Public and Private Enterprise in a Mixed Economy

Proceedings of a Conference held by the International Economic Association in Mexico City

Edited by
William J. Baumol

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Introduction

William J. Baumol
PRINCETON AND NEW YORK UNIVERSITIES

This volume reports the discussion at a conference held in Mexico City in January 1978. A conference on the role of public and private enterprise in mixed economies was first proposed to the International Economic Association by Lord Kaldor. A distinctive feature of any meeting devoted to this subject is the absence of any large body of theory or empirical evidence on which the discussions can be based. Thus, unlike many other conferences sponsored by the IEA, we could not hope to start from an accepted analytic base well known to all the participants. The conference could not hope to take stock of any systematic body of knowledge and devote itself to exploration of the most felicitous directions for its augmentation. Our work, then, had to devote itself to an earlier phase of the analysis of our topic – the determination of the issues and the hypotheses to which future research could usefully address itself. Our agenda, then, was the preparation of an agenda for future students of the subject.

In saying this I should not imply that the functioning of public and private enterprise is entirely *terra incognita*. There exist both theoretical and empirical materials of high quality that relate to the subject and that in some cases go to the heart of the matter. For example, there is an extensive literature on optimal pricing and investment policies for nationalised firms, almost all of it dominated by the pathbreaking work of Marcel Boiteux. There is also some systematic empirical work on the performance of public and private enterprise in particular industries or particular geographic areas. Here, the work of E. S. Savas and Richard Pryke is particularly noteworthy. Finally, there is a body of experience, of knowledge derived by observation in the course of managerial activities, which is waiting to be brought together and organised. In short, the conference dealt with an area about which considerable knowledge has been accumulated, but it seems never to have been brought together and shaped into a coherent body of analysis. Part of the task of the conference, then, was preliminary exploration of this body of information to estimate its dimensions and indicate its character in a way that would be useful to future students of the subject. This goal helped considerably in determining the list of speakers invited to the conference, as is clearly confirmed by the list of contents of this volume.

A second theme ran persistently through our discussions. This was the distinction between the less developed and the industrialised economies. There was a widespread feeling that nationalised enterprise has a special role to play in some stages of industrialisation of a developing economy which is quite different from its potential contribution in an industrialised society. This issue is, of course, of prime importance to a number of Latin American countries as well as to many LDCs throughout the globe and was perhaps a main source of interest to the Mexican sponsors of the conference. A number of the papers consequently addressed themselves to the subject of economic development and its implications for the role of public enterprise.

The shadow that hung over the discussion was, of course, the danger that ideological precommitment would preclude dispassionate analysis and that participants would come determined to preach rather than to study and learn. Inevitably, there were occasional manifestations of this malaise but they were, happily, rare. In most cases dedication and concern were kept distinct from partisanship and the discussions consequently did generate some light and little heat. This volume contains papers which to me were remarkably informative. For example, the descriptions and evaluations of the experiences in Hungary, France, Italy and Germany I found extremely illuminating and in several cases led me to revise a number of views I had held before. The discussion of the kibbutz in Israel strikes me as a model of analysis of the experiences accumulated by a particular type of enterprise. I stop at this point, leaving deliberately incomplete the list of papers I consider particularly valuable, for fear of being driven to replicate the book's table of contents in order to avoid giving offence to anyone.

Finally, I turn to the pleasant task of repaying debts of gratitude. First, I must thank the Programme Committee whose members, Herbert Giersch of the University of Kiel, José Encarnacion of the University of the Philippines, Lord Kaldor of King's College, Janos Kornai of the Hungarian Academy of Sciences, David Levhari of the Hebrew University, Jerusalem, Alan Peacock of the University of York, Rodolfo Becerril Straffon of Colegio Nacional de Economistas, Jorge Tamayo of Colegio Nacional de Economistas, and William Vickrey of Columbia University, were most helpful in their suggestions and were most patient with me during the slow process of programme formulation. Second, it is a pleasure to thank Professor Luc Fauvel and Miss Mary Crook of the Paris office who did everything they could, and more, to facilitate the process of organising the conference. I owe much to their judgement and experience, and the guidance they offered.

Lord Kaldor was a fertile mine of ideas who contributed excitement and substance to both the planning process and the conference itself. Without him it would have been a much duller and less fruitful enterprise.

