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A NOTE ON DEVELOPMENT PLANNING AND THE ROLE OF THE ENTERPRISE

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It is becoming increasingly realized that one of the most difficult problems for state policy with respect to the formation of government plans to promote economic development and to control an economy relates to the role of the enterprise (the "firm") in economic life. Apart from agriculture, it is in this area where the failures of central planning in the socialist economies have perhaps become most evident in recent years, and the changes that have been taking place in the economic management of these economies are to a large extent the direct result of the failure of earlier conceptions of the relation between the enterprise and "the plan".

But the problem is important also in so-called "mixed" economies where there is a significant private sector in industry, although here it appears in a different form and is usually posed as the problem of the relationship between the "private sector" and the "public sector". Any general economic plan must be concerned with the relation between these two sectors and it is usually recognized that the firms in the private sector will only fulfill a constructive role under certain conditions of freedom and security. But the plan must also be concerned with the proper role of firms in the public sector, where the general question of the relation between the growth of the firm and plans for the economy is much the same as in a centrally planned economy.

In a socialist economy the firm or enterprise is publicly owned, and in the socialist countries of Eastern Europe the problem of the role of the enterprise is receiving much attention, notably in Czechoslovakia where far-reaching changes in the economic system have recently been introduced. In discussing these changes, one Czech economist, for example, explained that an

> "...important goal of the changes in the system of management is to make the economy more dynamic. The previous concept understood economic development only as a collection of quantitative relationships, so that it was essentially static. With this conception, the most important task of planning to assure economic growth was to attain as high a rate of growth in savings as possible... there is now a new concept of relations between enterprises and society. Formerly this relation was founded on the principle that society decides for the enterprise how much it should save and the enterprise was then obliged to pay into the State Budget the planned profit. Applying this principle led, of course, to a number of anti-social tendencies... If a complex and integrated management of the enterprise is to be made possible... it is essential for the enterprise to have considerable freedom in managing its own finances, for it to decide itself how it can use its money, for instance, on wages or on investments, etc."[1]

Central planning can and does take a variety of forms with varying degrees of direct control over enterprises, but the notion that central planning of some kind is desirable for an economy rests primarily on the assumption that the "market" left to itself will not bring acceptable results in resource allocation, economic stability, income distribution and various other economic and social objectives. In particular, private profit and private control of industry are deemed inadequate as the guiding principle and the primary means for the regulation of economic activity. Nowadays, very few would quarrel with this assumption (although the further assumption of some socialists that these are not only inadequate but also immoral is, of course, another matter). Most economists recognizd that some form of

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[1]Miroslav Sokol, "Changes in Economic Management in Czechoslovakia", Czechoslovak Economic Papers, No. 8, 1967. pp. 12, 13, 15.

government economic management is desirable and the areas of controversy is largely limited to debate over the scope and form of such management.

The "Static" Nature of Plans

Many development "plans" are little more than a series of hoped-for projects; others involve the determination of a desired pattern of output in more or less detail for the economy as a whole including the division of the national income between consumption and investment, which is supposed to determine the rate of growth of the national income, the structure of industry, again in more or less detail, the allocation of manpower, etc. Available resources are appraised in both real and financial terms, and the planning process essentially involves the allocation of resources and flows of finance in accordance with the desired pattern and growth of output. In the more technically sophisticated planning, macroeconomic models of the economy are created, input-output tables constructed, and the whole complicated technical apparatus of modern "quantitative economics" is brought into play.

As Mr. Sokol pointed out in the passage cited above, a plan conceived of as a series of projects or of macro-economic quantitative relationships is essentially static. It is static in the sense that there is no built-in mechanism to induce changes in unforseen directions in response to changing circumstances. An economy where the activities of enterprises are governed entirely in accordance with "targets" determined in advance by a central plan will not itself be characterized by an endogenous or organic process of growth in the sense that movement from one position to another is a result of an interaction between the producing enterprises and their environment.

there is, of course nothing to prevent the growth of such an economy as investment takes place according to the plan, but in a very real sense the growth is a growth imposed from above, its efficiency depending on the "preferences", that is, the theories, of the planners. These preferences may be appropriate, and a satisfactory rate of growth may be achieved -at least for a what- but it can hardly be said to result from an inherent "dynamism" in the economy itself in the sense that is usually implied by the term "self-sustaining" growth.

