

INSTITUTE OF ECONOMICS
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OVER-CENTRALIZATION
OF ECONOMIC MANAGEMENT

(Critical analysis, based on research within the light industry)

BRIEF SUMMARY OF THE WORK

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LABOR MARKET

STUDY ON THE

LABOR MARKET

IN THE

IN THE

Preface

This paper is a product of investigations made by the Institute of National Economy of the Hungarian Academy of Sciences. Its topic became actual by the fact that independent initiative by leaders and workers of enterprises and local authorities was felt to be hindered more and more in these last years in Hungary by over-centralization of direction and by the bureaucracy by which it was accompanied.

The first step to be taken for this investigation was description and analysis of given methods of economic management. One feels induced to think this could be found in dozens of books but this is not so. There are of course books describing methods used in Hungary for leading the national economy, for planning, the system of wages and prices etc. But all these have a common feature: they do not tell how this economic mechanism really does work but how it would work if it were as the authors wish it to be. These books make the impression on the readers as though in this planned economy the most perfect harmony ruled, as though in this machinery all gears fitted most smoothly into each other. Just therefore it meant a new task which till now had not been carried out in Hungarian economic literature, to give a coherent description of how the economic mechanism does work in reality.

Naturally, this paper could solve but a part of this problem. It does not try to give a full perspective of all advantages and disadvantages of actual methods for economic direction, it has no intention to set the balance of results and mistakes. This investigation set deliberately the purpose to show contradictions and insufficiencies of the economic mechanism in vigour till now.

This paper investigates its problems tagging its examples from the light industry. But many of the phenomena described here may be found in other fields also and considered as more or less general.

I. THE SYSTEM OF PRECEPTS

1. Enterprise Plans

In the light industry, yearly plans of enterprises have been prepared centrally by the Industrial Departments of the Ministry. Yearly plans of the enterprises had but slight foundation by detailed calculations of needs. The manager, chief engineer and the chief of the planning department had almost no share in the preparation of his own enterprise plan.

The yearly plan has no real reputation with the enterprises, owing to following circumstances:

- There are no serious material consequences to the fulfilment of the yearly plan.
- The yearly plan says very little to the enterprise; it is so general that the enterprise cannot prepare itself on this base for its tasks.
- In connection with the yearly plan, the enterprises suppose from the very first that the total of the four quarterly plans will anyway differ from the yearly plan.

Contrary to yearly plans, the quarterly plan is really considered as a base to enterprise activity, strongly connected to the fact that the bonus of economic leaders depends of its fulfilment. But similar to the yearly plan, it is also fully prepared by the Industrial Department of the Ministry, including smallest details. All this means that some fundamental functions of enterprise management are exercised practically by the Industrial Department of the Ministry. Actually, the Industrial Department represents the economic unit, and independence of the enterprises is more or less illusory.

2. Plan Indices

The ministry prescribes the tasks for the enterprise by means of different economic indices /e.g., gross production, first costs, quality etc./. These indices must be looked upon as compulsory precepts.

The question arises: do the plan indices represent truly the will of central economic organs? Do they lead the enterprise without equivocity to what the superior authority really wishes?

From this point of view, the paper makes a survey of the different indices. In this summary, there should be mentioned but three of them.

The first is the index of production value. This index prescribes the gross amount of products to be manufactured by the enterprise, measured in Forints. This index entails simultaneously positive and negative, sound and adverse effects. The positive effect: when superior authorities raise from time to time the plan of production value they no doubt lead the enterprise to increase the amount of goods produced by it and so, indirectly, to increase productivity and to make better use of existing capacities. At the same time the negative effect appears that the enterprise tries to increase production value also by different "tricks" /e.g., laying greater emphasis on production of goods needing more material, that is to say: yielding greater Forint values, maybe producing explicitly unnecessary goods/. The paper makes a detailed analysis of how this might happen.

Another important problem is posed in connection with indices showing quality of products. These indices show but one side of quality, considering only some properties of the goods instead of overall considerations. So it may happen that quality of goods in reality grows worse and "quality indices" nevertheless indicate an improvement, or vice versa. This fault is all the more serious since meanwhile many elements of the economic mechanism lead to a deterioration of quality.