Our Mexican hosts – the Centro de Investigacion y Docencia Economicas – under the able and energetic leadership of Lic Trinidad Martínez-Tarragó provided the necessary facilities, arranged most effectively for our physical comforts, and, above all, contributed through its own members and via other Mexican participants many valuable ideas and much information about the special problems of enterprise in developing economies. Obviously, the success of the conference is in large part to be ascribed to the work of Mrs Martínez-Tarragó and her associates. The Mexican organisations which played a crucial role for the conference were the Secretaría de Patrimonio y Fomento, which supported the conference; the Colegio Nacional de Economistas, which sponsored it; and the Centro de Investigacion y Docencia Economicas which co-ordinated it.

Finally, I come to two debts, left until last both because of their magnitude and because of my feelings toward the persons to whom they are owed. Professor Dietrich Fischer took upon himself the task of keeping records of and summarising the discussions and in the process making sense and order of their meanderings and convolutions. Only he could have done this so effectively and so quickly. Carolyn Riportella undertook the assembly of the manuscript including editing, communication, diplomacy and handling of crises. She seems to have come out of it unscathed. Certainly, it is thanks to both of them that I escaped undamaged.

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Nicholas Kaldor
PROFESSOR EMERITUS, CAMBRIDGE UNIVERSITY

INTRODUCTORY

The subject matter of this meeting concerns the relative advantages of public and private enterprise in mixed economies.

This problem has a large number of aspects and it is one that cannot be analysed universally without taking into account the framework of political and social institutions, traditions and history, and the stage of economic development, of the particular country to which the analysis is applied.

For good or ill the world is divided into separate states which differ from one another in many things, not just in language, culture and historical image, but also in the nature of their political and social institutions which are a legacy of their past history. It is usual to distinguish among three broad groups of countries: socialist, capitalist and those of the 'third world'.

I. THE SOCIALIST COUNTRIES

In the first group we have the so-called Socialist states or 'centrally-planned economies' such as the USSR and the Peoples' Democracies of Eastern Europe, as well as China and some other countries of South-East Asia. The main feature of these countries is that private enterprise has more or less been abolished except perhaps in agriculture and in small enterprises employing not more than one or two workers. Yet, as one of the papers before us shows, the question of the type of enterprise to be preferred and to be expanded is a live problem even in the case of these economies, since, apart from state enterprises, they contain a large sector of co-operatives which, to a greater or lesser degree, are under the self-management of their worker-members, who are also collectively the owners of the enterprises though they cannot 'withdraw' their share individually. Within limits the members of the co-operatives, directly or through their elected committees, decide on the main policy issues concerning the type of products to be produced and the types of activity to which the enterprise should extend, as well as on the share of the current income which should be ploughed back into the enterprise rather than distributed. There are no clear principles to determine where the boundary line between state enterprises and co-operative enterprises should be drawn. The fact that co-operative enterprise is dominant in agriculture whilst state enterprise dominates industry and services is the outcome of a historical development which leaves open the question whether the co-operative type of enterprise should be extended to the industrial field or state enterprise be extended to agriculture, or whether it would be best to have both types of enterprise in all the main sectors of the economy, operating side by side. The Socialist countries also possess a privately owned sector producing for the market, but consisting mainly of small enterprises or of people working on their own account. Here again there is the question whether the limits of private enterprise should be constrained or loosened and what are the types of activities or the sectors of the economy for which they are best suited. All these matters are the subject of continuing discussion.

II. THE DEVELOPED CAPITALIST COUNTRIES

The mixed economies of the rest of the world raise problems of a different character. The world of the developed capitalist states of Western Europe, North America and Oceania is one in which private enterprise is dominant but where some public enterprise is also universal – they necessarily exist in those institutions which are charged with law and order, defence, public administration, and so on. In most countries they also extend to education, health and related social services, communications by road, rail, air and sea and public utilities. Many of these services could be (and partially are) provided by private enterprise – for example, education and medical services – others are a public monopoly mainly on the ground that they are natural monopolies, or that they can best be provided by a single organisation on a national scale – such as the provision of post and telecommunications, electricity, gas, railways, as well as the services which are generally provided by local authorities such as water supplies, sewage systems, street lighting, etc.

In addition to all these which we might broadly denote under the name of 'infrastructure', there is also in most countries public ownership of a varying number of industrial enterprises which are either directly or indirectly in competition with private enterprise, and where the question whether public enterprise performs better or worse than private enterprise is a matter of considerable controversy. In some countries (as in France at the present moment) the expansion of this 'optional' public sector (if I may use that term) is in the forefront of political discussion.

