital goods. In any case all bids reveal that the goods could be used yielding a productivity higher than that currently imputed to them, and for both successful and unsuccessful bids the additional rental associated with each bid does not go to the state but to the challenger, to reward the additional ability revealed and the informational function of the bid: "the overbid belongs to the bidder".

In this world anybody who has the necessary know-how and loves risk-taking can be an entrepreneur; others will prefer fixed wages, or mixed contracts to be stipulated with entrepreneurs or with entrepreneurial teams. Income could be freely spent or accumulated; at death, all of one's capital - the notional share out of which an interest is paid as basic income, and any accretion during one's lifetime - would revert to the state, and become part of the general pool out of which individual stakes are determined and, presumably, periodically adjusted.

Thus in Liska's approach a citizen's income has the function of an entrepreneurial stake. The other function of his basic income, i.e. free choice in public consumption, conflicts with it, unless basic income is high enough to cover both publicly provided needs (health care, education) and entrepreneurial resources.

Liska's scheme raises a number of unresolved problems. The first is the medium- long term nature of bids, and therefore the necessity of a "validation" process of the credibility of bids, similar to financiers' endorsement of investment projects in a capitalist economy. Then, the size, scope and durability (or, rather, volatility) of firms resulting from Liska's scheme may be at odds with the requirement of efficient organisation of production. Finally, special financial institutions would be needed to allow bidders in low capital intensity activities to make their funds available to above aver-age capital intensive activities, in an environment dominated by cooperative firms continuously splitting and regrouping (for a fuller treatment of these points see Nuti, 1991a).

5. CAPITAL-SHARING

Automatic participation in both profits and decision-making is involved in workers' shareholdings in the enterprise which employs them. Distribution of shares to employees is today a growing form of profit-sharing, which lays the foundations for continued further and wider participation: ESOPs, or Employee Share Ownership Plans, typically involve the payment of part of employee earnings into a trust fund used to buy the company's shares and to either distribute them to employees after a period of time or on retirement, or hold them to pay cash benefits to all employees thereafter (in which case it is ore appropriate to talk of ESOTs, or Employee Share Ownership Trusts; see Uvalic, 1991). These schemes involve forms of employee ownership of a capital stake in their own enterprises, and therefore must be distinguished from generalised distribution or sale of shares to the population at large. These are forms of "property owning democracy" or "people's capitalism"; they correspond to a project of generic economic democracy and not of specific enterprise democracy, *for* which *they are* often *conceived as a* substitute.[24]

ESOPs and ESOTs can be expected and indeed appear to have the beneficial effects of profit-sharing and power-sharing. In view of the modest share of equity capital that is usually attributed to employees the degree *of power-sharing and* profit-sharing *gained by* workers *is* equally modest;[25] this has the redeeming feature that the inefficiencies involved by full participation can be ruled out, but in turn there is no basic transformation of the employment contract towards significant enterprise democracy.

A potentially more important form of collective equity holdings by employees is that of workers' investment funds, of a kind introduced in Scandinavian countries after the Rehn- Meidner Plan in the 1980s (Meidner 1978,1987). The payment of a small share of wages into a nation-wide and diversified investment fund, which would pursue a policy of profit reinvestment, was originslly intended - and feared - as an automatic mechanism of gradual collectivisation of private capital. However this is only a temporary effect, which must necessarily stop once the fund is used to pay out redemptions or benefits, well short of "nationalising" a significant equity stake in national capital (George, 1985). Thus wage earners' funds have become no more than supplementary pension funds (Pontusson, 1987). These are certainly better than those pension funds which obtain a below- market return on their own and their employers' pension contributions; or where contributors, as in the UK, do not have *access to* surpluses *arising after the* payment *of pensions,*[26] *or* control *over* them (vide the multi-billion pounds fraud that Robert Maxwell & Sons were able to perpetrate in the UK against their own companies' pension funds). Wage-earners' funds, however, especially if managed in the interest of employees rather than of the labour force as a whole (including the unemployed), alter only very marginally the labour contract, for the delayed and contingent pay represented by supplementary pensions.

Conventional ESOPs and ESOTs have additional limitations. If shares are distributed directly to workers and are immediately transferable they are equivalent to a cash benefit and the scheme is no different from ordinary profit-sharing, out of which employees always can buy, if they wish, an equity interest in their enterprises. If the shares are not transferable immediately, or are held in trust for later distribution to employees after a number of years or on retirement, there is an element of illiquidity and of involuntary, non-diversifiable risk- taking; the provision smacks of pater-nalism (if workers were given cash they would not invest in their enterprises, whereas this is good for them, so it has to be done willy nilly on their behalf .....).

As long as the shares are immediately or (as in ESOPs) eventually distributed to employees, the scheme has the advantage of extending profit sharing also to a participation in any increment in the value of the enterprise which employ them. This is an important improvement over ordinary profit-sharing, which deserves further consideration (Ch. VIII.)

VIII

PROFITS AND CAPITAL GAINS

1. A RE-DEFINITION OF FULL PROFITS

The definition of profit as a cash flow excludes workers from participation in a most important element of entrepreneurial reward (penalty), namely the likely increase (decrease) in the value of the enterprise as a going concern. For full participation in entrepreneurial profit workers ought to share also such a change in value which is due to a market reassessment of future profits prospects out of old and new investments. This "full" net profit, in line with an economist's though not an accountant's definition of profit, can be easily calculated as the sum of distributed profits plus the increment in the value of the enterprise during the period (whether due to net investment or to a revaluation of future profits expected from older capital).

Should a proof be needed, it is provided in Nuti, 1992:

Let us call

FNP = Full net profits (understood as "full enterprise income" over a time period, i.e. operating profits net of depreciation but inclusive of that part - positive or negative - of the change in enterprise value which is over and above the value of self-financed net investment in the current period);

P = operating profits (gross of depreciation but net of interest payments on external finance);

D = depreciation;

DV = change in the market value of the enterprise as a going concern;

DP = distributed operating profits;

RP = reinvested operating profits;

NIP = net investment out of operating profits;

DVR= change in the value of the enterprise over and above reinvested profits, i.e. revaluation of profit prospects from already existing capital plus net present value of all investment over the period regardless of source of finance.

By definition,

(1) FNP P-D+DVR,
(2) P DP+RP,
(3) RP NIP+D,
(4) DVR DV- NIP.

Therefore using (2) - (4) we can rewrite (1) as:

(1')FNP = DP+RP-D+DV-RP+D=DP+DV.

Thus, although D is a purely arbitrary accounting convention and DVR is not directly observable, full profits can be expressed as the sum of distributed profits and the total increment in the value of the enterprise due to both revaluation of profit prospects and net investment over the period. (Since the net contribution of external finance to enterprise value is included under DVR, the value of new loans is automatically matched by a corresponding amount of new assets and therefore, does not appear in the enterprise valuation).

2. FULL-PROFIT SHARING

The workers' share of full profits can be paid out of distributed profits or, necessarily if their claims jointly with those of shareholders add up to more than distributed profits, in enterprise bonds and/or shares issued free of charge.