Serious difficulties emerge also in connection with first cost indices. These are looked upon by many people as the most complex index numbers of enterprise activity. This, however, is an exaggeration. It must be said that this index is essentially indifferent to the trend of product sales; its magnitude does not depend on how the product meets requirements of the customers. Besides its positive effect, the incentive to save, it has a definite negative effect, too. That means that first cost may be lowered also by deterioration of quality, or by restriction of the assortment. Enterprises make use of these possibilities more than once. This is the more dangerous since the whole actual system of plan indices and bonus leads the enterprises to neglect these tasks.

It is impossible to plan first cost indices with absolute precision even for a quarter. The paper proves this by several tables. Nevertheless, bonus of economical leaders depends on fulfilment of these indices to the tenth part of percents.

3. Other precepts regulating production

The superior economic organs give the enterprises compulsory precepts not only by the plan indices. There are many other kinds of precepts, decrees and restrictions which influence enterprise activity. All these curtail seriously the independent managerial rights.

II. THE INCENTIVES OF ECONOMIC MANAGEMENT.

The paper next investigates: what prompts the economic leaders to execute the different precepts and plans?

1. The economic incentives

Earnings of economic leaders of enterprises have several components. Above the basic salary determined in a fixed sum, they get a recurrent quarterly bonus, depending on the fulfilment of certain plan indices. In the light industry, this recurrent bonus corresponds to 20-30 per cent of the basic salary. The leaders establish their way of living by taking the bonus for granted, just therefore it has an extraordinary strong incentive effect.

After this, the paper discusses in detail the bonus system of Hungarian light industry, then it

emphasizes some of its general characteristics:

- The bonus system is modified incessantly since years. This arouses uncertainty and lessens its incentive effect.

- Independence of the enterprise and the manager is practically very limited concerning the bonus.

- Subordinate employees get their bonus very often on the basis of factors to which their work is absolutely ineffective.

The bonus system mobilizes at the present time above all to the fulfilment of two plan indices, i.e. the targets of production value and first cost cutting, beside these it gives a strong incentive to keep the wage fund within the set limits. Just therefore these are the "dominant" index numbers in the whole system of plan precepts.

After this, the paper considers the importance of the different extraordinary awards, then turns to the system of fixed basic salaries. This system has three principal insufficiencies:

a./ Difference between salaries for bigger, highly responsible and simpler, inferior jobs is too light. Thus, the leading technical and administrative staff do not see before them enough outlook to considerable pecuniar rise. And yet the trend upwards, the perspective of "career" in the sound sense of the word, the gradual progress on social scale and, altogether, the constant and considerable increase in basic salary - these are immense and irreplaceable pecuniar and moral incentives in the life of people and especially in that of technical intelligentsia and employees.

b./ basic salary system does not care for the period of professional practice and the service years.

c./ There are very narrow limits for salaries of men working on identical jobs.

Work of technicians is an extraordinarily complex, many-sided, and intricate mental work, especially with those having been entrusted with some leading function. Most of them have jobs which are not appreciable by two or three indices but only by a more many-sided and complex method. The actual system, however, where the levels of basic salaries are too near each other and bonus depends rigidly on the fulfilment of two or three plan indices is unable to provide such a complex evaluation. Thus, earnings of technicians or leading employees grow, to a certain extent, independent of their own performance. Beside his good or bad work, earnings of the technician depend on other factors: whether he happened to get "by luck" an easy-to-fulfil plan figure, whether he can, by some tricks, add 2-3 per cent to the correctly gained results, whether he is ready to neglect the interests of national economy in the interest of his bonus, etc.

The paper analyses further the problems of collective awards to the enterprise and punishments inflicted on the enterprise /forfeits, etc./, then it discusses the so-called "Manager Fund" and "Plant Development Fund". These are funds at the disposal of the enterprise or, more exactly of the manager if certain prerequisites are met. These two funds have a special significance since in the whole actual system of material interest only these are connected with enterprise earnings and rentability.

The paper raises some problems in connection with these two incentives:

- The manager of the enterprise and the other leading employees have no direct interest in increasing these two funds as they have no personal interest in increasing enterprise earnings.

- There is but a very slight sum which may be used from the Manager Fund for personal awards and so might connect immediately personal and enterprise interest also with subordinate employees.