The individual capitalist countries show a great deal of variation in respect of the importance of this 'optional' public sector. At one extreme there are countries which have had a Social Democratic Government for a very long period and yet refrained from nationalising private enterprise or creating public enterprise in sectors where it would compete with private enterprise. The best example of this is Sweden which had a Socialist Government in power continually for forty-four years, during which the country was brought to the forefront of all others in the matter of the provision of public education and health services, social security, etc., but where the state refrained from either taking over existing firms or creating new public enterprises in competition with private ones. At the opposite end of the scale is Italy, which never had a Socialist or even a Social-Democratic government (though Social-Democrats or Socialists were often part of a coalition dominated by non-Socialists) but where nevertheless the state-owned sector of industry is very large and extensive, as we shall learn from Dr Marsan's paper.

Then we have countries which occupy a mid-position: such as Austria, France and Britain, each of which has an important group of publicly owned enterprises. In the case of Austria, which is perhaps economically the most successful of these countries, the public sector (resulting from large-scale nationalisations immediately after the war) extends to the three largest banks and to the 'heavy industries' – coal, iron, steel, engineering, shipbuilding, oil refineries and the heavy chemicals. The industrial state enterprises are thus complementary to rather than competitive with the private sector and they have provided through their own steady expansion the indispensable base for a large expansion of manufacturing industry in general. (It is not, perhaps, generally known that next to Japan, Austria had the fastest rate of economic growth since the Second World War, and the fastest increase in real income per head – in sharp contrast to the inter-war period when her economy was stagnant through most of the period, with heavy unemployment.) The public sector of Austria, accounting for 16 per cent of all employees, 20 per cent of total output and 25 per cent of exports, is the largest (in relative terms) among the developed countries of the West.[1]

Then there is the case of France and Britain where the nationalised sector of industries is mostly the product of the post-war period. Both in Britain and France the 'infrastructure' services – electricity, gas, railways and air services – were mainly nationalised after the Second World War. In addition, in Britain the first post-war Labour Government nationalised the coal industry and also the steel industry, though the latter was later denationalised by a Conservative government, only to be renationalised again – though with a much narrower scope – by the Labour Government of 1964–70. In addition, the British National Oil Corporation is a recently created state-owned enterprise for the production and distribution of North Sea oil, operating in co-operation with private firms. The Government has also recently nationalised the shipbuilding and aircraft industries. The road haulage industry has also been partially nationalised. In France, in addition to the public utilities – gas, electricity,

[1]In Great Britain the nationalised industries and enterprises account for 10 per cent of output and of employment.

railways and air services – nationalisation extended to parts of the oil-producing and refining industry, the chemical industry, the aeronautical construction industry and the motor car industry as well as some of the large banks and insurance companies. Two enterprises discussed in detail in M. Dreyfus's paper are La Régie Renault and Elf-Aquitaine, both of which are in direct competition with privately owned enterprises.

The individual firms which are nationalised in France, like Renault, are mainly the historical result of their having been owned by collaborators with the enemy during the war. In Britain on the other hand there is a group of state-owned firms where state-ownership has much more in common with the state-owned firms of Italy – that is to say, it is public ownership 'by default', occasioned by the insolvency or bankruptcy of important enterprises which would have ceased to exist unless they were taken over by the state; and where their continued existence was considered to be a national interest. This is the case of Rolls Royce, one of the largest aero engine manufacturers of the world, and the motor car firm of British Leyland, which only recently was the largest producer of motor cars in Britain and the only large motor car firm in British ownership.

In both these countries, Britain and France, the question of whether nationalisation should be extended or otherwise is a matter of acute public discussion. In France the parties of the Left are united in wishing to extend nationalisation considerably, the acute difference between the Socialist and Communist parties concerns only how large this extension should be. In Britain on the other hand the professed aim of the Tory party is to restrict the scope of public enterprises, but (apart from the BNOC), as far as I know, they have no concrete plans for the denationalisation of any particular part of the existing public sector.

