

PART TWO

The
Fundamental
Question

The upheavals, the political, economic, and military earthquakes that punctuated the twentieth century, brought about significant mutations of the existing social order, the structure and functioning of the society's hierarchical and market organizations. To understand what happened (and what is still happening), it is necessary to analyze more precisely in what respects the social order has changed and what determined (and still determines) these transformations.

During the past century, most observers believed that the trigger was the competition between the political beliefs or ideologies, the drastically simplified representations of the existing political and economic systems. Their common implied reasoning is based on a vision of life that philosophers would describe as "idealist" or "platonian" in the sense that once the intellectual conception of the good society, the idea, has spread among people or among the elite, it influences the political authorities and the rulers who in turn apply it to the social reality to build a regime resembling, more or less, the initial abstract system.

With this process, the rulers' decisions are discretionary when the democracy is neither total nor direct: an autocrat or a government who is not fully controlled by his people's will still can apply the right

system or not. The choice of the concrete regime is thus both centralized and discretionary. In turn, this gives great importance to the “intellectuals” which are “system engineers,” manufacturers and traders of ideas. And it is because of this vision of their own influence on societal transformations that they are so willing to advise the rulers.

Thus, the twentieth century political and economic debate confronted the capitalist and socialist (or national-socialist) systems, or in other terms, the private and state ownership regimes, since no other form of collective appropriation could be found that would work without a state. It thus reduces the choice of society to a choice between the market and the state, or more exactly, between the markets and private firms on one side and the public administration on the other.

Conflicting Systems or Conflicting Nations?

In people’s minds this dichotomy was vindicated by the simultaneous development of the state and its bureaucratic apparatus, and the emerging socialist critique of the nineteenth century “capitalist” regimes. Admittedly, the rise of statism and interventionism was accompanied by a reduction of the market area to the benefit of the administrative economy. But the conviction that a choice had to be made between two antinomic systems was born out of the conflict between two nations, the United States and the USSR, which both seemed to be respectively the ideal type or the elected champion of each of the two systems.¹

1. This view is based on the conceptions of the nineteenth century socialists who, following Marx, considered the communist system as the natural and designated successor of the economic regimes existing in Europe and in the United States and that they described as “capitalist.” Politics thus turned into a dilemma between two opposed and conflicting organizational systems. This view was shared by the Liberals (Schumpeter, Hayek and Friedman) who believed that a binary choice between the market and the state had to be made but criticized the growing control exerted by

The Fundamental Question

131

According to the ideal type view, all contemporary nations thus had—it seemed—to make the fundamental choice between these two superpowers. This decision was viewed as discretionary and, depending on the personal preferences of the rulers and their people, on their preconceived political and social “convictions,” a bit like when a consumer has to choose between two models of cars or two dishwashers. Each one is free to prefer either the “American” or the “Communist” model, or even (for the least courageous or hesitant) a mix of the two in variable (and there again arbitrary) proportions. It thus seems that the societies’ political and economic organization is a question of aesthetics. As the ultimate “consumers of social systems” citizens are free to choose them according to taste and color. In the end, they must base their decision on their comparative experiences of the economic and political performances of these representative countries and of their regimes. Ideologies there are but a form of political advertising, each speaking highly of its product but with little credibility.

After a long and indecisive period during which the Soviet system seemed to outperform the American system, the trend eventually reversed. The final collapse of socialism and the implosion of the USSR gave credence to the idea that capitalism was definitely better than

the state over the economy all along the century.

According to this common “Marxist-Liberal” vision of history and political and economic systems (in other words, contemporary societies’ “fundamental constitution” or “social contract”), private property and markets are the main determinants of the systems’ effectiveness, with one side emphasizing the superiority of markets and private property, and the other the superiority of the state and public property. This simplistic conception of political choices became dominant because of the state’s growing control over liberal economies, the world conflict between liberal democracies and the more dirigist totalitarian states, and more particularly the cold war between two superpowers, the United States and the USSR, who in the end respectively embodied the capitalist or market society and the Socialist or Communist society. As the cold war dominated world politics after World War II, it reinforced the idea that the main political issue was to choose between the American and Russian systems, between the Liberal and Marxist conceptions of social organization.

socialism and that there was no longer any other option to organize societies. This idea was reinforced by the crumbling and the defeats of corporatist (or hierarchical) capitalism in Japan and Asia, in France and Germany under the combined effects of the financial crisis and the M&A and restructuring wave. The statist “third way” misfired and the new concept of “Rhenan capitalism” became a forgotten page in history books as soon as it was theorized. All this evolution seems to support the idea of a dilemma of the systems that would have described properly this century’s developments and conflicts. In this framework it seems that the political issue is for each government to choose, in a centralized way, the best system that should then be fully applied to the real society. This debate was supposedly settled at the end of the twentieth century, when it turned into a survival ordeal that could only leave the really good system running, thus signaling the end of history.