- The two funds already ensure that growth, technical development, social and cultural possibilities of the enterprise depend - at least to a small extent - on its own results, and not exclusively on decisions of superior authorities or eventually centrally granted investments. This connection between results and development of the enterprise is, however, still very slight.

- The system of the two funds is extremely intricate.

- The hand of the manager is completely tied up as for using the funds entrusted to his "independent disposal".

- Chief source of both funds is at the time being the net profit of the enterprise or, more precisely, the excess profit over the planned figure. Yet the planning of profits - as data given in the paper show - is very unreliable and therefore leads to recurrent unpleasant surprises.

2. Moral-political incentives

Economical leaders and technical staff of enterprises are not led by material interest alone. Other factors which may be summarized as "moral-political incentives" have also an important part in economical life. To these belong the consciousness of economical leaders, the incentive effect of well-done work; the controlling power of social and political organizations; the power of publicity and public opinion; public praise, awards, etc.

The effect of these factors is often overestimated. This effect has really its limits. So for instance political propaganda is unable to counteract with full success such harmful effects as are necessarily caused by the methods of economical management and pecuniar incentives discussed in the paper.

3. The part played by state control and punishments

To the incentive factors for economic leaders belong the compelling power of the law, the different punishments, the consciousness that those guilty of negligence will be held responsible.

In a system where the part played by the state in economy is extraordinarily increased, it comes necessarily to a greater extent to punishments, legal impeachments or - as it is called in Hungary - to the use of "administrative methods". The question emerges: how great should be the rate of using administrative methods?

It is well-known that, after 1949, in the public life of this country tyrannic "leading" methods became general and in many spheres persuasion turned into forceful methods. This was, among others, accompanied by the fact that in those years administrative measures began to prevail more and more also in the economical life. The paper illustrates this by numerous examples.

There is a very close connection between efficiency of material interest /and, beside it, moral-political incentives/, on the one hand, and the use of administrative means, on the other hand. The less a system relies on the material interest, and the less it can count on the fervour of the people, the more it is in need of using compelling measures.

III. Some fruitful and harmful trends caused by plan precepts and incentives

Plan index numbers introduced in the foregoing chapters, precepts and incentives have many and extraordinarily intricate effects on enterprise activity. As a result of all these effects, definite economic processes and trends make their appearance. The paper examines some such trends.

1. The vigorous increase in the quantity of production.

The system of precepts and incentives together exerts a very strong effect to increase the quantity of production. This effect has been the most vigorous in the past years and - notwithstanding its doubtless one-sidedness - brought real results.

2. The false "priority" of tasks

How does the planning and incentive system mobilize to fulfil the different requirements of economy? The most important six requirements are: to produce

- at the lowest cost,
- with the lowest fixed and circulating funds,
- in the best quality,

- as many products as possible,
- further, those products which community needs most,
- and all that so as not to endanger but to promote future production and complying with future needs of society.

In the actual system of economic management, the enterprises get detailed precepts for fulfilling separately all of these six requirements. Furthermore, they do not get precepts for these but even to the extent which means, which actual methods to use in order to fulfil these requirements. The worst of it, however, is that these different precepts have not the same influence on production. "Most important" is the fulfilment of index numbers connected with the bonus. All further precepts, or indices seem less important in the eyes of economic leaders. The paper enumerates numerous facts showing how enterprises neglect tasks of basic importance in order to fulfil index numbers connected with the bonus.

The hereby developed "priority" among the enterprise tasks has no real economic justification. In the whole of the national economy no one of the abovesaid six requirements must be neglected permanently for the sake of others because, sooner or later, there is a price to be paid for this. That happened in more than one sphere of Hungarian industry.

3. The fetish of the "100 per cent"

Among economic leaders an attitude has developed which attaches extraordinarily great importance to the fulfilment of plans in every instance to at least 100 per cent. They in fact "make a fetish" of the 100 per cent. This attitude looks upon the fulfilment of plan to 100 per cent as upon a node with objective significance like e.g., the 100 centigrades, the boiling point of water.

This attitude has no justification since in the exact setting of the plan there are a good deal of arbitrariness and casual elements. The paper shows at several occasions that plans can not be set with full precision.