The evidence concerning the relative efficiency of the public sector varies according to country, period and the particular criteria chosen. In Britain, for example, according to Mr Pryke, the public sector had a clear lead over the private sector in terms of output and productivity growth up to 1968[1] while according to his present paper, the experience was the reverse one for the period after 1968. The same appears to be true of Italy and for much the same reasons: with the deterioration of the economic situation and the acceleration of inflation, the State enterprises became the recipients of open-ended subsidies (mainly to hold down prices) with the usual demoralising effects on management and workers which that involves. There can be no doubt, however, of the success of the public sector in Austria and (at least partially) in France. In Austria the growth of output of the public sector was more than sixfold, and the growth employment threefold in 30 years.[2]

[1]See his book, *Public Enterprise in Practice: British Experience over Two Decades* (London, 1971).

[2]For France, cf. the evidence in M. Dreyfus's paper.

III. THE DEVELOPING COUNTRIES

The experience of the countries of Western Europe with public enterprise is, however, only of limited relevance for the question which should be at the centre of our discussions this week – the question, that is, how far the 'third world countries' of Latin America, Asia and Africa should develop their industries through public enterprise or through private enterprise.

This is a highly complex question, and all I can do within the compass of an introductory paper is to indicate which, in my view, are the main considerations relevant to the issue.

I assume that the main aim of all these countries is to have a maximum attainable rate of economic development so as to raise the standard of living of their populations. It is also agreed that such development is not attainable without a large manufacturing industry capable of absorbing a considerable part of the available labour force.

The main issues to be considered are:

(1) *The extent and continuity of development.* Here the argument in favour of nationalisation is that state enterprise can take its decisions on long-run considerations and these are not, or need not, be governed by the profit motive which should not necessarily be regarded as relevant from the point of view of investment decisions.
(2) *National or foreign ownership of large industrial enterprises.* While in principle this is independent of the choice between public or private enterprise, in practice in many of the developing countries, private enterprise means enterprise under the control of foreign countries.
(3) *Efficiency of operation.* Both from a technological and a managerial point of view.
(4) *Long-run effects on the general social structure.* I.e. the degree of equality or inequality in the distribution of wealth and power.

I would like to say something on each of these four points.

(1) Public enterprise and economic development

Private enterprise is actuated by the profit motive. Firms only invest in a particular 'project' when the profit which they expect from it (looked at either in isolation or as part of an interconnected plan of investments) is at least as high as any alternative way of investing the same funds. There are a number of reasons which can be adduced to show that such profit-guided investment will tend to be smaller than the social optimum.

(i) The profitability associated with the project is based on expectations, and as the future is uncertain these may be heavily discounted on account of uncertainty. This is particularly true in cases where it is a question of extending enterprises into a 'new field', either into a new industry which comes into existence as the result of new technical knowledge, or into a country in which an industry, existing elsewhere, has not yet been developed, and where the circumstances surrounding its future operations are uncertain (availability of skilled labour, management supporting public services, etc.). It normally cannot take into account either the static or dynamic economies which result from the expansion of the scale of industrial activities.

(*ii*) The theory which suggests that the profit criterion secures the best allocation of resources is only applicable under highly unreal assumptions under which the market mechanism operates perfectly, where both the amount of labour available for employment and the amount and the size of funds available for investment are to be taken as given, and where the profit resulting from any particular investment provides a measure of the net addition to the national output which can be attributed to that investment. There are a number of powerful reasons for rejecting such postulates. The additional flow of output which results from a given amount of investment may be very much greater than the stream of profits which result from it, and may be more reasonably measured by the value of the net output stream (or the stream of 'value-added') which results from that investment. When productive capacity is enlarged, it will in general be possible to increase the volume of employment, or to transfer labour from occupations where its net contribution to the national output is very small or zero to a new employment where its productivity is positive and large and where the earnings of labour are also much higher. For these reasons the measure of social profitability should not be the profit that is imputed to the owners of the capital invested in an enterprise, but should comprise also the addition to other types of income generated by the new investment. In principle, therefore, public investment can make use of better criteria for deciding on the amounts and kinds of investment to be undertaken than is the case with private investment.

(iii) This will be true also on account of the fact that when public investment is part of a national plan it is possible to take all kinds of criss-cross effects (or indirect effects) into consideration which would not be possible with private investment. Keynes once said that in the face of complete uncertainty investors generally rely on a convention that the future will be just like the present, and for that reason 'the effects of the existing situation enter, in a sense disproportionately, into the formation of long-term expectations'. Hence capacity is only likely to be created in so far as its use appears to be profitable at the *existing state of demand*. Since the demand for commodities depends on the level of incomes which are generated in production, the additional production generated in the future by the sum of the investment decisions of the present will itself increase the demand for commodities in comparison with the present level – a factor which private investors cannot take into account (or can do so only very imperfectly) since they take their decisions independently of each other. Investment by public enterprise, on the other hand, can take the comprehensive effect of all investments into account in judging the social profitability of any particular investment project. (It should be noted, however, that a State Plan is capable of doing this even when investment is undertaken by private enterprise, as the Japanese example shows. What is required is that there should be a fairly comprehensive state investment plan for industrial development, and that the state should be capable of giving effect to this plan, through the 'administrative guidance' of privately owned firms – provided that, as in Japan, these are native and not foreign-owned firms.)

