David Osterfeld

The Bureaucracy Problem

It is commonly held that the unplanned "anarchic" nature of capitalist production necessitates bureaucratic regulation to prevent economic chaos. Thus the prominent Hungarian Marxist, Andras Hegedus, argues that bureaucracy is merely "the by-product of an administrative structure" that separates the workers from the actual management of the economy. Since the owners make the decisions, all others must ultimately take their orders from this small group. Since that would be impracticable in an industrial economy, the problem must be handled by a division of responsibility which in turn entails layers of bureaucracy. The capitalists make the decisions which are then filtered down the bureaucratic pyramid. This means that the workers must wait to be told what to do by their immediate superiors, who in turn must wait for instructions from their superiors, and so on.

It is important to realize that Hegedus believes that these bureaucratic features are a product of capitalism itself, rather than the nature of large-scale production. "Where capitalist property relations prevail," he says, "it is futile to fight against bureaucracy. . . . To change the situation it is necessary first of all to eliminate private ownership of the means of production." Bureaucracy, he continues, was the "inevitable consequence of the development of property relations at a given stage in the division of labor and in economic integration. Consequently, it is also inevitable . . . that at some point there will be no further

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need for an administrative apparatus separated from society, because subjective and objective conditions will be ripe for direct self-administration."

In plain English Hegedus is saying that because capitalism separates the worker from the control of industry, production would be uncoordinated and chaotic were there not some agency for the transmission of knowledge. This is the function performed by bureaucracy under capitalism. Since under socialism the workers will make all of the industrial decisions, there will be no coordination problem in such a society. Bureaucracy will no longer be necessary and will be discarded. But, other than mere appeals to "democratize the administrative apparatus" and calls for a "healthy mobility in all areas of administration," he is vague on just how socialism will accomplish this.[1] Since Hegedus' views, particularly regarding the bureaucratic nature of capitalism, are not uncommon, it is time they be critically examined.

Three Problems of Coordination

Israel Kirzner notes that there are three problems of coordination that must be solved in any socio-economic system: (1) the problem of priorities, i.e., what goods and services should be produced; (2) the problem of efficiency, i.e., what combination of resources used in the production of a given commodity will leave the largest bundle of resources left over for the production of other goods and services; and (3) the problem of distribution, i.e., how to compensate each participant in the system for his contribution to the productive process.[2] The role of bureaucratic management can best be analyzed by seeing how both capitalism and socialism approach these problems as well as how well they can solve them.

I. The Problem of Priorities

Within a market system priorities are set by the consumers' buying and abstention from buying. Entrepreneurs, anxious to maximize their profits, will tend to produce those goods with the greatest discrepancy between price and cost. Since the consumers are willing to pay more for goods they desire most intensely, the prices of these goods, other things being equal, tend to be higher than those of the less intensely desired goods. Thus the goods that the members of society deem most important are the ones that, without the need for any conscious bureaucratic direction, are first and most plentifully produced in a capitalist system.

A common criticism of this type of reasoning is that there are many examples where the market cannot be said to reflect the priorities of the consumers. It is assumed, for example, that bread is more important than diamonds while it is noted that the price of diamonds is much greater than that of bread. The error in this criticism is that individuals are never confronted with a choice between diamonds *in the abstract,* and bread *in the abstract.* Instead, they choose between *individual units* of bread and diamonds.

> The market reflects the priorities of consumers without the need for any bureaucratic direction.

Since under normal conditions the quantity of bread greatly exceeds that of diamonds, the satisfaction or dissatisfaction caused by the addition or loss of any particular unit of bread, i.e., its marginal utility, is relatively low compared with that of any unit of diamonds. Were, by some quirk of fate, the quantity of bread greatly reduced or that of diamonds significantly increased, the marginal utility of the units of bread and diamonds would be altered causing the price of bread to rise and that of diamonds to fall. It can therefore be seen that the market does indeed reflect the priorities of the consumers and does so without the need for any bureaucratic direction. In fact, bureaucracy could only impede consumer satisfaction for, as Kirzner points out, "any non-market obstacles placed in the way of the pricing process thus necessarily interfere with the priority system that consumers have set up".[3]

Since socialism entails the elimination of the market, there is no mechanism by which priorities are established without conscious direction and control. Thus it is precisely socialism that cannot function without a burgeoning bureaucracy. A quick look at the planning process in the Soviet Union will clearly highlight the bureaucratic labyrinth endemic to even a moderately socialist economy.