This fuller form of profit sharing would have to apply to capital losses as well as gains, if necessary through withdrawals of shares and bonds also without payment, or through transfers of debt to workers; their earnings in cash and capital issues (or withdrawals) would be markedly more variable than if they shared profit as a cash flow (and, moreover, if they did not share losses). Because of workers' inability to diversify their labour employment to any meaningful extent, they would be bound to accept this kind of exposure only if it were to be partial, i.e. affect only part of workers' earnings - a part which could be collectively or individually negotiated - and preferably if it was compensated by economy-wide forms of income support (see next Chapter).

Once employees share not only profits as cash flow, but also increases (and falls) in capital values, they will not be tempted to restrict employment (as long as capital gains from employment expansion are not at first shared among newcomers) or respond perversely to price changes;

other things being equal, they will behave no more monopolistically than a conventional monopolist; they will be indifferent between self-financed investment, now fully credited to them, and distribution of profits; they will not favour labour-saving biases in investment projects. If conventional cooperatives were put on this footing, they would also be in a better position to attract risk capital, thus potentially moving out of their traditional preserve of low-risk small-size low-capital-intensity activities.

It is no accident that the current trend in the development of cooperatives, both in the transitional countries of Central-Eastern Europe and in the West, is to extend workers- members' capital rights (as it is already done in the Mondragon group; see Thomas and Logan, 1982; Wiener and Oakshott, 1986) and to open membership to suppliers of risk capital. These developments would bring cooperatives closer to the kind of labour-capital partnership envisaged by James Meade (1989) and illustrated in the next Chapter.

3. CAPITAL VALUATION

This approach presumes a competitive market valuation of enterprise assets; for listed joint-stock companies this could provided, for better or worse, by the stock exchange; for other enterprises some alternative procedure would have to be devised, such as a challengeable self-valuation of assets on the part of enterprise managers, accompanied by an obligation to surrender or revalue enterprise assets at the self-assessed prices (more details are given below; this is a variation of a method proposed by Maurice Allais for the purpose of assessing the tax basis of a capital tax; see Allais 1970 and Nuti 1988a). Alternatively, we could imagine introducing the marketability of jobs as in the Schlicht-Weiszacker proposal, however with the provision that capital distribution by enterprises should be such as to make the market price of jobs equal to zero: this would ensure that the capitalisation of any expected "pure" profit (over and above actual or imput interested on invested capital) would be distributed to existing employees before further employement expansion.

A self-assessed and challengeable valuation of enterprise capital, in economies or sectors not covered by financial markets but otherwise fully monetised and marketised, would require a set of fairly simple procedures, such as the following:

i. Enterprise managers are asked to assess the current value of their productive assets, as a whole and for specific components (such as individual plants) exceeding a certain ceiling, and to register it with a central public record office; if managers do. not provide such a valuation by a given date the central record office automatically enters the book value of enterprise assets.

ii. At any time subsequently any other enterprise or individual can bid for the enterprise's productive assets, as a whole or for a specifically listed plant or other large item. When this happens either the challenged enterprise revises upwards the valuation of its assets to the point that the request to purchase is withdrawn, or has to sell at the highest valuation offered. If the bid is for a section of the enterprise assets the enterprise can link it to other sections but has to prove that there is a technological connection between the two sections. If there is a sale, revenue is first used to satisfy creditors; any remainder is retained by the enterprise unless it has sold its entire assets in which case any net residual value is transferred to the enterprise's shareholders.

iii. At any time the enterprise can alter its capital valuation registered with the public records office, raising it as new capacity comes on stream or as the profitability of its products increases, or lowering it in consideration of wear and tear, obsolescence, or falls in the profitability of its products.

iv. Unsuccessful bidders are paid by the enterprise a small commission on their raise over the last previous bid (or over the initial value for the first bidder).

These procedures would provide a continuous, non-bureaucratic, decentralised and automatic evaluation of enterprise capital, whose periodical changes 'could then be taken as the basis for the determination of enterprise full profits for the purpose of full-profit sharing. Incidentally, such capital valuation would make it possible to assess past performance and guide current allocation, and would promote also inter-sectoral and inter-enterprise mobility of physical capital, necessary to ensure its efficient use.

Such procedures could be introduced even in state enterprises. If managerial incentives of state enterprises were linked to the rate of full profit earned on the previous capital valuation, any overstatement of current capital values would be discouraged because it would make it harder to obtain any given profit rate on an overvalued capital. State enterprises would have an incentive to use their capital equipment in the way that maximises its valuation and a disincentive to invest in ventures which might reduce the net value of their assets. Indeed, such procedures could have worked even in a "market socialism" system with still dominant or even exclusive public ownership: some of the tasks usually expected of a capital market could be replicated without a bureaucracy and with a minimum of financial innovation without touching at all the constraints of public ownership.

More generally, in any market economy the valuation as a going concern of a company not listed in the stock exchange could be obtained less satisfactorily but more simply, by forcing employees and shareholders to play a simple game at the request of any of them. Let the enterprise managers attribute a tentative and non committal capital valuation to the enterprise; this will imply an imputed value to company shares. Employees participating in "full" profit sharing stand to benefit from a higher valuation of enterprise capital; if this initial evaluation is not acceptable to one or more employees let the one who proposes the highest valuation quote his/her price. Let any shareholder decide whether he/she wants to be a buyer or seller at that price. If there are neither buyers nor sellers shares among shareholders, that price gives the correct valuation. If there are sellers, the employee must be forced to buy a prefixed number of shares at that price, and the game is repeated. If there are buyers among the shareholders, the high-bidding employee must be prepared to sell the same prefixed number of shares and, if he/she has not got them, must be committed to deliver them later plus any dividend which would have accrued in the meantime; the buying shareholder places the price of the shares in an account in the bidding employee's name, blocked until the delivery of the transacted shares. The game can also be repeated, until the share price reached is no longer challenged.

These procedures are an extension of the simpler game that even children play when dividing up a cake in two: one divides it up, the other chooses. Here one assigns a price, others decide whether they want to buy or sell, i.e. they have to "put up or shut up". The broader the number of players (all in the "external" procedure for capital valuation proposed at the beginning of this section, only shareholders and employees in the "internal" valuation procedure then suggested), the closer the results of these procedures to replicating the functioning of a full fledged stock exchange. Thus there is no reason why "full" profits inclusive of capital value changes should not be used as a basis for profit sharing even for state enterprises and for other companies also not listed in the stock exchange.

IX

JAMES MEADE'S FULLY PARTICIPATORY ENTERPRISE

1. FROM DEPENDENT WORKERS TO ENTREPRENEURS

James Meade (1989) proposes the fullest form of participation in enterprise decisions and results, without any of the drawbacks associated with alternative departures from the wage employment contract. Meade's participatory enterprise is a development of the unequal partnership (Meade 1972) discussed above (Ch. 7, Section), extended from partner/ workers to members contributing only capital, including the recognition of capital contributions of member-workers in the form of self-financed investment (Meade 1982 Appendix E and 1986a, b, and above all 1989 and 1993). The proposal still involves income inequality for equal work, but as we shall see it is perfectly possible to transform this inequality (which is likely to be unacceptable) into inequality in capital stakes (which is no different from wealth inequality in a capitalist economy). Meade (1989) labels his book "Agathotopia", i.e. literally a possible "Good Place" where his participatory enterprise might be implemented, rather than a "Utopia" nowhere ever to be found (see also Morley-Fletcher, 1990).