But a closer look reveals that this likely scenario, like Kipling’s *Just So Stories*, has the appearance of a serious explanation but cannot be viewed as a rigorous description of reality. Indeed, the dilemma that this conception initially sets between two well-defined systems is basically shaky. It neglects the fact that some organizational characteristics are shared by all nations and does not take into account an essential part of economic realities. Besides, even the idea of being forced to choose all or nothing between two polar systems is proved false by all the experiences of the various countries during the century. And finally, although the idea of a ruler choosing the society’s system discretionarily and in a centralized way is flattering for him and his advisers, and seems realistic, it is in fact superficial and does not reflect the real decision-making mechanisms.

This view belongs to the “constructivist” misconception of society that Hayek often denounced, while at the same time took seriously as a real possibility. The Fascist and Communist experiences convinced him that governments really chose the country’s social system discretionarily, while in reality totalitarian rulers merely legalized by reforms

and coups the ongoing transformations resulting from deep-rooted and uncontrollable social determinants, and claimed paternity afterwards. A more matter-of-fact study of politics leads us to believe, with the sociologist Michel Crozier, that a society cannot be reformed by decree. Like any other, organizational choices result from a multitude of individual decisions that determine the social structures which rulers must take into account.

In chapter 5, we will see how a society's organizational system is chosen and subsequently analyze the economic determinants of these choices in chapter 6. We will then broaden our analysis to the international organization of nation-states and their relations in peace and war.

All in all, this second part of the book will give us a broad picture of the general conditions that explain this century's deep transformations of the internal and external social order. It will also give us a means to sort out, in view of the ongoing events, the possible trends from the theoretically impossible ones, and we will study this issue in a concluding chapter focusing on the competitive state in a global civilization.

A Clumsy Dilemma

The commonly shared "Marxist-Liberal" vision is that of a war between societal organizational systems that expresses itself as a dilemma between two diametrically-opposed models: socialism and capitalism. One would have to choose either the state only or the market only, as a mix would be regarded as a false, inefficient, and intellectually unjustified solution since each of the "pure" systems claims its absolute superiority. However, a dilemma can only exist if its terms do not intersect and together cover all possible choices.

But, in this instance, this dualistic vision born from the military conflicts between capitalist democracies and totalitarian nations does not describe two mutually exclusive alternatives. Real societies are not

“all-market” or “all-state” organizations, and nothing indicates that the mixes of public and private economies that most of them adopt (in various proportions) are unstable and forced to evolve towards the most extreme mythical solutions. Even Hayek carefully underlined that he had never asserted, in *The Road to Serfdom*, that democracies inevitably turned into totalitarian states with time. He only warned people against such an eventuality that he thought could be avoided by increasing public opinion awareness.

In any case, the dilemma of the extremes is clumsy. The dichotomy on which it is based does not reflect economic realities: first, because these two categories do not cover the entire scope of social organizations, leaving aside those that are neither state nor market, and also because they share common ground, which is the case of the concepts of capitalism and socialism especially, since the former includes the latter as a special case.

Moreover, the two presentations of the dilemma used in politics are not equivalent. Capitalism vs. socialism? State vs. market? Is it the same? Public and private property of production means is what distinguishes the two elements of the first alternative. The extent to which equity ownership rights are distributed and capital markets are developed is seen as crucial. But there are several types of capitalism, more or less open and bureaucratic, where financial markets are more or less developed and sometimes non-existent, and where capital property is more or less concentrated. In particular, the Asian variety or the European statist banking capitalisms.

The other presentation of the dilemma, state vs. market, makes the distinction between a particular type of hierarchical organization on one side and a decentralized decision-making mechanism on the other, without taking into account all the reality of the private hierarchies that companies are. Many Liberals consider “free enterprise” and “market economy” as equivalents. And it is true that there are more markets in economies where most firms are private than in Socialist statist economies. However, across the world and more es-

pecially in the United States, twentieth-century “market” economies were mainly based on a hierarchical institution: the corporation. The corporation is not the market: even if it sells products and buys goods and services on markets, it is built internally on an authoritarian and hierarchical structure. The corporate hierarchy is based on the principle of military command. It functions much more like a public administration than like a market.