Planning in the Soviet Union

In order to construct the plan for the coming year the planners must have as much data as possible on the state of the economy for the current year. This job is handled by the Central Statistical Administration, which alone employs several million people. This information is then conveyed to the State Planning Committee, or Gosplan. Priorities for the coming year are established by the Council of Ministers in conjunction with several other political agencies and communicated to Gosplan, which attempts to coordinate all of the priorities as well as balance the output targets for every industry in the economy with its estimate of the inputs required to produce them.

The plan then travels down the

planning hierarchy going first to the industrial ministries, then to the subministries, and so on down to the individual enterprises. In this way each firm is informed of the output levels that have been set for it, and the plan begins to ascend the planning hierarchy with each enterprise now in a position to calculate for itself the inputs necessary to produce the given level of output.

> The entrepreneur is not only in a better position to estimate consumer demand but, just as important, a wrong guess is immediately reflected on the market.

As the plan travels upward, both the input and output levels are adjusted according to a bargaining process between the enterprise manager and the central planners. The former attempts to underestimate his productive capacity and overestimate his resource requirements to make fulfillment of his part of the plan easier, while the latter does just the reverse.

After finally reaching Gosplan the plan is surveyed in its entirety and the necessary corrections and adjustments are made. The plan is then sent back down the planning hierarchy with each enterprise being informed of its final production goals. And beyond this, of course, lie a host of government agencies required to insure compliance with the plan.[4]

Just what is this bureaucracy, which numbers into the tens of millions, able to accomplish? The first thing to notice is that despite the scientific jargon, its plans are in fact only *guesses* about what each individual consumer will want during the coming year. The estimates of the entrepreneur also are guesses; however, there is a crucial difference: his are based on market data while those of the socialist planners, at least under *pure* socialism, are not.

This means that the entrepreneur is not only in a better position to estimate consumer demand but, just as important, a wrong guess is immediately reflected on the market by a decline in sales. Since the loss of revenue prompts quick adjustments, any incorrect guess tends to be self-correcting. But under socialism, the plant manager need not worry about selling his product but only fulfilling his production quota. Consequently, (1) quality tends to suffer since managers try to find the easiest and quickest way to fulfill their quotas, and (2) production continues, regardless of whether anyone wants the products, until the plan is altered by Gosplan.

But if production of unneeded goods takes place in some areas, needs in others must remain unfulfilled. It is not surprising, therefore, that the Soviet Union is regularly plagued by gluts of some items and acute shortages of others. When quotas for the shoe and nail industries were set according to quantity, for example, production managers in the nail industry found that it was easiest to meet their quotas by producing only small nails, while those in the shoe industry made only small shoes. This meant gluts of small nails and children's shoes and shortages of large nails and adults' shoes. But setting quotas by weight meant the opposite: gluts of large fat nails and adults' shoes. Similiarly, since dress-makers don't have to sell their products they don't have to worry about style preferences. The result is periodic warehouses full of unwanted dresses. And at another time the Soviet Union found itself in the embarrassing position of having only one size of men's underwear—and that only in blue.[5]

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Thus it is not surprising that the quality of consumer goods in the Soviet Union is notoriously low, the average standard of living is about one-quarter to one-third that of the United States, and so many goods are in short supply that one must stand in line three to four hours each day just to get the basic necessities.[6] While capitalism can function with a minimum of bureaucracy, we have seen that socialism, far from eliminating it, requires a host of bureaucratic agencies. These are necessary in order to (1) collect the data for the construction of the plan, (2) formulate the plan, and (3) inspect the plants to insure that the plan is being carried out.

II. The Problem of Efficiency

Turning to production we find the same results. Under capitalism, the problem of the efficient allocation of resources is solved in the same way that the problem of priorities was solved: the price system. To produce their goods, the entrepreneurs must bid for the needed resources. They therefore stand in the same relation to the sellers of resources as the consumers do to the sellers of final goods. Thus prices for the various factors of production tend to reflect the demand for them by the entrepreneurs. Since what the entrepreneur is able to offer is limited by his expected yield on the final sale of his product, the factors of production are thereby channeled into the production of the most intensely desired goods. Those who best serve the consumers earn the greatest profits and, hence, can offer the highest bids for the resources they need.