The simplest way of illustrating Meade's scheme is by imagining the transformation of an already existing capitalist firm. At the point of transition the level of enterprise value added (net of amortisation and tax) in the last period and the number of existing shares are considered; workers and all other recipients of contractual incomes (rents, interest, patents, etc.) are given a number of free shares - let us call them contractual shares - which have the same duration of the underlying contractual relation but otherwise are paid a full dividend like ordinary shares (Meade calls them Labour shares but in principle could be attributed also to other contractual suppliers of services of fixed factors, such as land or capital equipment or funds; since duration is the only difference with respect to ordinary shares it seems preferable to label them "temporary"). All value added (and in some cases additional distributable surplus whose determination is discussed in the next section) is distributed as cash dividends or issues of free ordinary shares.

Initially contractual income recipients receive the same income which they would have obtained contractually; from then on they obtain a yield on their temporary shares. Workers are entitled not to job security as such but to a continued income at a guaranteed level even if they are dismissed, i.e. job tenure is transformed into job-related income-tenure (as indicated above, Ch. V, section 6).

While all shares (both contractual and ordinary) would entitle to identical dividend and voting power, on issues where a potential conflict remains between the two categories of shareholders decisions would have to be taken by a majority qualified by its composition, or referred to outside arbitrators. The two kinds of shareholders (effectively, capitalists and labourers respectively) each separately elect the same number of members of the Board of directors, who in turn appoint a Chairman who exercises a casting vote; the Board appoints a general manager in charge of the day-to-day conduct of business, and determines other major policy decisions.

In Meade's scheme the degree of power sharing is neither purely nominal nor excessive; it is genuinely parithetic, with conflicts resolved by the jointly appointed Chairman or by pre-determined outside arbitrators, thus generating neo-corporative institutions at the microeconomic level. Any desired degree of additional industrial democracy, i.e. employees' control over the organization of labour, may be added to the scheme. Any' remaining inequality would be due to differences in risk taking and saving, not to unjustified appropriation of quasi rents due to insider/outsider positions. The advantages of participation in decision-making and results would remain, and would not have to be overwhelming in order to make the scheme attractive as they would have to be otherwise.

2. DISTRIBUTION ALTERNATIVES

Meade's participatory enterprise comes in six varieties, obtained combining two alternative definition of distributed surplus and three alternative provisions for the treatment of retiring workers. It would seem that these complications arise from Meade's treatment of capital gains in real terms (instead of the monetary terms employed in the previous chapter), and that otherwise the participatory enterprise can be unified into a single type.

In all cases the distribution of surplus over and above the cash flow of the enterprise takes the form of free issues of ordinary capital shares to all shareholders (temporary and ordinary); one could broaden this pro-vision to include as an alternative the free distribution of bonds. Cash dividends are paid very frequently - since for workers they take the place of weekly or monthly wage payments - and a "dividend equalization fund" is set up in order to smooth out dividend payments over time. Some conflicts could still arise in the distribution of profits: promotion of employees would take the form of distribution of additional temporary shares, which would have to be negotiated; strikes could still take place in order to attempt a redistribution or an increase of temporary shares in favour of a group of factor owners; employees might press for additional allocations in kind, for instance in the form of social amenities reserved to employees. In these cases Meade advocates arbitration procedures.

Distributed surplus is defined by Meade either as the amount which could be paid out to shareholders while maintaining the real value of the enterprise capital value (the capital maintenance principle); or as the amount which could be paid out to factor owners for the duration of their temporary shares if there was no change in the quantities of factors employed (the income maintenance principle). In an unchanging situation there would be no difference between the two principles, not even after tax as Meade envisages an income tax scheme which exempts savings; but in a changing situation the difference can be substantial, especially in the treatment of temporary profits.

Factor incomes under either scheme are notionally split into a cost element (the market supply price of the factor) and a "pure profit" element (the rest, if any, being imputable to enterprise success). New partners would be offered a number of temporary shares corresponding to their supply price, i.e. without an initial element of "pure profit"; if the enterprise is successful they could later on also obtain dividends on their shares higher than the going supply price; alternatively, an entry charge is contemplated (as in the proposal by Schlict-Weiszacker and Sertel; see above for possible objections, Ch. VII, section 2).

As in Meade's unequal partnerships discussed above (Chapter VII, section 1), this provision leads to unequal pay for equal work. It would seem preferable to cream off the pure profit element of dividends to the advantage of existing shareholders, through distribution of additional ordinary shares, to the point of reducing subsequent dividends on temporary shares to the supply price of the underlying factors so that newcomers can be given exactly the same number of temporary shares. This provision would not be purely cosmetic: it would capitalise pure profits and genuinely reward the entrepreneurship of existing members without altering the principle of equal pay for equal work: existing members would obtain higher incomes than newcomers by virtue of their holdings of ordinary shares, undistinguishable from any other ordinary shares which they may have purchased out of their cash savings, and not through visibly discriminatory treatment of their current services. Moreover, any pure profit that might materialize will lead to an increase in the value of the enterprise, and therefore the maintenance of that value should allow for the distribution of additional shares as dividends to existing members in any case.

On retirement, workers would receive a contributory pension plus a possible continued participatory income. Three possible regimes are envisaged, according to three alternative rules. The first is the rule of redistribution, under which the temporary shares of retiring workers would be redistributed to the remaining ones; this would maintain unchanged the share of employees incomes in distributed surplus, but it is difficult to see the merit of this particular rule. The second is the rule of retention, whereby workers would retain until death a number of temporary shares corresponding to the pure profit element of their income at retirement; if the pure profit element of earnings was distributed to current members at all times in the form of additional capital shares there would be no need for retiring workers to retain their temporary shares until death, because all "pure" profits expected to accrue after their retirement would have been already paid out to them in the form of free capital shares. The third retirement provision is the rule of cancellation: temporary shares would simply be cancelled on retirement; this may unduly cut off workers from enjoying delayed and risky profits - unless, again, any pure profit element of earnings had been converted into free ordinary shares.

It would seem that if distributed surplus was defined as the amount payable while maintaining the monetary value of the enterprise, and if this surplus was entirely distributed to all shareholders - in cash or bonds or shares - temporary shares could be cancelled at retirement and there would only be a single, unified regime for the participatory enterprise.

Whatever the regime selected, possible reductions in the value of the participatory enterprise, over and above what can be accommodated by holding cash dividends below the enterprise cash flow, could be handled through a free withdrawal instead of a free distribution of bonds or ordinary shares. A free withdrawal of ordinary shares from holders of temporary shares would expose them fully to entrepreneurial penalties, whereas no such provision would be necessary for ordinary shareholders as in their case proportional withdrawals (or distribution) of shares would leave unchanged the value of their holdings. Temporary shareholders' exposure to such capital losses may have to be limited to the amount of shares previously distributed freely from earlier capital gains. In order to ensure solvency of temporary shareholders in the discharge of this obligation in case of falls in capital values, their freely issued ordinary shares may have to be subject to a lien for a period of time before they can be sold. Otherwise, on receiving ordinary shares as part of their earnings, temporary shareholders could, and indeed would be well advised to, trade them for shares of other enterprises in order to diversify their portfolio and reduce risk. Nevertheless, workers would be exposed to greater income risk than under the wage employment regime. This exposure could be reduced either through forms of part-time participation, or through provisions for the payment of a basic income to all citizen (Meade's Social Dividend).

