D=630816

ECONOMIC ANALYSIS AND WORKERS'
MANAGEMENT, 3, XXV (1991) 303 - 306

'DIVERGENT EQUILIBRIUM' IN A LABOR-MANAGED ECONOMY: A REJOINDER

Željko BOGETIĆ[1]

Let me first make it clear that I have a deep respect for Professor Vanek's contribution to the field of economics, particularly in international trade and later in economics of labor-management, which he championed so forcefully for many years. Great minds influence generations of newcomers as well as parts of the establishment in the profession, and so did Professor Vanek. But it is precisely because people take great minds very seriously, we who claim credit only for hard work, not necessarily Solomonian-type-wisdom, need to point out their obvious errors.

Professor Vanek's comment on my paper simply runs in too many directions, thus making it difficult to reply to the many issues he raised, without losing conciseness and perspective on the main argument. In the end, he does not harm the central point of my paper, that a labor-managed (LM) economy suffers from behavioral peculiarities which can generate problems not only at the firm level (in partial equilibrium), but also in the economy-wide setting (in general equilibrium). I should add at the outset that my paper had neither the intention nor ambition to give a coup de grace to the idea of labor-management; that has been done quite capably by its proponents, from government to firm level, particularly in Yugoslavia. I simply wanted to point out to some fundamental problems of market clearance in such an economy; problems which might call for a different set of policy instruments to achieve certain policy goals, than those which are customarily used in an economy composed of profit-maximizers. I do admit that I did not develop this latter implication, but left it for a separate paper, which might have given grounds for misinterpretations.

For the sake of clarity, I will center my reply on only two criticisms that Professor Vanek raised, and will try to show obvious errors in their logic. Finally, I will briefly reflect on a broader issue of entry of new firms in a labor-managed environment.

First, Professor Vanek's insisting that negatively sloped output supply function »is not correctly specified« misses the point that it is not specified at

[1] World Bank, Washington, D.C.. Views expressed in this note are mine and do not necessarily represent views of the World Bank.

all: *it is implied* by a very few, generally accepted, assumptions about the behavior of LM firms and technology (i.e., income per worker maximization and the standard production function). Furthermore, as can be seen from equations (6) and (7) in my paper, it is also a result of a perverse reaction of LM firm's demand for labor to a rise in the product price, which is exactly the opposite from the reaction of a profit-maximizing (PM) firm. Also, from equation (7), given the income-per worker maximization hypothesis, the only way a LM firm can display inelastic output supply is *in the special case* when the marginal product of labor is pushed to zero, perhaps by institutional pressures on LM firms to hire more labor than they normally would; a situation quite similar to the one prevailing in Yugoslavia for the past few decades. The negatively sloped supply function is a more general result stemming from more general assumptions than those of Professor Vanek.

Second, the indirect income per worker function (equation 5) does depend on the product price, and so does the real income per worker. The former, again, is a direct consequence of the postulated maximand of LM firms, and the standard microeconomic theory of indirect maximand functions. The arguments of indirect income per worker function, in general, *a fortiori* must enter labor demand and output supply functions. Moreover, even if these do not depend on the product price (which is only a special case), the indirect income per worker function will still be sensitive to price changes because the price enters the nominator of income per worker function. Professor Vanek's odd normalization by quantity rather than by price does not alter this fact. »Divergent equilibrium« will still be implied by the very nature of the microeconomic behavior postulated for LM firms. The same will not hold for a PM economy, because of exogeneity of the price of labor with respect to the firms' choice of labor input: flexible product price and wage will, in general, establish general equilibrium.

Third, in the latter part of his comment, Professor Vanek broadens the scope of discussion to repeat his argument from earlier works that strong entry of LM firms will take care of any possible problems in an LM economy. Although my paper does not deal with the long-run issue of entry of new firms I feel that a comment on overly optimistic expectations of new entry in an LM economy is in order. Briefly, yes, entry is important in any economy, but perhaps it is critical to an LM economy; only the strong entry of firms can hide special behavioral problems of an LM economy. But as this happened nowhere except in Mondragon, we should stop and ask an obvious question: why? In Yugoslavia, the entry was extremely sluggish, to say the least, in spite of decades of soft credits and the overall institutional environment favoring LM firms. This points to another important issue in an LM economy which neither Professor Vanek's reply nor my paper address: the issue of apparently different relative strengths of LM and PM economies to generate and stimulate entrepreneurship. I suspect that addressing this issue can go a long way toward providing an answer to the fundamental questions of why we do not see more LM firms in modern economies and, more specifically, why new entry was so lacking in Yugoslavia. The uniqueness of Mondragon against a myriad of unsuccessful attempts to create a dynamic and sustainable LM economy is

striking, and points to its oft-forgotten features which may well be critical to its performance: clearly defined private property rights of the coop members, and competitive pressures of the Spanish mixed economy and the international market. Needless to say, none of these existed in Yugoslavia to any significant extent.The Yugoslav experience shows that the long-run new entry may never come. In the meantime, one needs to deal with problems of the short-run, and that is particularly true of a labor-managed economy.

»Divergent equilibrium« or disequilibrium in some markets is only one problem in such an economy. Avoiding its recognition does not help, and it unnecessarily postpones discussions which seek solutions.