There has been a great deal of discussion in economic literature about the pre-conditions for "self-sustained growth", and the importance of raising the rate of saving to some allegedly critical percentage of income is given pride of place. But if this term means anything at all it surely means that there is somewhere built into the economy a dynamic relationship which by its very nature both creates investment opportunities and promotes further investment. This is not characteristic of a plan, nor will the mere raising of saving and investment in some way or other produce such a result. It is only achieved when individual productive units-the firms-are continually and restlessly searching for ways of expanding. In this process lies the primary source of economic dynamism.

In theory, a plan can be made dynamic through the introduction of appropriate procedures for revisions in the light of events, but this is more like a model of "comparative statics" than a model of dynamic interrelationships. In principle such interrelationships can also be incorporated into planning by the introduction of "feedback" and response systems. This involves an elaborate "computarization" of the economy and, so far at least, the fruitfulness of models of this sort as a means of centrally controlling an economy remains to be demonstrated. They are essentially mechanical models and whether they can take adequate account of, or give adequate scope to, the contribution that can be made by the judgement and genius of a myriad of individuals in the society needs much more investigation than it seems to have had.

In any event, as noted above, the experience of many of the Eastern European countries has not so far been satisfactory in this respect; their difficulties have, to a large extent, stemmed directly from the inability of the planners to take adequate account of the role of the enterprise and the nature of its growth. Not only have the "preferences" of planners often proved grossly inadequate (and the theories of development or growth exposed by the planners are predominant and crucial in a planned economy) but the reactions of the enterprises in the economy to the framework imposed on them by plans have often been perverse. Moreover, for countries that must depend heavily on a diversified variety of manufactured exports, freedom of enterprises to respond directly to the market may be of decisive importance. As is suggested below, this may be vital for the future of Egypt.

The Role of the "Firm"

In any economy, the basic unit of industrial production is the firm or enterprise, for it is the firm that acquires the factors of production, organises them in the productive process, designs the methods of production and the products, and usually surveys markets and arranges sales. In particular, the firm is the organization through which innovations are put into practice. The enterprise I am calling the "firm" is more than a factory or plant, that is, more than a physical producing unit operated by workers and managers to produce the types and quantities of goods for which the plant is designed. A firm is an organization which, in addition to operating one or more factories, has the broader task of selling goods, searching for markets, raising finance, including finance for expansion, determining its pattern of output and the use of its resources in new ways. In a "market economy" it is the primary dynamic unit, acting as an intermediary between final purchases of products and the sellers of productive services.

An established firm is a continuing organization of people knit together in a defined institutional framework working to obtain an income which is in part paid out to the suppliers of productive services (including management), in part to owners (who may be private individuals or governments), and in part retained for further investment. To this end, an enterprising firm often undertakes research of various kinds, promotes inventive activity among its people where practical, and experiments with new ways of producing and selling its existing products or with the introduction of new products, and expands in new directions. Many of the activities that firms in a private-enterprise economy engage in may be considered socially undesirable or even economically disadvantageous to the economy as a whole, but this is another question. The point I am trying to make here is that the firm is the elemental focal point of point of economic dynamism. If for any reason firms are unwilling or unable to act in an enterprising manner which furthers the industrial development of the economy there will be no other source of dynamic industrial growth to call on.