3. PART TIME PARTICIPATION

In order to reduce risk, in the impossibility of physically diversifying their employment, workers could be allowed to choose to continue to be employed at a fixed wage, wholly or partially (say, 75 per cent of their work time as partners and 25 per cent as fixed wage workers). Even those workers who chose to remain employed under a standard employment contract would do so through choice, not out of necessity; this would alter the whole nature of the standard employment contract even if participation remained simply potential. Lenders and other longer term factor suppliers who were not particularly concerned with enterprise performance could also choose a contractually fixed payment for their services. In this case the distributed value added would be net of fixed wages, fixed rents and fixed interest payments.

4. BASIC INCOME

Before considering Meade's use of a Social Dividend as a way to reduce individual exposure to risk generated by his participatory enterprise it may be useful to consider more generally alternative forms of basic income, modes of its finance and the arguments put forward for its introduction.

In common language basic income includes apparently different notions and sources. Namely there are two notions, respectively:

i. A fixed income accruing to everybody by virtue of membership of a community, i.e. a citizen's income;

ii. A graded supplementary income accruing exclusively to those citizens who do not reach a minimum income level ,i.e. a minimum income guarantee.

A citizen's income, in turn, may have different alternative sources of finance:

i. it can be regarded as the individual share of the distributed profit obtained from publicly owned net assets, i.e. literally as a national dividend;

ii. it can be a redistributive transfer across citizens, funded out of taxation or out of state budgetary deficits, i.e. a negative poll tax.

The other notion of basic income, as a guaranteed minimum, can be either fixed or variable. It can be a guaranteed fixed subsistence level, in which case the scheme is a negative income tax at a fixed rate up to subsistence income; seen from another angle it is also a "poverty trap" in that up to the guaranteed income level there is a 100% fiscal clawback of other incomes in the form of lower supplementary payment. Alternatively there could be a negative income tax at a falling rate up to an income level higher than subsistence, in order to alleviate the disincentive effects of fiscal clawback.

Citizens' income and minimum income guarantee appear as radically :different approaches and indeed have different justifications and modes of implementation. These differences however are illusory due to the very presence of taxation. Even if a citizen income is paid to everybody, if more of it is clawed back in tax from the richer recipients than from the poorer ones the system is indistinguishable in practice from an income guarantee.[27] Both notions amount to a supplementary net income for the needier, accompanied by higher taxation from the richer taxpayers: thus both approaches can be described by a. function linking pre-tax and after-tax income; the difference being one of the parameters.[28] It is conceivable that two otherwise identical societies by the same pre-tax income distribution, one with a citizen's income scheme and the other with a minimum income guarantee scheme, might end up with the same after-tax income distribution. Indeed, for an equal commitment to egalitarian policies on the part of the government, and equal incentive effects of income redistribution, one should actually expect the same after-tax income distribution under different schemes.[29]

The two alternative notions are indistinguishable also as to the source of finance: if government revenue consists not only of profits but also of tax of any kind it is impossible to establish whether the citizen's income is paid out of one or the other[30].

Instances of basic incomes can be found for instance in France, where a "Revenue Minimum d'Insertion" and a "Contribution Sociale Generalisee" were widely debated and were introduced in 1988, much criticized by the Right opposition but retained by the Balladur government.

The general economic case for basic income schemes, as for other forms of redistribution, is the democratization of markets. Economic agents are often regarded as "voting by the dollar" in the market place but their voting is non democratic: their preferences, as well as their price and quantity expectations and beliefs about future states of the world, are weighted by their income, wealth and access to credit. Economic democracy, by itself just as desirable as - indeed part of - political democracy, is enhanced by egalitarian policies, and by redistribution schemes such as guaranteed income and/or citizen's income, or access to unsecured credit. Concern for fairness, or social justice, can be regarded as an expression of economic democracy rather than as separate aims.

However, basic income schemes compete with other forms of redistribution (e.g. the provision of collective consumption) and with other desirable uses of public funds;[31] they are likely to bring about adverse effects on economic efficiency (e.g. lower supply of effort, moral hazard) and therefore must be limited to the forms and scale that yield an equality/efficiency trade-off, and a trade-off with other desiderata, regarded by the government as politically preferred to all other feasible trade-offs. Therefore basic income schemes, though a respectable object of political convictions, cannot find in redistribution a compelling argument from purely economic analysis.

In economic literature a basic income has been proposed for a variety of purposes (for a history of the early stages of this idea see Morley-Fletcher, 1980-81; see also Standing 1989 and Nuti 1990a). Some proposals are based on a natural entitlement to productive factors, land or capital, directly or through an entitlement to the scarce jobs associated with them; they include: i. Thomas Paine's birthright to land, converted into basic capital and income payments;[32] ii. Tibor Liska's proposals for generalized access to capital and entrepreneurship (reviewed above in Ch. VII, section 4); iii. a related recent variation on this theme by Bert Hamminga, based on a tradable birthright to jobs (1988). Other proposals are aimed at specific economic policy targets: iv. Brandon Rhys Williams' rationalization of welfare payment;[33] v. Milton Friedman's argument for the freedom to choose the quantity and quality of social consumption and its suppliers;[34] vi. Gunnar Adler-Karlsson's proposal for internationalist support of world citizen income funded by advanced countries to facilitate growth in less developed countries and system transition in post-communist economies (1990). These arguments do not add up to a general case, as they are either rooted in systems other than capitalism or are somewhat conflicting among themselves; only Meade's proposal is part of a coherent alternative system.

The Social Dividend envisaged by Meade in order to alleviate the riskiness of variable incomes is a non taxable, unconditional payment made to all citizen, whose taxable income however is subject to a surtax on its initial slice; there would be no tax-free allowances (other than exemption of savings, as indicated above). This is a compromise between a 100% clawback of basic income, which would remove all incentive to earn additional income, and an unconditional basic income with no surcharge, which would be intolerably expensive.

The Social Dividend would depend only on age, i.e. would be diversified for children, working age adults, old-age pensioners. Each worker's income therefore would be made up of four components: the Dividend, income from investment (including the ordinary shares distributed by his/her enterprise and other shares), a fixed wage for part of his/her labour and a variable dividend on his/her temporary shares. This diversification should take care of the risk implication of replacing wage employment with Meade's participatory provisions.

