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WELFARE, PRODUCTIVITY AND SELF-MANAGEMENT

by

Ugo PAGANO

University of Siena

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Summary

This paper considers the implications of workers' preferences on the uses of their own labour power for the theory of the firm in general and, in particular, for the labour-managed firm. Maximization of utility of workers is regarded as a more plausible objective for the labour-managed firm. It follows that *ceteris paribus* workers can achieve greater welfare under self-management; their productivity will be lower than in the profit-maximizing and the income-per-head maximizing firms, while it can be either higher or lower (but probably higher) than the participatory and the conflictual types of firms.

Introduction

In recent literature self-management (and/or workers' participation) has been advocated for several reasons. This paper is concerned with one important reason for self-management: that self-management allows a firm to take decisions so that workers' preferences on the uses of their own labour power are taken into account. This advantage of self-management demonstrates that workers in a self-managed firm can achieve

nated differently from the operation of the market mechanism. Planning replaces the market within the firm. Market prices coordinate production only outside the firm. Within the firm the employer replaces the role of market prices and coordinates production. In a firm, Coase observes, "if a workman moves from department Y to department X, he does not go because of a change in relative prices but because he is ordered to do so".[2]

H. Simon[3] has clarified how the relationship between the employer and the employee differs from other market contracts and leaves room for the firm-type coordination outlined here. According to Simon the employment contract "differs fundamentally from a sales contract--the kind of contract that is assumed in ordinary formulations of price theory. In the sales contract, each party promises a specific consideration in return for the consideration promised by the other."[4] By contrast, the employment contract involves that, in exchange for a given wage, the employee agrees to accept the authority of the employer and the employer is allowed to decide which particular actions the worker will perform. Hence, after the employment contract is signed, the planning of the employer replaces the market mechanism. Simon, Coase and, more recently, K. Arrow[5] and O. Williamson[6] have given explanations for the fact that in important spheres of economic activity firms replace the market as a coordinating mechanism. This paper is not concerned with these explanations, but notes that all these authors agree that the firm is an island of planning. Moreover, an important consequence of this literagreater welfare than workers of a textbook, profit-maximizing firm.

While the effects of self-management on workers' welfare can be stated in such an unambiguous way, the effects of self-management are rather unpredictable. Labour productivity is lower in a self-managed firm than in a textbook, profit-maximizing firm. On the other hand, the textbook, profit-maximizing firm is reinterpreted here as an extreme case where workers' preferences have no weight. Less extreme cases such as the "participatory" and "conflictual" firm are examined. When compared with these other firms, the self-managed firm can show higher labour productivity (although the opposite may be true).

The paper is divided into three sections. The first section defines a "firm" and reviews some traditional equivalence results between the profit-maximizing and self-managed firm. In the second section workers' preferences are introduced into the analysis and the equivalence results of the first section are replaced by the different results achieved by the profit-maximizing, the participatory, the conflictual and the self-managed firm. Finally, in the third section, the performance properties of the self-managed firm are compared with those which characterize the "participatory" and "conflictual" firms.

1. In his article "The Nature of the Firm"[1] R. Coase observed how the firm is both a possible agent of a market economy and an institution where production decisions are coordi-

respect his authority (within certain limits, of course) for a wage, such that the employer is "free" to decide whether, on a particular day, the worker should draw and/or straighten and/or cut the wire. In this case, if the employer perceives that these tasks are being performed in the "wrong" proportions, he can simply formulate a new plan and give new instructions to the workers. This third case is the only one where we can say that firms (defined as above) exist in the economy or, in other words, that sales contracts (for intermediate products and tasks) have been replaced by the employment contract.

Now, take a very simple case of a representative firm; a firm in the sense outlined above. Labour power is bought and sold in the market at price w but the uses of labour power are not the objects of market contracts. These uses of labour power (or tasks) are decided by the employer and are a matter of firm-type (instead of market-type) coordination. We focus attention on this planning problem by making as simple a case as possible. Assume (implicitly) that the amount of capital used by the firm (as well as by the twin cooperative considered next) is exogenously fixed. Furthermore, assume that there are only two uses of labour power (or tasks) (keeping in mind that the number of these tasks can be very large in real-life representative firms). Under these simplifying assumptions the firm has only to decide: (i) how much output to produce, (ii) how much labour power to employ, (iii) how to allocate labour power between the two tasks assumed to be necessary for the output of the firm to be produced. Assume that the firm faces a competitive market price p for the output Q and pays a competitive wage w for each unit of labour power. Denote the levels at which the two tasks are performed by x_1 and x_2 and the total amount of labour power employed by N. Thus we have:

$$x_1 + x_2 = N \tag{1.1}$$

The production function of the firm is:

$$Q = f(x_1,x_2) \tag{1.2}$$

To take decisions (i), (ii) and (iii) described above, the firm will

$$\text{maximize } pQ - wN \tag{1.3}$$

This yields the following first-order conditions:

$$p\frac{\delta f}{x_1} = w \qquad p\frac{\delta f}{x_2} = w \tag{1.4}$$

and therefore:

$$\frac{\delta f}{\delta x_1} = \frac{\delta f}{\delta x_2} \tag{1.5}$$

Condition (1.5) implies that labour power is allocated within the firm so that the marginal product of labour is the same in each of the tasks (marginal productivity rule). We can easily see that the same result would be achieved by a self-managed cooperative <u>if</u> its only goal were to maximize income per member, i.e.

$$\text{to maximize } y = \frac{pQ}{N} \tag{1.6}$$

Maximizing (1.6) yields the following first-order necessary conditions:

$$\frac{\delta y}{\delta x_i} = \frac{p\frac{\delta f}{\delta x_i}N - pf(x_1,x_2)}{N^2} = 0 \qquad i = 1,2 \tag{1.7}$$

tasks.[8] The preceding section shares this assumption since welfare has been assumed to be influenced only by the amount of output produced by one unit of labour power and not also by the way that unit of labour power is allocated among different tasks.

Now, remove this restrictive way of modelling workers' preferences and assume that society's welfare depends on both output produced and the (dis)utility derived by employing one unit of labour power. In more formal language, assume that welfare maximization is obtained by maximizing the weighted sum of the utils (derived from the output) and the utility of work per unit of labour power. I.e.

$$W = \frac{auQ + bU(x_1,x_2)}{N} \tag{2.1}$$

where $U(x_1,x_2)$ is the (dis)utility of work and a and b are respectively the weights of the productivity and (dis)utility of work. Also assume that $a = 1 - b$. Maximizing (2.1) yields the following first-order necessary conditions:

$$\frac{\delta W}{\delta x_i} = \frac{Nau \frac{\delta f}{\delta x_i} - auQ + Nb \frac{\delta U}{\delta x_i} - bU(x_1,x_2)}{N^2} = 0 \qquad i = 1,2$$

and therefore

$$au \frac{\delta f}{\delta x_i} + b \frac{\delta U}{\delta x_i} = \frac{auQ + bU(x_1,x_2)}{N} = W \qquad i = 1,2$$

from which we have:

$$au \frac{\delta f}{\delta x_1} + b \frac{\delta U}{\delta x_1} = au \frac{\delta f}{\delta x_2} + b \frac{\delta U}{\delta x_2} \tag{2.2}$$

(2.2) implies that labour power should be employed so that the weighted sum of marginal productivity (in "utils") and the marginal (dis)utility of labour power should be the same in each use of labour power. In general (2.2) also implies that the marginal productivity rule should not be employed as a management criterion since it ignores the preferences of workers as to the allocation of their labour power. More precisely the marginal productivity rule is a sub-case of (2.2) which holds under two special conditions. From (2.2) we can reobtain the marginal productivity rule

$$\frac{\delta f}{\delta x_1} = \frac{\delta f}{\delta x_2} \tag{2.3}$$

either if

$$b = 0 \tag{2.4}$$

or if

$$\frac{\delta U}{\delta x_1} = \frac{\delta U}{\delta x_2} \tag{2.5}$$

In the first case the weight of the (dis)utility of work is set equal to zero and preferences for work are therefore ignored. In the second case the marginal (dis)utility of the two tasks happens to be the same--a rather special result which implies that the workers are indifferent between them.

So, first an allocation of labour power which maximizes the productivity of labour may be socially undesirable, since task allocations implying a lower productivity (but a greater utility of labour) may be preferred. In other words, an allocation which satisfies condition (2.2) may well be preferred to an allocation which satisfies condition (2.3) although (2.3) is a necessary condition for maximizing labour productivity.

Second, and related, the profit-maximizing capitalist-managed firm and the income-per-head-maximizing self-managed cooperative achieve sub-optimal results because they apply the "marginal productivity rule" instead of condition (2.2) as a management criterion. That is, it follows from condition (2.2) that profit-maximization and income per head maximization are both socially undesirable management criteria for the very same reason: they both ignore the preferences of workers on the uses of their labour power.