From the inside, hierarchical organizations such as General Motors, the Bank of Italy and the World Health Organization have a lot in common. Employees work in similar conditions under the direction of superiors on whom their daily work and promotion depends. This is what William Niskanen, a classical liberal economist and an academic specialist of bureaucracy, underlined after having worked for the U.S. Defense Department and before becoming Ford’s chief economist: “A government bureaucrat who joins Ford feels at home and is thus immediately operational.” And his colleague Gordon Tullock logically concluded: “In other words, these structures are very similar.”²

Presenting the dilemma as an opposition between capitalism and socialism is also untenable. While communism is clearly defined by state property and the almost total centralization of production decisions, the opposed system—which is supposed to be unique—is designated by the uncertain and inadequate concept of “capitalism,” whose incoherence has frequently been underlined by many economists.³ In the economic sense, a system is capitalist if it uses inten-

2. Gordon Tullock, *Economic Hierarchies, Organization and the Structure of Production*, Kluwer, 1992, p. 41.

3. Friedrich Hayek: “Generally, the words capitalism and socialism are used to describe yesterday and tomorrow’s society. They conceal rather than explain the transition that we are experiencing” (*The Road to Serfdom*, Routledge, 1944, p. 36).

The word capitalism itself only appeared in the early twentieth century long after communism as Braudel underlined (*Civilization and Capitalism, 15th–18th Century*, part 2: *The Wheels of Commerce*, Harper Collins, p. 275). Debating with Bastiat, Louis Blanc gave it a new meaning when he wrote in 1848: “. . . [That is] what I would

sively the capital, the machines and even human capital according to its more modern sense. All modern societies, including the Socialist, are obviously capitalist. Capitalism, which defines as the intensive use of capital, is a notion that applied perfectly to Stalin's Russia and today to all the societies in the world, contrary to the primitive societies that accumulated little, if any, capital. "Socialism" has no other sense than that of state monopolistic capitalism where political authorities own all the country's capital except human capital—although slavery had been partly reintroduced in the Nazi and Communist totalitarian societies. In a rigorous sense, these notions do not define mutually exclusive categories of existing societies.

Among those, some choose state capitalism and the others a form of capitalism that authorizes the private property of companies' capital

call capitalism, i.e. the appropriation of capital by some to the detriment of the others." In 1867, Marx still ignored the word. And it is only in the early century political debates, especially in the scientific field with Sombart's *Der Moderne Kapitalismus* (1902), that it gained recognition as the logical antonym of socialism. Braudel concluded: "it is thus a political word" (p. 276).

During a long time, this word was criticized by the economists because it mixes a "hodgepodge of meanings and definitions" (Herbert Heaton). Alexander Gerschenkron simply considers it tantamount to the industrial system ("Capitalism, that is the modern industrial system," *Europe in the Russian Mirror*, 1970, p. 4). And he is undeniably right in the strict technical sense, i.e. that of a capitalistic production system that uses intensively the "technical capital" (durable equipments). In that economically-founded definition, it is clear that all modern economies—which are industrial before focusing on services—use technical capital intensively.

Even Hayek finds it difficult to define the terms of this opposition. While he considers that the concept of socialism is well-defined and a synonym of planning, a centralized economy, statism, he finds no single word to describe the opposite system. He uses one after the other the words "capitalism," "competition," "a society" or "a market economy," "liberalism" or "a freedom society."

As we underlined, all these terms have major drawbacks: (1) the meaning of capitalism is so general that it includes Socialist societies, (2) competition is not always respected on all the markets that can be monopolies or oligopolies, (3) in a market economy, corporate hierarchies play a major role, (4) the definition of liberty or liberties has always been elusive.

The only distinction that designates mutually exclusive categories and that enables us to sort out according to a single criteria all the societies is the centralization or decentralization of decisions and of the organization of production.

and the free trade of these ownership rights on capital markets. Similarly, all modern economies use corporate bureaucracies—whether public or private—to organize most of their productions. In fact, the main difference lies in the degree of concentration of these companies' ownership. When the state owns most of them, it groups all the activities together within a single bureaucracy that manages them all and distributes them the necessary capital while suppressing market exchanges between firms, prices and competition. On the contrary, when there are several private owners, there are also several independent hierarchies whose activities are coordinated by goods and capital markets, competition and prices.

What differentiates the various economic regimes is neither the degree of “capitalism” nor the institution of the corporation, but rather the degree of centralization of property and decisions. The political problem of system choice does not consist in choosing between such polar concepts as capitalism and socialism but rather between different degrees of centralization from an infinite range of possibilities. The Soviet Union and the United States only represent two specific solutions among many others.

This assessment cannot be reduced to a play with words. It puts a serious question mark on the rationality of the mythical opposition that rules all the debates and analyses about political systems. If that opposition is incoherent and does not fit with reality, the debate is distorted and has no effect on that reality.