The budgetary burden of a universal Social Dividend would be so high, however, as to have to rely on the state having, instead of a National Debt on which to pay interest, a National Asset i.e. net wealth on the scale of something like a half of national assets, yielding revenues at market rates sufficient to finance the scheme without prohibitively high taxation rates.[35]

Such high degree of state ownership could be reached either through a cataclysmic capital levy - which would require a gigantic social revolution, possibly traumatic and counterproductive and therefore rejected by Meade; or the gradual build up of state ownership through budget surpluses. This socialization process would not lead to a departure from the private market economy, since it would involve only the beneficial ownership of capital assets, not their management; state assets would take the form of participation in private companies, through state holdings and investment funds. This is what Meade calls "Topsy Turvy Nationalization": instead of nationalizations funded through issues of national debt, with interest burden on additional debt offsetting any profits from the property acquired, and managing nationalized companies, the state would gradually redeem national debt and acquire ownership (with a capital levy or recurring surpluses) without taking over management, paying out basic income compensating for earlier taxation; this would involve a kind of forced investment on the part of the public, with redistributive rather than allocational effects.

5. THE PARTICIPATORY ECONOMY

The outline of Meade's participatory enterprise already defines some general features of the national economy in which this type of. enterprise would be the dominant form. Other desirable features are added by Meade.

The participatory economy would have a large state budget; in the run up to socialization of the necessary share of state assets it would have to run substantial budgetary surpluses, but in a growing economy it would continue to run surpluses in order to finance the continued acquisition of-the same share in new net investment.

Savings would be exempt from income tax: any sales of assets would be added to the tax basis and all acquisitions would be deducted; but taxable income would be subject not only to the initial surtax mentioned above but also to high progressive tax rate. Additional tax revenue would be raised through a tax on pollution, auctioning limited pollution rights, and a tax on advertising (in order to reduce consumerism; after all, much advertising can be treated as a special form of pollution). There would be substantial taxation on the transfer of wealth, by gift inter vivos or bequests on death, plus a modest but generalized wealth tax.

Monetary policy would be aimed at stabilizing monetary GDP in order to maintain high and stable employment without inflation.

The special taxation and income-subsidy regime of the participatory economy raises the question of its compatibility with the requirements of an open economy. Meade raises this issue (1991) and advocates what he calls "Compensated freedom of movement of goods, capital and workers". Thus workers would be free to migrate but would not enjoy the extra egalitarian benefits offered in the country of destination over those of the country of origin; capital would also be free to move but would remain subjected to any extra egalitarian tax in the country of origin.

6. A COMPARISON WITH LISKA

It may be worth comparing James Meade's proposal with that of the Hungarian reformer Tibor Liska (see above, Ch. VII, section 4): both have a Social Dividend, private management of a large state ownership stake, and extended profit-sharing replacing wage labour. Yet Liska's state ownership consists of physical capital whose lease is auctioned off to the best potential users; his Social Dividend comes from an individual capital stake which is the seed corn expected to enable everybody to turn into an entrepreneur; his partnerships are short lived as workers group and regroup themselves and therefore may not even have an opportunity to decide whether they are or not "discriminating" in Meade's sense of offering to new members terms different from those of old members. These differences are' substantial enough not only to protect each author's originality but also to obtain a different end-result. Moreover, there is a different the path of transition, which in Meade starts from capitalism as we know it, whereas in Liska starts from a "real" socialism on the verge of reform (where de-etatisation of some of the state capital is just as revolutionary as the formation of state capital in the Meadean economy).

7. IMPLICATIONS

The subtitle of James Meade's "Agathotopia" is "A Tract for the Times Addressed to All Capitalists and Socialists who Seek to Make the Best of Both, Worlds". James Meade appears to deliver this ambitious promise through a comprehensive - scheme for systemic transformation. We have suggested a number of possible simplifications, criticisms and possible parallel remedies, but the construction seems sound enough not to warrant the label of "utopia" - other than in the literal and trivial sense of an arrangement which has not yet been implemented anywhere.

The main drawback of Meade's construct is its cost in countries afflicted by large national debts and current deficits, and unable to run budgetary surpluses large enough and long enough to implement the Social Dividend scheme. A large state capital net of national debt was achieved recently, for a brief period, by the countries least inclined to introduce it: the UK, which having almost entirely repaid public debt at the end of the 1980s has now built it up again; and most of the "transitional" economies of central-eastern Europe, where public domestic debt was almost entirely monetized, external debt has been rescheduled or forgiven, and a large net state capital stock was potentially available but most of it is now being privatized free of charge.

At present and, given the current recession, for a long time to come, the only possible candidates for the full implementation of a participatory economy of the kind outlined here are small rich countries, such as Middle East oil producers.[36] In these countries, moreover, some of the features of the participatory economy happen to correspond to dominant principles of Islamic economics, such as the transformation of interest payments (outlawed and condemned) into participatory income, and the Islamic notion of "asabiyah", understood as solidarity, group feeling, group consciousness.

It is perhaps unlikely that shareholders and managers of joint stock companies might accept this broader notion of profit and power-sharing, which would effectively dilute entrepreneurship extending it to employees, unless they were subjected to very considerable political pressure and workers' contractual power. It is more likely that this kind of arrangement might come into being - on a small scale - through the evolution of coopera-tive enterprises, with a possible further enhancement, as a result, of the growth prospects of cooperatives and the scope of activities which they might undertake.

It is tempting to suggest, on the basis of the reflections developed here, that there is an evolution of the labour employment contract away from dependent labour - with money income security, job insecurity and subjection to authority - to entrepreneurial labour - with higher income risk tempered by partial fixed earnings and by fiscal support, with participation in decision making and with job-related-income security in lieu of job security. If this is not a convincing actual trend in positive economics, it is a benchmark against which to assess alternative proposals for enter-prise democracy, and certainly a feasible and desirable evolution path worthy of consideration - whether by normative economics or by political action.

X

SUMMARY AND CONCLUSIONS

The organization of production in traditional enterprises - whether owned by a single capitalist entrepreneur , by a group of private shareholders or the state - associates labourers and capital through a wage employment contract that has been shown to have a mixture of benefits and drawbacks.

The standard employment contract is characterized by:

i. a fixed wage payment per unit of time;

ii. no employment tenure;

iii. workers' subjection to their employer's authority, both in the organization of labour and in the overall allocation of labour and other resources.

These features have ensured a number of significant achievements; labour mobility towards its most productive uses, workers' certainty of income while employed, the possibility of "central planning" within the enterprise. Thus the standard labour contract has promoted efficient employment and redeployment of labour, high levels of effort for fear of dismissal, productivity gains from large scale and from rational organization.

These basic features have also some negative implications. First, there is a need for and a cost of supervision for the monitoring and enforcement of individual exercise of "normal" effort and waste of above normal effort that might be exercised by labourers if the wage was geared to results but which, understandably, is not supplied for a fixed wage. Second, there is no necessary, direct connection between earnings and enterprise performance and therefore no incentive to raise the effectiveness of collective effort, or to improve labour organization, or to cooperate in facilitating labour redeployment. Third, a confluctural, antagonistic relation between "us" and "them" usually prevails between workers and employers, in wage determination and in the employment policy of firms. Employment insecurity, with a permanent pool of unemployed, falls totally on workers; in particular, workers are exposed to unemployment risks due to enterprise performance, which in turn depends on entrepreneurial decisions in which they have no part; hence the perceived unfairness of exposure to this kind of unemployment risk, as it represents responsibility without power. Finally, a money wage rate fixed for the period between negotiations, especially

if strongly indexed, and fairly inflexible downwards due to workers' reserve pricing of their services and/or strong Trades Unions, is an element of rigidity whenever the maintenance of employment or the achievement of near-full employment requires lower wages.