Third, income per head maximization cannot be a good way of approaching workers' self-management. It is unreasonable to think that workers would ignore their own preferences on the allocation of their own labour power.[9] A better approximation to "true" self-management can be obtained by assuming that members of a cooperative pay attention to both the income they earn and the (dis)utility they feel when deciding which tasks to perform; a self-managed cooperative maximizes the weighted sum of income and utility derived by one unit of labour power (and not simply the income derived by it). The objective function of a true, self-managed cooperative is, therefore, a function T such that:

$$T = \frac{apQ + bU(x_1,x_2)}{N} \tag{2.3}$$

where a and b are again respectively the weights of the productivity (in value) and utility of labour. Similarly to (2.1), maximizing (2.3) yields the following first-order conditions:

$$ap\,\frac{\delta f}{\delta x_1} + b\,\frac{\delta U}{\delta x_1} = ap\,\frac{\delta f}{\delta x_2} + b\,\frac{\delta U}{\delta x_2} \tag{2.4}$$

If the price p of output is equal to the social evaluation of product u, then the self-managed firm achieves those conditions necessary for social welfare to be maximized. Compared with the textbook profit-maximizing capitalist firm the true self-managed cooperative is characterized by a higher welfare and by a lower productivity level. The profit-maximizing capitalist firm achieves conditions (1.5). These conditions are equivalent to the conditions necessary for maximizing labour productivity which are, in general, inconsistent with conditions (2.2) necessary for maximizing social welfare. The true self-managed cooperative achieves conditions (2.4). These conditions are equivalent to conditions (2.2) which are necessary for maximizing social welfare but are, in general, inconsistent with the conditions necessary for maximizing productivity. This result implies that in comparison with the textbook profit-maximizing firm the self-managed firm can improve working conditions and welfare in general by internalizing workers' preferences. Also it can be expected to have a lower productivity since its goal shifts from a goal equivalent to maximizing productivity (i.e. profit-maximization) to a more general goal which includes that of making jobs as attractive as possible. On this ground the conclusion of the preceding section can be challenged. When compared with the textbook profit-maximizing firm, the "true" self-managed firm can claim to improve working conditions.[10]

3. The conclusions of the above section have a limited validity however, because the textbook profit-maximizing firm has to be (at least partially) reconsidered when workers' preferences are taken into account. Whereas in the self-managed firm labour productivity (and, therefore, income per unit of labour

power) and the (dis)utility of labour are both taken into account by the same people, in the capitalist firm these two goals are likely to "belong" to two different classes of people: the employers and the employees. It is common experience that after the wage contract has been signed employers and employees complain (and often fight) for two different sets of reasons. The employers usually complain about low work productivity, about tasks that are improperly performed (which can be conceptualized in terms of our model by saying that the workers perform different tasks from those desired by employers) or about low work mobility within the firm (i.e. workers refuse to move to tasks desired by employers). In contrast employees usually complain about the difficulty of the boring, uninteresting and disagreeable tasks they have been assigned; the joint maximization of productivity and utility considered in (2.3) is split, in the capitalist firm, into two different maximization problems performed by two different classes of agents.

The employers try to maximize labour productivity; i.e. they maximize

$$\frac{pQ}{N} \tag{2.5}$$

since, given the agreed wage, the higher the product extracted from one unit of labour power, the higher their profits.

The employees try to maximize the utility derived by performing one unit of labour power (or to minimize labour disutility); i.e. they maximize

$$\frac{U(x_1,x_2)}{N} \tag{2.6}$$

because, given the agreed wage, the higher the utility derived from one unit of labour, the higher is their welfare.

If we denote by a^* and b^* (where $a^* = 1 - b^*$) the weights that (2.5) and (2.6) have in the objective function of the firm, then the firm has an objective function:

$$F = a^* \frac{pQ}{N} + b^* \frac{U(x_1,x_2)}{N} \qquad (2.7)$$

This function, F, is very similar to the function T maximized by the cooperative. Maximizing (2.7) yields necessary conditions almost identical to (2.4) (i.e. the conditions achieved by a self-managed cooperative). Indeed, the only difference between F and T is the nature of the parameters a^*, b^* and a, b. The two weights a and b of the function T express the preferences of the members of the cooperative and, in particular, the weights that members of the self-managed firm give to the income and the utility obtained by employing one unit of labour power. In contrast, the two weights a^* and b^* of the function F express the weights that employers and employees manage to establish in practice.

The textbook profit-maximizing firm can be reinterpreted as a particular case of a firm maximizing F. This case holds when the weight of the employees (i.e. b^*) in establishing the goals of the firm is equal to zero and the weight of the employers (i.e. a^*) is equal to the maximum weight (i.e. is equal to 1). In this particular case the firm maximizes the labour productivity and achieves an allocation shown to be equivalent to that which maximizes profit. The textbook case is, therefore, a very particular case where workers behave as machines and offer no resistance to a management rule which ignores their needs.