In short, the market is a highly interdependent mechanism that, without any bureaucratic direction, is able to achieve exactly what Hegedus thought impossible: the transmission of knowledge to the relevant individuals. If, for example, steel should become more scarce, either because part of its supply has been depleted or a new use for it opened up, its price would rise. This would both (1) force the users of steel to cut back on the purchases, and (2) encourage the suppliers to increase their production.

In a free market economy those who best serve the consumers earn the greatest profits and, hence, can offer the highest bids for the resources they need.

Not only are the actions of all market participants automatically coordinated by these price fluctuations, but the individuals involved do not even have to know why prices rise or fall. They need only observe the price fluctuations and act accordingly. As F. A. Hayek states, "The most significant fact about this system is the economy of knowledge with which it operates. . . . The marvel is that without an order being issued, without more than perhaps a handful of people knowing the cause, tens of thousands of people whose identity could not be ascertained by months of investigation, are made to . . . move in the right direction."[7]

It is also important to point out that even within an enterprise bureaucracy is kept to a minimum. First, if a firm becomes bureaucratically top-heavy it will be undersold and, if reforms are not made, put out of business by less bureaucratically structured enterprises. And second, as Ludwig von Mises notes, "There is no need for the general manager to bother about the minor details of each section's management. . . . . The only directive that the general manager gives to the men whom he entrusts with the management of the various sections, departments, and branches is: Make as much profit as possible. And an examination of the accounts shows him how successful or unsuccessful they were in executing the directive."[8]

Another Soviet Dilemma

But in a *pure* socialist economy the entire apparatus of the market would be absent. All decisions regarding the allocation of resources and economic coordination would have to be made manually by the planning board. In an economy like that of the Soviet Union, which has over 200,000 industrial enterprises, this means that the number of decisions that the planning board would have to make each year would number into the billions. This already Herculean task would be made infinitely more difficult by the fact that in the absence of market data they would have no basis to guide their decisions. This problem became evident in the *only* attempt to establish a pure socialist, i.e., non-market, economy: The "War Communism" period in the Soviet Union from 1917 to 1921. By 1920, average productivity was only ten percent of the 1914 volume with that of iron ore and cast iron falling to 1.9 and 2.4 percent of their 1914 totals. In the early 1920's "War Communism" was abandoned and since that time production has been guided by means of restricted domestic markets and by coopting the methods determined in the foreign Western markets.

The task of the Soviet planners is greatly simplified by the existence of the limited markets, but the fact that they are so limited means that the economy still operates inefficiently and suffers from two problems inherent in bureaucratic management: incessant bottlenecks and industrial autarky.

Incessant Bottlenecks

Since it is simply impossible for one agency to be able to familiarize itself with every nuance and peculiarity of every plant in the entire economy, much less to be able to plan for every possible contingency for a year in advance, the planners are forced to make decisions based on summary reports. Further, they must establish broad categories of classes which necessarily gloss over countless differences between firms. Consequently, every plan contains numerous imbalances which surface only while the plan is being implemented.

The Soviet economy still operates inefficiently and suffers from two problems inherent in bureaucratic management: incessant bottlenecks and industrial autarky.

Since there is no market, these surpluses and shortages cannot work themselves out automatically but can only be altered by plan adjustments made by Gosplan. Thus, shortage of good A cannot be rectified unless or until so ordered by the planning board. But plan adjustment in one area will have ramifications throughout the economy. To alleviate the shortage of good A, resources will have to be transferred from the production of good B. Since this will reduce the planned-for output of B, the output of those industries dependent upon B will likewise have to be reevaluated, and so on, in ever widening circles.

