

Chapter 5: Summary and Overall Conclusions

5.0 Introduction

This final chapter summarises the main conclusions of this volume. In section 5.1 the most important findings will be presented, including the conjectures that were developed. In section 5.2 suggestions for further research will be offered while the last section 5.3 contains some consequences for economic policy.

5.1 Findings

5.1.1 Anomalies in the market-government debate

In the first chapter a stick-figure presentation of the market-government debate is given, focusing on the efficiency and effectivity of economic production in its broadest sense.

Because most production takes place in organisations a model was developed of the ideal-type categories of organisations and their interrelationships. Four categories are distinguished: commercial organisations, associations, public organisations and households. Between them there is a constant flow of trade, of gifts and subsidies and of levies, while many public organisations can formulate rules and regulations. These rules and regulations can be distinguished in rules *correcting* the market, rules *influencing property rights* and rules that facilitate or mitigate the operation of the market.

The main types of organisational inefficiencies described are X-inefficiency, Schumpeterian inefficiency, allocative inefficiency and Keynesian inefficiency. Attention is also given to the hindrance of the effectivity, efficiency and equity of government organisations caused by pressure groups.

Attention is then directed at three anomalies and one puzzle, which cannot be solved within the present corpus of the debate. The first is the *agency paradox*: all explanations of the superiority in terms of performance of commercial organisations as compared to public organisations derive from Adam Smith's "invisible hand" assumption in the end. The paradox consists of the fact that most commercial production is carried out in organisations where the manager is not the owner. In other words, in organisations that are just as much agency-managed as public organisations.

The second is the *Sturm-de Haan paradox*: while there is no relationship between economic growth and the level of the Gwartney-Lawson economic freedom index (EFW-index), there is a significant relationship between increases of the EFW-index and economic growth.

The third is the *privatisation paradox*: while few doubt the superiority in terms of performance of commercial organisations as compared to public organisations, it is paradoxical that the consequences of privatisation are mixed.

Finally, a riddle is encountered. It is found that the weight of the onslaught of the Spanish flu in the United States was *positively* correlated with economic growth in the following decade. Within the existing framework of economic theory no adequate solution of this puzzle can be found.

The main conclusion of chapter 1 is therefore that economic theory “breaks down” somewhere; a void must be filled.

5.1.2 New conjectures

In the second chapter new combinations of existing theories and new conjectures are developed that together seem to “do the job.”

The first four sections contain a model, in which (contrary to economists from Williamson onwards) control is considered to be dynamic and not static and more or less a constant. The consequences of *variable* control are introduced. It is explained how any organisation eventually becomes uncontrollable, no matter how competent its management and no matter how motivated its workers/members. Uncontrollability is defined as the situation in an organisation in which “*only a small fraction of the intentions of the principal are effectively satisfied by workers/members, the organisation is ineffective and the principal lacks the information necessary to restore effectivity.*” It is best described by the example of a broken windshield of a car. Even the best driver cannot keep his car on the road under those conditions. It was explained that control loss is increased by, inter alia, the number of hierarchical levels, the size of the organisation and the complexity of its operations (especially when management information is difficult to quantify objectively).

In the next two sections other causes of loss of effectiveness are identified. These causes differ in predictability.

More importantly, some of them are not internal but lie in significant changes in the economic environment (technology and markets of both produce and production factors). As Schumpeter noted, stage-coaches will become obsolete by the introduction of railways. Restructuring a stage-coach organisation to make it suitable for running railways is impossible, so the organisation will lose all its effectiveness.

Summarizing, the **first conjecture** is that at a certain stage organisations irreparably lose their effectiveness and that *this effectiveness cannot be restored*. This loss can have both *external and purely internal causes*. To my knowledge this conjecture is new and untested.

In the sixth section the consequences for an organisation of losing its effectiveness in general, and of uncontrollability in particular are described. From Joseph Schumpeter onwards the prevalence of organisational dissolution in the market is well known and appreciated¹⁴³, while János Kornai described the “soft budget constraint” as unerringly protecting ineffective public organisations. The **second conjecture** (again, to my knowledge new and untested) is that this difference between the market and government constitutes an important cause of the fact that the average effectiveness of a market organisation is so much better than that of an average public organisation.