Planning and the Role of the Firm

It is widely alleged that in underdeveloped countries private firms and individuals have in the past, and still are, unwilling or unable to take on the task of industrial development, lacking either the ability to overcome the peculiarly difficult obstacles in a backward economy, the enterprise to attempt to do so, or the incentive to take up industrial pursuits in contrast to commercial or financial activities or speculation. In consequence, government action is held to be required not only to create the necessary infrastructure and accept the necessary risk involved in the establishment of industrial plants, but also to control and direct the activities of the "private sector". Again, there are probably few who would challenge the proposition that considerable government action is required to speed up and direct development and that for such action government should plan carefully what they want to do. In most countries nowadays some sort of macroeconomic plan exists. It is not my purpose to attack such planning but to suggest that in many countries, including Egypt, planners have taken inadequate account of the dynamic role of the enterprise in the process of growth, and in consequence of the importance of giving sufficient scope for its expansion as the initial conditions which may have inhibited its growth change. It is obvious the mere freedom to expand is not enough to ensure dynamic behaviour on the part of firms, but I shall argue that a development policy is not likely to produce self-sustaining growth until it first induces and then gives scope for such behaviour.

I should like to make clear that the problem discussed here is not, in principle at least, related to the question of whether or not enterprises are publicly owned. It has long been standard in the analysis of business enterprises to distinguish between ownership and management, and it is widely recognized that for large firms in any event, the effective control of the firm, including the making of fundamental policy, lies primarily with management. Indeed, one could make a strong case for the proposition that the chief significance of private ownership is that it permits the existence of capital and stock markets, and that the chief essential difference between a privately-owned large firm and a public enterprise is that the former can raise risk capital from private markets. In addition, in the private sector new firms come into existence in a different way. In this paper, however, I am not concerned with the problems of public ownership, but with the relation between a central government plan and the freedom of action required by enterprises if they are to become the source of an organic and dynamic growth in the economy. If we leave aside the problem that arises for private enterprise in a mixed economy when government policy regarding private firms is either frankly antagonistic or simply vacillating and unclear thus creating such an atmosphere of uncertainty that firms refuse to take risks or make heavy commitments, there are broadly three ways in which the scope for enterprises which would permit them to fulfill a dynamic function, tends to be inhibited by government planning:

1. By the government telling firms what to do and prohibiting independent action and especialy investments without prior approval.

2. By the absorption of scarce resources in new projects or in projects imposed by the "plan" on such a scale that existing enterprises are denied adequate resources.

3. By the imposition of regulations which destroy or pervert the incentive of the firm itself, or of its managers, to take special risks or make special efforts.

The first occurs in the so-called "command economy", which has been characteristic of a number of Eastern European countries and is apparently what some Egyptian economists had in mind when they argued for a widespread nationalisation of industry on the ground that this would enable the state to control and direct the flow of investment in the economy. A hierarcy of government agencies of one kind or another has been set up in Egypt to control the investment of enterprises in accordance, in principle at least, with the plan.

The second occurs most commonly when the plan envisages the construction of new projects, and especially large ambitiously designed projects, which absorb the greater part of the foreign exchange available, thus creating a "foreign exchange shortage" which compels the government to refuse permission for the expansion of existing enterprises in many projects even universally accepted as desirable. It should be remembered that any government can in this way create a "foreign exchange shortage"; as will be argued below, such a course may be particularly dangerous for an economy which must depend on the development of a diversified range of manufactured exports. Again, there is reason to think that this kind of policy has inhibited expansion in Egypt.

The third way in which the dynamism of enterprises may be restricted tends to occur in economies where certain types of social policies, in particular, policies with respect to income distribution, are carried to great lengths without regard to their economic consequences, or where the enterprise is prevented from establishing a direct relation with the market, as is the case when it is required to sell through an intermediate selling organization which has no connection with it.

Let us now consider in more detail and in the light of the nature of the firm and of its growth, the way in which these three types of restrain on enterprise affect the firm.