Empirical evidence bears out the economic theory. Paul Craig Roberts notes that what goes under the pretentious claim of planning in the Soviet Union is merely "the forecasting of a target for a forthcoming few months by adding to the results of the previous months a percentage increase." Yet, even this "plan" is "changed so often that it is not congruous to say that it controls the development of events in the economy." The planning bureaucracy, he goes on to say, simply functions as "supply agents for enterprises in order to avoid free price formation and exchange on the market. . . ." While this appearance of central planning "satisfies the ideology," the "result has been irrational signals for managerial interpretation, and the irrationality of production in the Soviet Union has been the consequence."[9]

Thus the evidence indicates that the perennially disappointing Soviet grain harvests are far more a result of the system than the weather, for even in "peak planting and harvest seasons as many as one third of all machines in a district may be standing idle because there are no spare parts. Central planners are acutely aware of the need for spares . . . yet the management system seems unable to match up parts with machines that need them."[10]

The problem of bottlenecks is nothing new, as indicated by a report of some time ago: "the Byelorussian Tractor Factory, which has 227 suppliers, had its production line stopped 19 times in 1962 because of a lack of rubber parts, 18 times because of ball bearings, and eight times because of transmission components." The same writer notes that "the pattern of breakdowns continued in 1963."[11]

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Perhaps the absurd lengths to which attempts at central planning can be carried is illustrated in an incident reported by Joseph Berliner. A plant inspector, with the job of seeing why a plant had fallen behind on its delivery of mining machines, found that the "machines were piled up all over the place." When he asked the manager why he didn't ship them out he was told that according to the plan the machines were to be painted with red paint but the manager only had green and was afraid to alter the plan. Permission was granted to use green, but only after considerable delay since each layer of the bureaucracy was also afraid to authorize a plan change on its own and so sent the request to the next highest agency. Meanwhile, the mines had to shut down while the machines piled up in the warehouses.[12]

Industrial Autarky

The problem of bottlenecks is closely connected with that of organizational autarky. Plant managers are rewarded according to whether or not they have fulfilled their production quotas. To avoid becoming a victim of a bottleneck, and thus not fulfilling the quota, the tendency emerged for each industry to control receipt of its own resources by producing them itself. "Each industry," says David Granick, "was quite willing to pay the price of high-cost production in order to achieve independence." In 1951 only 47 percent of all brick production was carried out under the Ministry of the Industry of Construction Materials. And by 1957 116 of the 171 machine-tool plants were outside the appropriate industry, despite the fact that their production costs were in some cases up to 100 percent greater.[13]

To combat this tendency Nikita Khrushchev reorganized the economy in 1957 by setting up 105 Regional Economic Councils to replace the industrial ministries. In the absence of other reforms, however, he merely succeeded in substituting "localism" for "departmentalism," as each economic region endeavored to become self-sufficient. To counter this the economy was further centralized in 1963 but this only increased inefficiency by further rigidifying an already inflexible economy. Unable to find the key to efficient planning, 1965 marked yet another significant step toward a return to a market economy. These reforms not only introduced a limited profit system but also called for "high degree of local autonomy for producers and suppliers. Detailed planning of every important aspect of production would disappear, to be replaced by minimal direct guidance from above."[14]

Marx postulated the withering away of the state. It is at least as significant as it is ironic that the continued shift of the socialist countries from bureaucratic planning to the market—what William Grampp terms the "new directions in the communist economies"—indicates a "withering away" of the sort never envisioned by Marx.[15]

III. The Problem of Distribution

When considering the problem of distribution, we again find that capitalism is the enemy of bureaucracy. Under capitalism, production is for profit. Capital and labor constantly flow to where they can obtain the greatest return. As can be seen, there can be no separation between production and distribution; for those individuals who, in the eyes of the consumers, render the greatest services to "society" are precisely the ones who reap the greatest rewards.

> In any society where the state controls all the essential facets of the economy there is a natural temptation for those in control of the government to use their political power to obtain economic privileges.

Turning to socialism, it is difficult to say much in theoretical terms about the way in which wealth is distributed since there are a number of conceivable bases for distribution: equality, need, merit, and services rendered to society. It should be obvious, however, that the implementation of any of these would require conscious bureaucratic direction. It should also be pointed out in this context that the attempts to establish strict equality have never been successful and probably never will be. This is so for two reasons.