In the seventh section two archetypes of organisational demise are defined and described. In the first, *economic necrosis*, the organisation falls apart and nothing remains. In those cases in which the organisation did not add value to society, but actually subtracted value from it, this is, of course, still a gain to society as a whole. The second archetype is *economic apoptosis*, defined as *carefully carving up an organisation, ideally along those hierarchical lines where control is lowest*. After apoptosis part of the productive capacity survives to every one’s advantage. The **third conjecture** is that economic apoptosis of ineffective organisations is an important mechanism through which the market can and does enhance its productivity.

Economic necrosis and apoptosis are difficult if not impossible to execute in the case of monopolistic public

¹⁴³See also Disney, Haskel and Heden (2003: 691)

organisations performing essential collective services (MPOPECS). Once these organisations lose their effectiveness, they constitute a serious obstruction of public welfare. This is our **fourth conjecture**.

Finally, in the eighth section of the second chapter, it is shown that, as the distinction between “sheltered” and “exposed” organisations (the first are protected from the consequences of ineffectiveness, while the latter are not) largely coincides with the distinction between public and market organisations, these conjectures do indeed explain the difference in effectiveness. This constitutes our **fifth conjecture**.

5.1.3 Corroborating the conjectures

The main problem in finding corroboration of our findings is that some of the key theoretical concepts are new and lack empirical backing. Neither was the relevance of at least one of the older concepts (control) confronted with reality. However, in developing these conjectures quite a number of “stepping-stones” are used for which data are available. In addition, a number of side conclusions logically follow from the line of reasoning. If these latter are falsified the line of reasoning proper would lose credibility. An excellent example is presented in section 3.1. If commercial organisations can grow infinitely, the concept of control would become dubious. Fortunately for this author, ample corroboration can be presented.

In section 3.2 evidence of the prevalence of organisational entries and exits in the market and its absence in the public sector is given. Section 3.3 contains data on the contribution of these exits towards increasing average productivity. In the market less productive organisations are indeed more prone to dissolution than more productive organisations; therefore the process of dissolution contributes to overall productivity.

In the next four sections it is demonstrated that our conjectures do indeed solve the four anomalies. The utility difference between manager and owner (the agency problem) is replaced by the necrosis/apoptosis of ineffective organisations as the explanation of the superiority in terms of effectiveness of the market sector as a whole.

In section 3.5 we demonstrate our solution of the the Sturm-De Haan paradox. If productivity *growth* in the public sector is more

or less comparable to that of market organisations in the same country (and there are few reasons to believe it is otherwise) the acceleration of growth that accompanies *liberalisation* is caused by moving employees from less productive public (and sheltered) organisations to more productive (and exposed) market organisations. The *level* of “economic freedom” would not affect economic growth. This solution is corroborated by empirical data.

In 3.6 it is demonstrated how (according to our conjectures) it is not moving an organisation from the public into private ownership and/or control, but exposure to risks of necrosis/apoptosis that improves productivity. This explains the mixed results of privatisation.

Finally, in 3.7 our solution of the Spanish flu enigma is given. This pandemic can have caused the accelerated dissolution of less productive organisations. However, measures of the influenza pandemic *do not* correlate with business failure rates. Failures are defined as “closures leading to, or likely to lead to loss to creditors”. This forces us to introduce a sub-conjecture, that the type of dissolution caused by the Spanish flu did not result in losses to creditors. Introducing a sub-conjecture, however plausible, weakens the strength of the argument until it is tested.

5.1.4 Illustrations

The first three chapters were filled with seemingly abstract theory and statistics. Lest the reader forget that the subject matter concerns real people and real organisations, a final chapter was included in which two pairs of case histories are described.

In the first the aftermath of an extreme economic shock was described in two countries, Japan and Korea. The government of Japan reacted by sheltering organisations from the consequences of the shock; the government of Korea did nothing of the sort and let the storm of organisational destruction rage. While the Korean economy rapidly regained health, the Japanese economy remained in the doldrums for many years.

The second pair of case studies concerns the reaction of British and French monetary authorities to the crises of Barings and Crédit Lyonnais, respectively. Both banks are shown to suffer from uncontrollability. The British authorities followed a “laissez passer” policy, leaving it to the ING bank of the Netherlands to

perform what constitutes a near perfect example of economic apoptosis. The French authorities did everything to save Crédit Lyonnais. The bill for the French was astronomic, especially because the chaos continued after the French authorities “took charge.” The only consolation that can be developed that, possibly, systemic damage would have been even larger. However, the costs of increased moral hazard in French banking must also be included. The latter two have never been quantified. The net result is simply not known, even in hindsight.