Direct Control of Activities of Firms

Like other human organizations, an enterprise involves the life of the men who work in it and, if it is to operate effectively, must call forth some sort of commitment from them, especially from those whose function is to undertake responsibility and devote what talents they have to creative, non-routine activities. Men seem to try to find a satisfaction or meaning in their working lives by identifying themselves with the institutions in which they work and finding in the success of the institution a purpose worthy of the commitment they make.[1] Cooperation to this end leads to the development of the firm as an organism in its own right which establishes its own goals and reacts aggressively or defensively to the outside world to advance its interests or to protect itself from the adverse consequences of external events. The psychology of social organizations is not within the special expertise of economists and I have not space to analyze this aspect of the problem here. But since economics is a social science, such psychology

[1] It is partly for this reason that a closer association of "the workers" with the control of the firm is often deemed desirable, but there is a difference in kind between activities that involve the acceptance of personal responsibility for a large variety of matters, the need to make important decisions affecting the firm as a whole, the organization and management of other men, and in particular the need to exercise imagination and creative judgement, and the routine activities undertaken by the majority of workers. It is sometimes feared that the latter will necessarily be "exploited" or unjustly treated if they do not participate in management, or believed that since workers too are part of the firm they have a natural right to participate in the control of it. Thus, in some countries (and in some firms in all countries) arrangements are made to enable them to do so. Whether or not such arrangements exist makes no difference to the argument put forth above, which is not concerned with the composition of management but with the scope to be given it.

treated as passive agents executing other people's decisions; they will inevitably react creatively or perversely according to the circumstances.

The central planning of a "command economy", in principle at least, tells the firm what it ought to do both in terms of targets to be fulfilled and in terms of the general policies governing its operations. It is true, that even in such an economy, planning starts to a considerable extent from the bottom up, so to speak. Firms are consulted about their requirements and objectives and they put forth their own plans for consideration. They are not left out of the planning process. Nevertheless, the "coordination" of the plans of firms in the light of the overall "strategy" adopted for the economy is in the hands of a variety of superior organizations, which make the final decisions, hand down the targets and instructions, and lay down the criteria according to which the success of firms will be judged. The scope for enterprising activity on the part of firms is thus confined to their participation in plan-making and in putting forth suggestions for revisions, but always subject to the higher authority of the controlling organizations. A variety of techniques for decentralising decision-making can be built into the structure of control, but this is merely another way of saying that the firm may be given a certain amount of freedom or autonomy in particular areas. But at some point such freedom for the enterprises becomes incompatible with central planning of this kind, which rests on the assumption that a coordinated plan governing the actions of firms will give better results than would be achieved by allowing firms to react to opportunities without reference to the objectives of an overall plan for the economy.

With this approach to the relationship of the firm to the plan, several problems arise. In the first place the plan may be wrong in important respects, wrong in the sense that it requires actions of the firm which are patently unreasonable or it prevents the firm from taking action that is patently sensible. If one is to rely on the criticisms of economic policy that have been published in socialist countries, such results are common, ranging from the simple over-production of goods the market will not absorb as a result of attempts by firms to fulfill the targets given to them, to the employment by the firm of workers it cannot use (and which may even be in demand elsewhere) in order to fulfill their employment targets. If the firm at the same time is required to make profits to fulfill financial targets, it often reacts to protect itself from the adverse consequences of failure, by maneuvering to obtain especially low targets, by using its resources inefficiently in order to justify higher prices, by altering the quality of products, etc. Here the scope for "enterprise" may be very great as the "organism" engages in defensive maneuvres in its own interest, but the "enterprise" is of course perverse from the point of view of the growth of the economy.

These are negative results of enterprise. If we turn to the more positive side of the enterprising activities of a firm, a problem arises when the economic limit in the expansion of the size of the market (which may be a function of transport costs) or because of its rate of growth, alternatively, firms often find fairly early in their career that they can profitably enter new lines of activity while continuing to expand in existing lines. This is commonly due to the fact that the rate of growth of the market for their existing products is insufficient to absorb the resources available to the firm,