(2) National or foreign ownership

In principle the question whether a particular country's industries should be developed by national or by foreign enterprise is a different one from whether the enterprise should be privately or publicly run. In some countries (such as Japan or Sweden) the scope for foreign-owned or foreign-controlled enterprises was firmly restricted from the start. However in the developing countries the standards and attainments of education are not normally sufficient for self-generated development of modern industry by native entrepreneurs, since they lack the knowledge and ability to run such enterprises, and/or the willingness to bear the risks. Hence, in practice, public enterprise may be the only alternative to foreign-owned and foreign-controlled private enterprise. It should be pointed out, however, that the absence of the necessary know-how presents an obstacle to the development of industry under public enterprise in the same way as to native private enterprise, i.e. that public enterprises will also be dependent on foreign know-how for their operation, so that in practice it may not make so much difference whether an enterprise is formally owned by the state or whether it is owned by a foreign parent company. It is also argued in favour of a foreign-controlled private enterprise that there will normally be much greater willingness to provide the necessary know-how for efficient operation – both from a technical and a managerial point of view – to a subsidiary than to provide the same in the form of technical assistance for the running of a nationalised enterprise.

In my view this presents a very real dilemma to many developing countries. It is generally agreed that foreign domination of a country's industries leads to highly undesirable results, both socially and politically, and may be creative of tensions, both domestic and international. There are several distinguished economists in the United States (such as Professor Hirschmann) who advocate that the United States should divest itself entirely from the enterprises it owns in Latin American countries, and that this is an essential prerequisite for the development both of more satisfactory international relationships and also for the sound evolution of political institutions within the countries. The best solution might be (a suggestion once made by Myrdal) that the governments of developing countries should aim at the creation of *joint enterprises* in which the developing country would provide the greater part of the capital, while the parent company of the developed country would provide the technical and managerial know-how, and they would both have equal participation in the shares of, and equal say in the running of, the enterprise, but with the proviso that the government of the developing country should have the option of acquiring the foreign parent country's share of the enterprise after a stated number of years.

(3) Efficiency of operation

The strongest argument in favour of private enterprise in developing countries is that it is generally better managed and technically more efficient than public enterprise. In the developed countries, as we have seen, there is no clear presumption on present evidence one way or the other. But it could be argued that the case against public enterprise is stronger on efficiency grounds in the less developed countries where considerations other than fitness and efficiency for a job may play an important role in appointments for the top posts in state-owned enterprises – these may be decided as a matter of political patronage, in the same way as the top posts in government services. (This does not mean that private enterprise is free of such patronage; in the case of enterprises owned or controlled by the family of the founder, family members receive undue preference for top appointments.) However, I think on balance it would be conceded that in less developed countries privately run firms may be more efficient in that they involve less bureaucracy and have a better quality of management than public enterprises.

Both this consideration and the one preceding may argue in favour of private enterprise or of joint private and public enterprises as the main vehicle for development. But it should be kept in mind that any such judgement can only be made on the basis of the existing situation the continuation of which cannot be taken for granted. It is possible for a country to develop native talents to a high degree of technical skill through education in the same way as a number of countries such as Japan or the USSR have done and it is possible also to develop a cadre of administrators both for government services and for the running of public enterprises who would bring to their task the same qualities of selfless devotion and incorruptibility as that of the public servants of many of the developed countries of Western Europe.

(4) Long-run considerations

While it cannot be demonstrated that private enterprise is superior to public enterprise in the majority of cases and the majority of countries, there are reasons for supposing that public enterprise is inferior in terms of efficiency of operation, technical dynamism etc. in countries which are less developed economically and also less mature politically – these two things generally go together.

It would also not be contested by unbiased observers that the establishment of fully fledged socialist states in the Soviet Union and various countries of Eastern Europe has not produced the results which were expected of it, not only by those who were the fervent advocates of a Socialist state, but of the