First, to spur output the Soviet Union, for example, has always had to rely heavily on the bonus system for its plant managers and the piece-rate system for workers. The increasing centrality of the bonus system is indicated by the fact that while in 1934 bonuses equalled about four percent of a manager's salary, today it often reaches one-half, with bonuses for some industries comprising as much as eighty percent of income.[16]

Second, in any society where the state controls all the essential facets of the economy there is a natural temptation for those in control of the government to use their political power to obtain economic privileges. Thus it is not surprising that the 1917 revolution, regardless of intentions, only resulted in the replacement of one privileged elite by another.[17]

One example will illustrate this point. There are a host of "special shops" in the Soviet Union selling everything from food to jewelry. These stores, which are allegedly for the benefit of foreign tourists, have high quality merchandise at below cost prices in order to compensate the tourist for the government's artificially high exchange rate for rubles. However, James Wallace points out that "high-ranking government officials, senior military officials and upper ranks in the Communist Party are all privileged to shop in these stores as a fringe benefit of their jobs." They are therefore able to buy "hard-to-get goods for a fraction of the prices their neighbors pay for often-lower-quality merchandise."[18]

It is a revealing sidelight, and one that should be especially noted by those who condemn capitalism for its unequal "distribution" of wealth, that there is greater inequality of wealth in the more socialist countries like the Soviet Union than in the relatively more market-oriented economies such as the United States. This moreover, is not a historical accident but in conformity with economic theory. For under capitalism there is a natural tendency for capitalists to invest in areas with a low wage level, thereby forcing those rates up to a level commensurate with that of other areas doing the same work, while workers in low paying jobs tend to migrate to areas where pay is higher. Similarly, entrepreneurs invest in areas manifesting high profits. But the increased output forces prices and profits in those areas to fall. In short, while capitalism will never eliminate inequality, it does tend to reduce extremes of wealth and poverty.

Conclusion

Under capitalism the price system performs the crucial function of transmitting knowledge throughout the society and thereby eliminates the need for bureaucracy. But precisely because it eliminates the market, bureaucratic management is indispensable for a socialist economy. Furthermore, since there is an inverse relationship between central planning and the market, bureaucratic management is inherently contradictory. Its dilemma can best be summarized, perhaps, in the form of two planning paradoxes:

Paradox One: For central planning to be viable it needs market data to guide its decisions. But the greater the role of the markets the less that of central planning. Conversely, the more extensive the area of central planning the more limited the market data, and hence the more inefficient must be the operation of the economy.

Paradox Two: If the planning board endeavors to maximize consumer satisfaction it merely does manually what the market does automatically. It is then just a wasteful, redundant entity. But if the planning agency plans operations that would not have been undertaken on the market, then that is an indication that the priorities set by the agency are in conflict with those of the consumers. It is clear that, regardless of the course adopted by the agency, the position of the consumers must be worse off than it would have been under a market economy.

—FOOTNOTES—

[1]Andras Hegedus, "Marxist Theories of Leadership and Bureaucracy: A Marxist Analysis," *Political Leadership in Eastern Europe and the Soviet Union,* Ed.: R. B. Farrell (Chicago, 1970), pp. 53-54.

[2]Israel Kirzner, *Market Theory and the Price System* (Princeton, 1963), pp. 36-38.

[3]*Ibid.*, p. 39.

[4]For a good summary of this process see Herbert Levine, "Input-Output Analysis and Soviet Planning," *American Economic Review* (May, 1962), pp. 128-31.

[5]See William Loucks and William Whitney, *Comparative Economic Systems* (New York, 1973), pp. 302-4; and Marshall Goldman, *The Soviet Economy* (Englewood Cliffs, 1968), pp. 92-4.

[6]Loucks and Whitney, pp. 322-26; and James Wallace, "In Classless Russia 'Some Are More Equal Than Others,'" *U.S. News and World Report* (August 4, 1975), p. 35.

[7]F. A. Hayek, *Individualism and Economic Order* (Chicago, 1972), pp. 86-7.

[8]Ludwig von Mises, *Bureaucracy* (New Rochelle, 1961), p. 33.

[9]Paul Craig Roberts, *Alienation and the Soviet Economy* (Albuquerque, 1971), pp. 78-85.

[10]James Wallace, "Communist System's Toll on Farms," *U.S. News and World Report* (August 18, 1975), pp. 16-7.