This "fetishization" is accompanied by many kinds of harmful effects. One of them is the often quoted rigidity of economy. Another specific effect may be called the "psychology of lost hopes". When it seems hopeless to reach 100 per cent, the enterprise does not try as hard to reach at least 99 per cent since it lost anyway the bonus and the moral appreciation.

4. "Speculation" in planned economy

The chapter on plan index numbers has shown how the different indices may be increased not only by measures which are useful to national economy but also by resorting

to several undesirable methods. Everywhere among the enterprises one may find economic leaders who are veritable artists of this peculiar "speculation in planned economy". They do not commit illegal frauds but simply make smart use economic contradictions and equivocities to be found in index numbers influencing the bonus.

5. Struggle about loosening and tightening the plan.

Enterprise leaders are directly, personally interested in getting a loose plan since it is easier to overfulfil it and so they have an easier way to material and moral recognition. The loosening trend by the enterprises produces its reaction at the superior authorities which suppose anyway that the complaining enterprise wants an unreasonably loose plan. Consequently, a veritable struggle is going on between enterprise and superior authority upon the setting of plan figures.

Improvement of economic results is extraordinarily delayed by a phenomenon which might be called "planning-in of results". This must be understood as follows: the level reached by the enterprise in a given period by overfulfilment of the plan, is prescribed for the enterprise already in the next period as a planned, as a compulsory minimum. Thus, economic leaders see that their eventual extraordinary efforts for which they got in a period an extra bonus are required from them already for the next period "gratis". The paper quotes several such examples. For such reasons enterprise leaders literally get frightened if they overfulfil their plan to a too great an extent and prefer to go slow.

6. The periodic inequality of production

Industrial production goes on at the end of a month or a quarter with multiple vigour, but falls back badly at the beginning of the month or of the quarter. This peculiar periodicity or fluctuation of production is repeatedly provoked by the fact that all planning, reckoning of results and the supporting material and moral incentives are built on the time-table of the calendar. Consequently, it is not true that this fluctuation may be stopped simply by better organization.

7. Conflict between "today" and "tomorrow"

The enterprise must help its future development by many measures /technical development, perfection of products, maintenance and renewal of machinery, training of operators etc./. Before enterprise leaders the same quandary emerges again and again: should they neglect future development of the enterprise in the interest of fulfilling or overfulfilling the actual quarterly plan?

Or should they rather give up interests of the actual plan to the future? Since all material and moral incentives are connected with the execution of actual plans and, on the other side, economic leaders do not feel peculiar individual losses when neglecting the future - the tasks serving a constant development are always pushed into the background.

IV. RELATIONS BETWEEN THE ENTERPRISES; THE "BUYER" AND THE "SELLER" ENTERPRISE.

1. Relations between light industry and home trade

When the trade is supplied with ample and selected stocks of goods then it can exert a certain "pressure" on industry for the meeting of different requirements by the consumers. In such a situation the meeting of several requirements of primary importance may be ensured at the enterprise by intervention of trade "from below" - without, however any special precept to the enterprise "from above". The paper cites examples how increase of trade stocks in certain spheres had contributed to improvement of quality and assortment of the goods.

If, however, there is a shortage, if "hunger for goods" appears, then industry easily may disregard wishes of the trade and consumers find themselves in a defenceless position. In Hungarian national economy this situation arose more than once. Under such circumstances it was tried to keep back enterprises from considering only narrow enterprise interests by means of ministerial precepts; so it was tried to bring them to yield a greater assortment or to improve the quality. Thus, goods shortage gives way to over-centralization.

In the light industry, generally the Industrial Department of the Ministry levels the corresponding department of the Ministry of Home Trade. Economic relations developed in effect not between industrial and trade enterprises but between superior authorities. This far reaching centralization of administration also contributes to the monotony and uniformisation of the selection of goods.

The paper examines further the system of contracts and discusses also the question of producer prices.

2. Some questions of material management

In the last years the light industry repeatedly experienced shortage of the most important basic materials, many subsidiary materials, fuels, power and different semi-finished products. As data given in the paper show - there is almost no material of which in the last years stocks would have reached the level fixed by the standards.