In general, within a capitalist firm, workers and employers maximize the two different functions (2.5) and (2.6), and the two weights a^* and b^* express their power relations in the formation of the goals of the firm. We could say that, within the capitalist firm, there is an "internalization" struggle. Each side tries to make the other give as large a weight as possible to its objective function. Each side tries to make the other internalize its objective function.

This internalization struggle can take two forms. It can take the form of open conflict. In this case, which can be called the case of the "conflictual firm", monitoring, disciplinary measures and so on are used by the employers to try to internalize their goal with the workers. The workers react by strikes and other forms of struggle. The internalization struggle can also be solved more peacefully by finding instruments that reduce goal incongruence and produce "fair" compromises. In this case, which can be called the case of the "participatory firm", profit-sharing and involvement of the workers in the decisions of the firm and job tenure are used by the employers and the employees as means for internalizing each other's goals and reducing goal incongruence.

Unlike the textbook profit-maximizing firm, in both the conflictual and the participatory firm the productivity weight can differ from the maximum weight desired by the employers and the utility weight can be positive. Consequently, conflictual and participatory firms do not necessarily maximize productivity and it is possible (but not necessary) that the self-managed firm achieves higher productivity than these more realistic types of capitalist firms. Two other reasons make this likely. The absence of goal incongruence and of struggle between employers and employees can have positive productivity effects in the self-managed firm. Moreover, only in the self-managed firm can workers fully enjoy the fruits of their productivity (and fully suffer the consequences of low labour productivity). This itself is likely to increase productivity.

In spite of the possibility that self-management may increase labour productivity, the true advantage of self-management is that workers themselves choose the weights they give to labour productivity and utility. Under self-management these weights are only the expression of social preferences and not the outcome of fierce conflicts or acceptable compromises. For this reason the "weights" chosen by a self-managed firm are preferable to those chosen by a capitalist firm, even when labour productivity is lower under self-management than in the capitalist firm.

Notes

1. COASE (1953).

2. COASE (1953), p. 333.

3. SIMON (1957).

4. SIMON (1957), p. 184.

5. ARROW (1974).

6. WILLIAMSON (1975).

7. SMITH (1776), p. 8.

8. This point is more completely illustrated in PAGANO (1983a) and PAGANO (1983b).

9. This observation is also made in VANEK (1969) and HORVAT (1982). This point implies that the workers may have different and even conflicting interests in the distribution of work within the cooperative. In this paper I am not concerned with this problem. I assume that workers are uniformly allocated and have identical preferences among different tasks.

10. REICH and DEVINE (1981) believe that self-management can improve working conditions because it reduces monitoring costs which, in turn, are shown to imply a very detailed and unsatisfactory division of labour within the capitalist firm. I agree, but the point made here is different: working conditions can improve under self-management independently of monitoring costs simply because the maximand of a self-managed firm is different from that of a

capitalist firm. I have also shown in PAGANO (1983a) and (1983b) that a very detailed division of labour is introduced in a capitalist firm quite independently of decreasing monitoring costs.

DREZE (1976) and DREZE and HAGEN (1978) have suggested that the choice of working conditions can be treated in a way equivalent to the choice of the quality of consumption goods. In both cases they come to the interesting conclusion that the market is efficient only if the number of goods is greater than the number of characteristics. However DREZE's analysis misses one important difference between the product and the labour market. The former is usually organized by sales contracts, the latter is often organized by employment contracts. In the case of employment contracts the most important issue is not the possibility or impossibility of computing a complete set of characteristics from a complete set of traded commodities. By contrast a more important and preliminary issue is that the employment contract implies that the set of traded commodities is incomplete. In other words the existence of firms implies that some task or intermediate product markets (that would be traded under a regime of complete sales contracts as I have illustrated in the pin-making example) do not exist. Here it is the existence of firms that implies that workers' self-management can improve working conditions whereas in DREZE's paper it is the impossibility of computing characteristics' prices that allows the same conclusion. While the two points are different, they are not, of course, incompatible.

11. In an interesting paper SVEJNAR (1982) examines the case of a firm where the objective functions of employers and employees are jointly maximized. SVEJNAR's paper considers the bargaining process concerning the distribution of income. Here the wage is assumed to be fixed by competition before production takes place and the analysis focuses on the decisions concerning the organization and allocation of labour power.

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