These acknowledged drawbacks have provided the stimulus for experiments and discussions of alternative formulas of employment contracts, towards profit-sharing; industrial democracy (participation in the organization of labour); participation in entrepreneurial decisions or power-sharing - ranging from minority co-determination to majority self- management; equity sharing by employees; extension of employment tenure.

Industrial democracy yields workers' welfare improvements, with undetermined effects on labour physical productivity; employers may willingly agree to such provisions as long as these do not raise unit labour costs. Fuller participation in entrepreneurial decision making - co-determination - also yields benefits, through workers' "incorporation" and reduction or better composition of conflicts. Co-determination strengthens the case for participation in enterprise results, in the form of profit. Self-management i.e. total or determinant participation in entrepreneurial decisions -however, would allow employees to appropriate the enterprise through control over employment and earnings; it would virtually eliminate enterprise access to risk capital; it is also incompatible with a prefixed guaranteed wage.

Participation in enterprise results by itself, without power-sharing, may yield some advantages, but these are much more limited than claimed in the literature and are the negation of full enterprise democracy. Combined participation in both decisions and results, however, raises strong presumptions of both greater inefficiency and greater inequality, illustrated in the vast literature on self-managed enterprises a la Ward-Vanek (cooperatives, old-style Yugoslav enterprises). Moreover, full participation in both decisions and results is illusory without some employment tenure, which unaccompanied by participation at least in enterprise results has adverse effects.

A number of possible solutions to these dilemmas can be found in the literature but are not fully satisfactory. (i) Unequal partnerships (Meade) resolve efficiency problems at the expense of equality and involve unequal pay for equal work. (ii) The marketability of the employment contract (Schlicht-Weiszacker and Sertel) introduces a semi-feudal element and raises additional problems. (iii) Workers' free access to any enterprise of their choice (a Hertzka and Lange-Breit utopia) resolves the inequality aspects of profit-sharing at the cost of large scale inefficiency. (i) Workers' competitive access to rentals of capital goods through an initial free capital stake, feasible in a state ownership system (Tibor Liska's "entrepreneurial socialism") also raises unresolved problems, such as the need for a validation process of bids, the volatility of enterprises, the need for specialized intermediaries which would necessarily interfere with the envisaged system. (v) Workers' ownership stakes in their enterprises are a form of modest participation in both decision-making and results, at the cost of greater risk than for a diversified portfolio of workers' shareholdings.

The thesis put forward here is that the dilemmas of participation can be resolved only if

i. the notions of participation in enterprise results and decisions are further refined: entrepreneurial profits to be shared out are redefined as the sum of distributed profits plus any change in the capital value of the enterprise over the same period (Ch. VIII); a line between partial co-determination and full self-management is drawn by parithetic representation of labour and capital with agreed procedures for the settlement of disputes; job tenure is transformed into job-related income-maintenance. Contractual incomes of factor suppliers are transformed into dividends from temporary shares: all contractual incomes recipients - including wage earners - are given - for the duration of their contractual link with enterprises, for the whole of their claims or only for a predetermined agreed fraction of them - voting shares initially yielding an equivalent return (Ch. IX, on the fully participatory enterprise, drawn from the work of James Meade with some modifications).

ii. the changes are made simultaneously in all three directions (power-sharing, profit-sharing and job tenure) transforming dependent labourers into full entrepreneurs;

iii. the economic environment in which fully participatory enterprises are to operate is also modified, introducing significant forms of generalized income support (citizen income or guaranteed minimum income or a combination of the two) in order to reduce the greater exposure to risk resulting from the replacement of fixed with participatory incomes. Otherwise the transformation of wage employment into a fully participatory relation can only take place on a reduced, part-time basis; in this case even the continued presence or dominance of wage employment would alter its nature by making it a voluntary choice with respect to a potential exercise of entrepreneurship.

At present and, given the current recession, for a long time to come, the only possible candidates where a full participatory economy could be implemented are small rich countries, such as Middle East oil producers.

It is perhaps unlikely that shareholders and managers of joint stock companies might accept this broader notion of profit and power-sharing, which would effectively dilute entrepreneurship extending it to employees, unless they were subjected to very considerable political pressure and workers' contractual power.

In spite of its character of a "luxury" good, and the political difficulties associated with its implementation, the project fora participatory enterprise and economy is a benchmark against which to assess alternative proposals for enterprise democracy, and certainly a feasible and desirable evolution path worthy of consideration, whether by normative economics or by political action.

FOOTNOTES

1. The purpose of this chapter is not meant to be survey of the immense literature on the topics considered but the introduction of concepts and themes which will recur frequently in the subsequent analysis.

   "The person who has gained the habit of a particular craft is rarely able afterwards to master another: a person who is still in his natural state has an easier time acquiring certain habits and is better prepared to gain them: When the soul has been impressed by a habit, it is no longer in its natural state, and is less prepared to master another habit, because it has taken on a certain imprint from that habit. This extends even to scholars whose habit has to do with thinking ..." (Khaldun, 1377; Ch 5 on the various aspects of making a living, such as profit and the crafts, p. 318 of the 1967 English translation).

3. "When the 'available labour is all gone or decreases ... God permits profits to be abolished ..." (Khaldun 1377, p.299 of the 1967 translation).

4. Polanyi (1944) correctly argues that labour is not a commodity like any other, because when labour is exchanged it remains physically attached to its seller (strictly speaking one should talk of labour services rather than labour). However, Polanyi takes this to imply that labour is a "fictitious" commodity: "Labour is only another name fora human activity which goes with life itself" (Polanyi 1944, p.72, approvingly quoted by Archer 1993). This is a generous but impressionistic and inaccurate proposition: there is nothing fictitious about labour services, which are only too real. Unlike the classical English tradition, that regards labour services as produced - to the point of distinguishing between the subsistence and the surplus elements of labour costs, Polanyi regards labour as non produced for sale and therefore not a commodity; thus the same allegedly "fictitious" nature is attributed by Polanyi also to land ("which is not produced by man") and to money ("a token of purchasing power which, as a rule, is not produced at all, but comes into being through the mechanism of banking or state finance"): "none of them is produced for sale" (p.72).

5.. Sometimes laboureres have hired capital in a distant past, in the beginnings of proto-capitalism, as individuals or as small groups; they still do it today in cooperative enterprises, but mostly in special conditions, see Ch. VI.

6. We shall see below (Ch. VII, section 4) that an economy of workers-owned enterprises leasing all their fixed capital could be contemplated in a system where all capital goods are state owned (see Liska 1963, Barsony, 1982) but would have other drawbacks (see Nuti 1991 a) and has never been realised other than partially on a small scale (in the Soviet Union during NEP, and in the current transformation of post-communist economies).