[11]C. R. McConnell, "Some Fundamentals of Economic Planning in the Soviet Command Economy," *The Soviet Economy* Ed.: Harry Shaffer (New York, 1968), p. 32.

[12]In David Granick, *The Red Executive* (New York, 1961), pp. 133-34.

[13]*Ibid.*, p. 135. Industrial autarky is, of course, nothing more nor less than a monopoly. It is interesting to note that this has become such a serious problem for many socialist economies that Yugoslavia, for example, has been forced to adopt antitrust laws to deal with it. See William D. Grampp, "New Directions in the Communist Economies," *Business Horizons* (Fall, 1963), p. 34.

[14]J. P. Hardt, *et al.*, "Institutional Stagnation and Changing Economic Strategy in the Soviet Union," *Man, State and Society in the Soviet Union*, Ed.: Joseph Nogee (New York, 1972), p. 183. Also see the special, "Socialism," in *Time* (March 13, 1978), pp. 24-41. See especially p. 26: The socialist economies, it notes, are characterized by "heavy overstaffing (of) every office and factories with workers who seldom can be fired for failing to produce. Bureaucratic controls further cripple efficiency and managers have little leeway for innovations. Consumer goods are still shoddy and chronically scarce. . . . Yugoslavia seems to have the fewest economic problems among Marxist-Leninist states. It also has the least rigidly controlled economy in Eastern Europe."

[15]Grampp, pp. 29-36.

[16]Granick, p. 111.

[17]See Milovan Djilas, *The New Class* (New York, 1968). Also see the interesting comments on the Bolshevik Revolution by a Russian anarcho-syndicalist and contemporary of the Revolution, "M. Sergven," in "The Paths of Revolution," reprinted in *Libertarian Analysis* (Winter, 1970), pp. 9-12.

[18]Wallace, "Classless Russia," p. 35. The recent scandals in the U.S. Government Services Administration—scandals which *Newsweek* referred to as "the biggest money scandal in the history of the Federal government" (September 11, 1978, p. 29)—only further demonstrate how easily bureaucratic planning lends itself to exploitation. Also see the brilliant article on the Washington bureaucracy by Tom Bethell, "The Wealth of Washington," *Harper's* (June, 1978), pp. 41-59. Especially see page 43: "The laws of supply and demand not only do not apply to Washington, they are turned inside out. Problems elsewhere in the country merely contribute to the wealth of Washington. The fuel crisis takes the shape of a new Department of energy, where 19,000 bureaucrats under Dr. James Schlesinger's command will have $10 billion to play with—roughly equal to the total profits of all the oil companies."

Can Capitalism Survive?

BEN ROGGE, who teaches economics at Wabash, has never fancied himself as a writer. The formal books which he has planned from time to time languish in his desk drawers. He says, with the deprecatory whimsicality that is part of his nature, that he functions best through the spoken word. He is a platform man.

The distinguishing mark of a Rogge speech, however, is that it invariably reads beautifully. The collection of addresses which Ben Rogge has linked together under certain loose topic heads to make a book, *Can Capitalism Survive?* (Liberty Press, 329 pages, $9.00 cloth, $3.50 paperback), proves that the spoken style, when it is enlivened with parenthetical humor, can take on the quality of a good essay.

Rogge's values and beliefs are as firmly set as anybody's, but he does not make the tactical mistake of trying to grab people by their lapels and mesmerize them into a goggle-eyed march to the mourners' bench. He has a feeling for sinners, and he is not chary of admitting his own foibles. He is not what Mencken would have called a wowser. Thus, in discussing the orthodox conservative's demand for a strict enforcement of the anti-marijuana laws, he reflects, with characteristic ruefulness, on what the prohibition mentality might do to deprive him of his "noble and useful gin and tonic."

If Diogenes, in his search for an honest man, had come upon Rogge, he would have called his quest successful. Part of Ben's whimsical honesty resides in his willingness to admit that he frequently concedes himself a five-foot putt at golf.

As is inevitable in any collection of occasional speeches (or essays) the unity of the book must depend more on tone than on structure. The topics, in *Can Capitalism Survive?*, are heterogeneous. There is a marvelous historical essay on what happened at Harmony and New Harmony in Indiana, where Rappites from Wurttemberg in Germany and