Material shortage causes very heavy losses. It produces standstills in the continuity of production. It leads to material wastage since the plant is forced to use expensive materials instead of cheaper ones. In other instances it impairs quality. The paper mentions many such cases. The mentioned evils are accompanied by an "unseizable" economic loss: if processing industry is worried by shortages it is defenceless against the enterprise by which it is being supplied and thus, it can not raise severe requirements.

In economic life, material shortage inevitably strengthens the centralization of management. This is true even for capitalistic conditions, though their very existence is depending upon the independence of the enterprises being owned by separate businessmen or capitalist groups. At the time of vigorous militarization and especially in wartime of economy, however, when shortage in certain materials grows permanent, even here different centralized forms of material management appear. It is but logical that in a nationalized industry which anyway is led centrally, material shortage is still more accompanied by increasing centralization.

Thus a peculiar contradictory situation develops. On the one side, material shortage is one of the factors which force superior authorities to plan very minutely. On the other side, exactly the frequent shocks of material supplies make it impossible to comply with all details of these very minute plans.

3. On the right proportions of production and consumption

Trade complains about too small stocks of some consumer's goods. Industry often mentions the lack of due reserves in basic materials and semi-products. The point is that there is a coherent, overall problem: that of relations and proportions between production and consumption /consumption to be understood as personal and productive consumption together/.

Economic policy in Hungary - above eliminating large-scale overproduction which leads to crises - created rather often and on a rather wide range a situation to be characterized as "underproduction". It is not that national economy produces less than the absolute demand of society - this is natural. But a relative shortage does exist. On the one hand, there is a shortage in certain means of production, above all basic materials and semiproducts, in relation to capacity and planned tasks of the processing plants. On the other hand, there is sometimes a shortage in consumer's goods in relation to demand. Yet the advisable proportion would be a certain relative over-production - on not too great a scale but general and permanent kind.

What is the cause of the shortage? Partly it is a disagreeable but necessary concomitant symptom of quick development. But the evils accompanying the quick development of productive forces have been deepened and sharpened by different mistakes.

The most important of these are the heavy faults in the policy of industrialization. Their effect was felt in material supply in two different ways. The first of these: while national economy tried to realize the overtrained and partly mistaken plans, numerous basic tasks were necessarily neglected. Such tasks pushed into the background were - beside a systematic raising of the living standard, continuous technical renewal of machinery etc. - also the permanent replenishment of material stocks and their corresponding increase.

Further more, the faults in industrialization appeared likewise to the effect that different industries did not develop in sound proportions. Proportionate development would require that enterprises supplying some material /e.g. the leather industry/ increased their capacity to a higher degree than the material demand of the industry processing the same material /e.g., the shoe industry/. Beside material reserves there should be adequate capacity reserves. Yet, of many fields of Hungarian industry, rather the contrary is characteristic. The machine industry increased quicker than steel and iron supplies; the whole industry grew quicker than power production, etc.

All this shows a basic insufficiency of economic planning during the last period. The task of planning is to establish the main proportions of national economy according to the social interest. Yet in the Hungarian practice planning at large - while absorbed in a thousand petty problems - failed to ensure the setting up of the main proportions.

The paper further analyses other causes of apparent defects: the lag of agriculture, problems of foreign trade, etc. One source of material shortage is that even available material is not used economically enough. Economic mechanism lacks the necessary incentives for saving and, what is more, some of its elements, in fact, induce to wasting.

Thereafter, the paper investigates the disproportions between the production of consumer's goods and personal consumption. Then it states as a summary: the phenomena of insufficiency may be explained partly by an erroneous economic policy, partly by negative features of the economic mechanism. These two causes or sources of inefficiencies cannot be rigidly separated. They are deeply interconnected and this fact could be characterized - though in a greatly simplified manner - as follows: The more the extraordinary quick pace of industrialization is

pressed, an increasing degree of centralization is rendered the more inevitable. If, however, the pace is more deliberate and steady, an economic mechanism may develop in which enterprises may be much more independent and direct relations between enterprises may play a greater part.

4. A "model" of economic mechanism

The paper attempts to outline the "model" of actual economic mechanism.