7. Many transactions involve "made to order" commodities, especially in construction, services, specialty items, repairs, and might appear as equivalent to futures markets (an objection raised by Martin Weitzman). However, in order to compete in these markets one still needs to have acquired capacity beforehand, i.e. before the orders materialise; therefore investment in the production of goods made to order is still undertaken on the basis of expectation instead of contracted prices for future deliveries. Also, most inputs for "made to order" goods are purchased in spot markets.

8. This "separation theorem" should not be confused from the homonymous theorem of general equilibrium theory, about the determination of a price "hyperplane" separating production and preference sets.

9. Moreover, the conflict between profitability and growth has been exaggerated by Marris on two counts. First, at any moment of time, growth through financial acquisitions can always be enhanced by higher profitability and cannot be in conflict with it; this escapes Marris's attention probably because he compares alternative steady states rather than alternative short run policies. Second, when short term profitability of production is traded off for higher growth and future profits, this will lead to an increase in "goodwill" which if properly accounted for should be added to the value of current net investment in company balance sheets, and should in any case be perceived by financial markets: thus at least some of the conflict between profitability and growth is due to inadequate accounting or myopic markets.

10. In the classification of policy instruments, state enterprises are classed under direct controls (with price controls, income controls, credit controls etcetera, other instruments being indirect and falling under fiscal and monetary policies).

11. Unless political interference with managerial appointments in state enterprises lowers significantly standards of competence, as it often occurred in Soviet-type economies.

12. In France, to give an example, outside the civil service there are two types of employment contract, strictly defined by "conventions collective de travail": the "contrats a duree indeterminee" which used to be the norm, and the "contrat a duree determinee" which have now become the new norm. Under the first the employer cannot dismiss workers at will; even in this case, however, security of tenure is precarious, as the contract can be terminated in case of "licenciement economique", i.e. when enterprise viability is threatened by market conditions, so that the employer has to provide evidence of economic difficulties and dismiss groups of workers rather than individuals (This information was provided by Marie Lavigne). Even in this case the longer time span of the contract guarantees only higher severance pay, not employment.

13. Among bibliographical reviews see Pettman 1978; Bartlett and Uvalic 1986; on cooperatives, Hill, McGrath and Reyes, 1981; on the history of these ideas, see Morley-Fletcher 1986; on recent European developments in profit-sharing and capital-sharing, see Uvalic 1991 and 1993. See also Jones and Svejnar 1982.

14. The classification refers to a capitalist economy. In traditional Centrally Planned Economies employment in state enterprises is usually of type 2; wage employment is restricted to a small private sector; cooperatives are similar to type 8. However central planning and administrative methods of resource allocation, together with enterprise specific subsidies and taxes, prevent the exercise of entrepreneurship and therefore any possibility of effective participation.

15. Claims about the superiority of profit-sharing contracts in dealing with risk are based on rather special stipulations. Pohjola (1987, extending Atkinson 1977) shows that profit sharing contracts are superior to fixed wages when trade unions and risk-neutral firms negotiate non binding contracts stipulating not only labour earnings but also employment levels, in which case profit sharing converts employment risk into income risk in the presence of random shocks. However, when information is asymmetric and the firm has private information about production profitability (as in the case of owner-managed firms where profits can be concealed) firms have an incentive to protect their private information and profit-sharing schemes can never be incentive compatible (Pohjola, 1990). Hart and Holstrom (1985), on the contrary, claim the superiority of profit-sharing contracts over state-contingent wage contracts - for risk-averse employees and employers - precisely on the ground of asymmetric information, which requires wages being

made conditional to something observable also by workers,- such as profits. Aoki (1977) claims that there exists a superior profit sharing contract over the fixed wage contract, for employees being relatively - more risk averse than employers. All these propositions, however, neglect other ways of reducing risk (e.g. through product and portfolio diversification) alternative to profit-sharing contracts.

16. Weitzman attributes to profit-sharing the higher stability of employment to. be found in -Japan, but this cannot be 'considered as evidence of Weitzman's claims about non-inflationary overfull-employment resulting from profit sharing, as Japan has never known a state of over-full employment.

17. If profit-sharing were to ensure full employment and over-full employment, it would be all that more difficult to deny employees some say in the organisation of labour or even in the general management of the enterprise; this in turn would jeopardise the ability to sustain full and over- full employment, since it is difficult to think of enterprise decisions which do not affect employment directly or indirectly.

18. Charles Fourier intended to limit the profit share in value added to one ' third; Henri de Saint- Simon wished to abolish profit altogether, and opposed inheritance; Robert Owen's' enterprise also limited profits; for an extensive survey and references see Landauer, 1959, Vol. I, Ch.1, pp. 21-71. Philippe BuOhez (1831) envisaged a workers' cooperative reinvesting' twenty per cent of net income, the resulting accumulation belonging not to members but to the cooperative, considered as "... indissoluble, not because individuals would not be able to detach themselves from it, but because this association would be made eternal through the continuous admission of new members. Thus this capital would not belong to anybody, and would not be subject to inheritance laws". This is precisely the dominant cooperative regime today; see the extensive introduction to Morley-Fletcher 1986.

19. Recent research suggest that in reality the Yugoslav enterprises and indeed the whole Yugoslav economy behaved in ways very similar to conventional centrally planned economies, exhibiting for instance a strong investment drive, socialisation of losses, government direction through the credit system (Uvalic 1992). Nevertheless, old-style Yugoslav enterprises (at least before the privatisation schemes now under discussion) embodied distinctive features such as workers' self- management, temporary usufruct of state assets by employees for their employment duration, sharing of after-tax value added net of amortisa-

tion and interest on loans. These features are similar to those of traditional cooperatives, to which we therefore can assimilate it to understand its built-in tendential behaviour in spite of the stricter external constraints to which it was subjected.

20. Axel Leijonhufvud has reminded me that Maynard Keynes (1979, pp. 63-102) attributed to cooperatives, or rather to a cooperative economy, the additional advantage of not being subject to insufficient aggregate demand. This is because he presumed that cooperatives barter labour for goods, so that the supply of labour is always an effective demand for goods, whereas in a capitalist enterprise system labour buys money and money buys goods but labour does not buy goods. This presumption is totally arbitrary and unwarranted.

21. See Morley Fletcher, 1986.

22. This penalty on departure goes both against the notion of limited liability, presumably not ruled out by cooperative membership, and against the basic freedom of labour mobility that since the advent of capitalism workers have always enjoyed. There seems to be no need for members to take on more personal responsibility for their cooperative's loans than is the case for joint-stock holders and, in any case, this can be stipulated at the time loans are taken. Unless members at the time of joining have specifically taken on personal responsibility for the cooperative's liabilities, if one member's departure makes the cooperative insolvent and he cannot be replaced, the cooperative simply will have to go into liquidation.

23. We are not considering work-sharing here because it is usually understood as a nation-wide scheme for employment promotion (for instance, as proposed by Michel Rocard in the 1993 French elections) rather than a measure taken at the enterprise level, other than a temporary response to sudden falls in the enterprise labour requirements.