5.2 Suggestions for further research

When rereading the first four chapters the author realises every time how much the wording of the title of this book must be stressed. It is indeed “a first enquiry”. Nearly every statement needs further analysis, formalisation and experimental-empirical-statistical testing. A few topics stand out in terms of priority.

- i) The empirical testing of the relationship between privatisation and productivity should continue, focusing on the roles of ownership, delegation, competition and sheltering.
- ii) Empirical investigations into the relationship between effectiveness and organisational dynamics could very well falsify (or corroborate) the conjectures developed.
- iii) In this volume it is argued that corporate mergers and acquisitions are usually accompanied by economic apoptosis. However sound, this argument begs empirical backing. Again, the results could falsify our conjectures.
- iv) It is recommended that the Brainerd-Siegler investigation of the influence of Spanish flu on the economy is redone, focusing on organisational dynamics. Few situations offer such a natural laboratory setting for testing the theories developed in this book.

5.3 Consequences for economic policy

If the conjectures developed in this book survive scrutiny (and the size of the “if” can hardly be exaggerated), a new element should be added when deciding on the appropriate governance of economic organisations. This new element can best be formulated

as a question: “What are you going to do with a certain organisation *when* it loses its effectiveness?”

An excellent illustration of the relevance of this question would be provided by the banking sector in the Netherlands, in which just four banks dominate. It is plausible to believe the moment will come, only postponed but not precluded by intense supervision by the Dutch Central Bank, when one of these banks falls into disrepair. Because of potential systemic damage, financial stakeholders (possibly with the exception of shareholders and the like) will be protected. Legal instruments should be in place to ensure that this protection does not prevent economic apoptosis.

The question is most acute in the case of monopolistic public organisations producing essential services. Their sheltered nature derives from the fact that they can be neither missed nor replaced. In the case of private services (i.e. health care, education) good public governance will therefore be aimed at preventing such a situation from developing, by ensuring that consumers will be offered a choice. Two instruments are involved: overcapacity (e.g. when a nursing home closes, the patients can be transferred to other institutions) and multiple providers. The costs of uncontrollability presently being born in terms of expenses and/or reduced quality of service significantly exceed the costs of these preventive measures.

In the case of providing genuine collective services (roads, public safety), the main instruments could be outsourcing (“preventive apoptosis”) and decentralisation. This last instrument may seem strange. But if, for instance, a county police force fails damage will be less and it could very well be more simple to find solutions than if a national police force fails. A definitive conclusion lies beyond our field of enquiry.

5.4 Postscript: Karl Popper on democracy

An interesting parallel is found in the writings of Karl Popper: “Es ist daher falsch, wenn man die Betonung auf die Frage legt (wie es von Platon bis Marx und auch später immer wieder getan wurde): “Wer soll regieren?”... Alle diese Frage sind falsch gestellt. Denn es kommt nicht darauf an, wer regiert, solange man die Regierung ohne Blutvergießen loswerden kann. Jede Regierung, die man

wieder loswerden kann, hat einen starken Anreiz, sich so zu verhalten, daß man ihr zufrieden ist. Und dieser Anreiz fällt weg, wenn die Regierung weiß, daß man sie nicht so leicht loswerden kann” (Popper, 1987: 54).¹⁴⁴

This parallel is interesting and far from accidental. In this volume it is argued that an important reason that organisations operating in the market are more effective than public organisations is that the latter operate under the “soft budget constraint” of Kornai, while the former have to perform or perish. In other words, the market eliminates ineffective organisations; the states allows them to survive, to the detriment of all. Popper states that in an open society ineffective governments can be removed, while in a closed society this is impossible (without bloodshed).

¹⁴⁴“It is therefore wrong to put the stress (as so many from Plato to Marx and even later have done) on the question: “Who should rule?”... All these questions are wrongly posed. For it does not matter who rules if it is possible to get rid of the government without bloodshed. Any government that can be thrown out has a strong incentive to act in a way that makes people content with it. And this incentive is lost if the government knows it cannot be easily ousted” (Translation Popper, 1999: 94).