The starting point is the enterprise which is the basic unit of economy. Effects reach the enterprise from two "planes". One "plane" is horizontal, the productive enterprise is in trade relations with other enterprises. On the one hand, it receives from them material, power, machinery, tools, etc., on the other hand, it delivers its own products to them. Enterprises appear on equal footing.

The other "plane" is vertical: superior administrative bodies influence the enterprise. The relationship is one of subordination.

Actually the present economic mechanism may be characterized by the fact that "horizontal" relations have an extraordinarily slight influence on enterprise activity. What, for whom, at what price the enterprise produces, how many means of production from whom, at what price it buys - all this is chiefly decided by its superiors.

The paper sketches vertical relations. The superior authority influences enterprise activity by several "levers". Most important of these are:

- Operative central management of actual production /this was the main topic of the first two chapters/. The ministries and industrial departments perform in this respect the part of some national "dispatcher bureau".

-Control of investments.

-Financial and credit system.

-Price system.

-Material and technical supply system.

-State control of foreign trade.

-Control of wage funds and personnel strength.

-Central appointment of leading officials.

Special influence on the enterprise has the first lever - the operative central management of actual production. This is the "principal axis" connecting the center and the enterprise. Extraordinarily great effect have also the central systems of material and technical supply, the control of wage funds and personnel strength. On the other hand, the levers by means of which the center could indirectly manage production /e.g., financial and credit system or the price system/, nowadays make but very slight such effects.

V. OVER-CENTRALIZATION AS A SOCIAL-POLITICAL

PROBLEM.

So far the, economic aspects of over-centralization were investigated. Yet, in fact, we meet here a phenomenon which is greatly depending on political guidance and, with different problems of whole of social life. Over-centralization has chiefly political causes.

The paper mentions in short a few social correlations and points to some theoretical, principal issues of over-centralization.

Such a point is: the theoretical sources of the superabundance of precepts. A sentence torn from a speech of Staline running: "Our plans are neither plan-prophecies, mere planguesses, but plan-precepts", has become a dogma in literature about planning. Although this sentence appears as a simplifying, one-sided and just therefore a misleading one. This formula provided "ideology" for the practice of management, that was eager to build everything on precepts. The essence of socialistic planning envisages the development of the main proportions of national economy relying on an overall plan, for the benefit of the whole society and in the interest of socialist development. The precept is but one indispensable instrument of accomplishing this task. However it is possible and also necessary to employ other instruments besides. Therefore it is theoretically erroneous and practically dangerous to proclaim the precepts to be a panacea and the unique instrument, it appears none the less objectionable to identify socialist planning with management by precepts.

In a chapter of the paper entitled "Fear from all spontaneity" a polemic is carried on with a thesis of the "Textbook on political economy" and theoretical problems of spontaneity are discussed.

Another chapter deals with one of the most important social consequences of over-centralization, i.e. the untoward growth in the administrative personnel of economic management. The paper contains some data on this topic.

Mistrust of economic leaders, and shop democracy are then discussed. It is stated that control of the enterprise by the workers was in the past years rather of a formal kind.

VI. EFFORTS TO FACILITATE THE DEVELOPMENT OF LOCAL INITIATIVE AND OF ENTERPRISE INDEPENDENCE.

The different phenomena of over-centralization exist in no way incidentally beside each other, they are far from independent from each other. Over-centralization is a coherent and uniform mechanism that is characterized by its own inner logic, by a number of particular tendencies by what may be called "regularities".

In view of the inner contradictions of this mechanism, permanent efforts are being made to improve the mechanism, to render it more harmonizing with economy. Two trends may be discerned. The one wishes to overcome the inner contradictions by enhancing centralization itself and still furthering the part and range of precepts.

The other trend wishes to fight contradictions by measures against excesses of centralization and struggles for greater independence of the enterprises.

The paper presents an analysis of the reasons for which measures for reduction of over-centralization had borne no real fruits. A polemic is started then with notions which, in the author's opinion, had sought solutions of the problem by pursuing wrong ways.

Finally, it deals briefly with reform suggestions prepared by state authorities at the time the paper got its definitive text, i.e. in the Autumn 1956. It is shown how, while preparing these suggestions, the economic leaders became increasingly convinced of the points of view emphasized throughout this paper: that minor, gradual changes independent from each other, can bear no proper fruits. A uniform and overall reform is vital.