24. This project has been pursued by the Thatcher government in the UK through privileged access of small investors to the privatisation of state enterprises; in Central Eastern Europe since 1990 through mass privatisation and the distribution of vouchers at nominal prices or free of charge (as in Czechoslovakia, Poland, Russia) or privileged access to credit (Hungary). In France the first forms of "capitalisme populaire" were attempted under de Gaulle and Pompidou; this was a pillar of the "nouvelle societe" advocated by the then Premier Chaban-Delmas, whose famous speech on this concept was said to have been written by his "conseiller pour les affaires sociales", a then less known Jacques

Delors. This approach to "capitalisme populaire" has been reproposed in 1993 by the Balladur government with the, launch of a privatisation "emprunt", a loan which was oversubscribed by almost three times and whose subscribers will be able to convert their bonds into shares of the "privatisables". These initiatives have nothing to do with enterprise democracy and with the kind of capital sharing discussed here, but tend to be associated with it: see for instance the May 1993 offer of Rhone-Poulence shares to its employees at a privileged price before the official start of privatisation, an offer which was also oversubscribed (with acknowledgements to Marie Lavigne for this information).

25. Even minority stakes may assign potential corporate control: Pohjola (1988) calculates that a 30 per cent share of voting rights is enough to obtain a working control of any industrial company in Finland, and that less would be needed in countries where share ownership is more dispersed. However, usual degrees of employee stock ownership are well wide of this mark.

26. Such a lack of access to surpluses can only be justified if it is matched by a parallel employers' obligation to make up any shortfall that might arise.

27. It should be stressed that the fundamental identity between the two systems is due not to "churning" (i.e. the simultaneous payment of tax by and benefits to the same people) as such, but by the fact that "churning" is not uniform.

28. Namely, it can be a step function or a continuous one, with a different intercept i.e. minimum support level (negative when a poll tax prevails; positive when income is supported, larger or smaller), different break-even point (i.e. the income level at which tax and subsidies even out); different slopes (usually the function expressing after tax to pre-tax income is an elongated S-shaped rising function intercepting the 45 degrees line in its lower section). More importantly, calculations may be centred on households or on individuals.

29. A practical difference remains: a citizen's income accruing to everybody though later taxed would reverse the traditional status of mutual claims between citizen and the state, according to the old principle of "solve et repete" (first pay to the state what you owe, then claim back anything that may be owed to you by the state). Under a citizen's income scheme first the state would have to pay a basic amount to all, then claim what may be owed in tax by the recipients. The importance of this practical difference depends strictly on the efficiency of fiscal administrations

and the opportunities for tax evasion and avoidance.

30. The distinction also vanishes if there are no state profits, net of interest payments on national debt.

31. In order to reduce the cost of basic income schemes a parallel obligation or readiness to work is sometimes required as a precondition of participation (on the history of this idea see Morley-Fletcher 1980-81, 1989a section 14). This is often opposed on moral/political grounds (the transformation of a right to work into an obligation) or because of low economic effectiveness, or because of reliance on the abundance brought about by technical progress; however, an obligation or readiness to work would meet at least some of the objections raised against basic income schemes.

32. Impressed by the American revolution and the implications of free access to land in America, Thomas Paine envisaged the payment of 15 pounds sterling to every person (rich or poor) at the age of 21, as partial compensation for the loss of his natural inheritance due to the introduction of land ownership, plus ten pounds sterling a year to the over-fifties for life on the same ground (Paine 1796, 1776; for a more recent statement of this approach see Lange 1937-38; see also Morley-Fletcher 198-810.

33. Thus basic income would replace the existing structure of partly means-tested partly unconditional social benefits, poverty relief, national insurance, and simultaneous taxation of lower incomes (see Rhys Williams 1989, including James Meade's Preface to the volume; Parker 1989; BIRG 1989).

34. Milton and R. Friedman (1981) propose a negative income tax in lieu of services in kind, in order to reduce the public provision of welfare services, and at the same time allow consumers to exercise free choice - through market purchases - as to the relative quantity and quality of services usually falling under public responsibility, such as education and medical care, or social insurance. Here basic income is granted in lieu of public consumption.

35. In any case it might be impossible to obtain the necessary revenues through taxation, regardless of rates, as beyond a certain point tax revenues are bound to decline with the increase in tax rates. This relationship between tax revenue and tax rates, known in modern economics as the Laffer Curve, was already put forward in 1377 by Ibn Khaldun: "When tax assessments and imposts upon the subjects

are low, the latter have the energy and desire to do things ... the tax revenue which is the sum of total of individual assessments increases. ... [when] individual impost and assessment is greatly increased, in order to obtain a higher tax revenue eventually, the taxes will weigh heavily upon the subjects and overburden them... The result is that the total tax revenue goes down ... the amounts of individual imposts are increased. Finally civilization is destroyed." (Ch 3, pp. 230-231 of 1967 English edition).

36. For instance, Kuwait before the Gulf-War: "If we wished we could put the burden of work on foreign immigrants and distribute a life rent to all citizens of Kuwait" (Sheikh Jaber al-Ahmed al-Jaber AI-Saba, Emir of Kuwait, 1990 before the Iraqi invasion - when there was zero income tax, free education and health, an extended social security service, large scale government subsidies including grants to newly married couples; Kuwait then boasted a GNP per head of over US$20,000).

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ISLAMIC DEVELOPMENT BANK (IDB)

Establishment of the Bank

The Islamic Development Bank is an international financial institution established in pursuance of the Declaration of Intent by a Conference of Finance Ministers of Muslim countries held in Jeddah in Dhul Qa'da 1393H (December 1973). The Inaugural Meeting of the Board of Governors took place in Rajab 1395H (July 1975) and the Bank formally opened on 15 Shawwal 1 395H (20 October 1975).

Purpose

The purpose of the Bank is to foster the economic development and social progress of member countries and Muslim communities individually as well as jointly in accordance with the principles of *Shari'ah.*

Functions

The functions of the Bank are to participate in equity capital and grant loans for productive projects and enterprises besides providing financial assistance to member countries in other forms of economic and social development. The Bank is also required to establish and operate special funds for specific purposes including a fund for assistance to Muslim communities in non-member countries, in addition to setting up trust funds.

The Bank is authorized to accept deposits and to raise funds in any other manner. It is also charged with the responsibility of assisting in the promotion of foreign trade, especially in capital goods among member countries, providing technical assistance to member countries, extending training facilities for personnel engaged in development activities and undertaking research for enabling the economic, financial and banking activities in Muslim countries to conform to the *Shari'ah.*

Membership

The present membership of the Bank consists of 47 countries. The basic condition for membership is that the prospective member country should be a member of the Organization of the Islamic Conference and be willing to accept such terms and conditions as may be decided upon by the Board of Governors.

Capital

The authorized capital of the Bank is six billion Islamic Dinars. The value of the Islamic Dinar, which is a unit of account in the Bank, is equivalent to one Special Drawing Right (SDR) of the International Monetary Fund. The subscribed capital of the Bank is 3,654.78 million Islamic Dinars payable in freely convertible currency acceptable to the Bank**.**

Head Office

The Bank's head office is located in Jeddah in the Kingdom of Saudi Arabia and the Bank is authorized to establish agencies or branch offices elsewhere.

Financial Year

The Bank's financial year is the Lunar Hijra year.

Language

The official language of the Bank is Arabic, but English and French are additionally used as working languages.

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