Indeed it is the very incoherence of this opposition between capitalism and socialism that prevents us from understanding the astonishing upheavals of the twentieth century: the initial triumph of statism and communism, and more recently the collapse of socialism and dirigism. Who was wrong then? The dirigist centralizers which were acclaimed from 1917 to 1989 or the Liberals who were pushed aside from the end of the nineteenth century until the last decade of the millenium and only had *in extremis* the marvelous surprise of the collapse of socialism? As the capitalism/socialism dilemma does not

take into account the fact that there is real diversity of capitalisms in which states continue to play a major role (a much greater one than in the nineteenth century), it does not enable an understanding of the ongoing evolutions. If socialism was really that better, why did it collapse? If markets and private property triumphed in 1989, why did not the state rapidly lose power and why does it still take a 40 percent to 50 percent cut of the national product in rich countries, as the Liberals wonder?

With the roulette of history, the last winner cannot be sure to continue to cash the dividends of a favorable fate.

Neither does that false dichotomy explain the global decline of democracy during the first twentieth century that resulted in dictatorship and totalitarianism, and its revival at the end of the century other than by the results of World War II and the cold war. This does not teach us anything about the initial triumph of authoritarian regimes and suggests that if these wars had ended differently, democracy would not have reemerged. It leaves undetermined the ambiguous relation between economic systems and political regimes: capitalism can be either authoritarian or democratic and the same would be true of socialism, although to a lesser extent.

Contemporary history will remain incomprehensible if we stick to the Marxist-Liberal alternative between the state and the market that takes no account of the existence of firms, and if we support the theory of an automatic escalation of all regimes towards the extreme cases of total planning or “all market,” which has never been satisfactorily justified or confirmed for the simple reason that it does not exist in reality.

Organizational Economics and Individual Choices

To solve these mysteries and address these unanswered questions, economic analyses require a better-defined framework that takes into account the degree of development of not only the state but also the

firm. This implies an analysis of the organizational modes of production. The organization of societies is above all the organization of production in the broad sense, including political production, the production of collective safety and goods. And the fundamental choice of any social activity for the production of private or collective goods and services is between the market and the hierarchy, the latter including firms and states as specific cases.

Winner of the 1991 Nobel Prize in Economics for his explanation of the existence of firms in a 1937 article entitled “The Nature of the Firm,” Ronald Coase puts the emphasis on the contrast between markets and firms. When companies’ ideal size increases, markets tend to decline, and conversely when markets develop, hierarchies shrink. Williamson generalized this reasoning by presenting hierarchies, companies’ fundamental mechanism, as a substitute for markets. We can thus infer that, as a consequence, the opposition between the state and the market appears only as a particular case of the opposition between the firm and the market.

In this view, the main determinant of any social organization is companies’ optimal size and consequently the area left to markets in societies. But the markets’ importance can be reduced by the development of both public hierarchies (and the state which governs them) and private hierarchies, that is corporations.

This economic and organizational view of social system choices easily explains the parallel evolution of all the societies’ organizational structures during the twentieth century. Thus, the trend towards hierarchization was illustrated by both the triumph of the Communist regimes, where giant public companies were supervised by a central planning body, and the concentration of the giant private companies that used internal planning in cartellized—oligopolistic or monopolistic—private capitalist countries such as the United States and Germany, and often in cartelized mixed capitalist countries, like for instance in France and Japan. That is why “capitalism” and “socialism” evolved in such similar ways.

That way, the course of the twentieth century seems much more coherent and is provided with a general explanation. The optimization of hierarchies' dimensions drives nation-states into either nationalist and imperialist expansionism and war, or fragmentation, separatism, and world peace at times of downsizing. The same analysis can explain the part played by the state in a national economy of a given size, and adding to that the centralization rate of private hierarchies which evolve in the same direction, also explains the politico-economic system of a nation.

There is thus an infinite range of possibilities: a very centralized politico-economic apparatus results in socialist planning, while a discreet and decentralized state, small companies, and developed markets, gives a liberal capitalism. An intermediate development of public and private hierarchies determines the dirigiste French-style capitalism and a wide range of more or less corporatist mixed systems.

But these choices are not made in a fully-centralized way. That would only be possible in an already fully-centralized society that would ban any activity outside its single hierarchy. In all the other less extreme cases, it is the individuals who choose either to work independently on markets or to integrate the hierarchical pyramids of private or public companies. They make their decision according to the costs and rewards of each alternative. And if we sum up all these individual choices made according to economic opportunities, we obtain pyramids more or less big and numerous and more or less developed markets. A society's organizational structure thus results from a number of decentralized decisions. Generally, the choice of a society is not a "macro-decision" but rather results from a multitude of "micro-decisions."

In Chapter 5, we present the terms and conditions of the basic individual choice between markets and hierarchies that has to be made for all human activities and in all the economic and political sectors. The overall structure of a society depends on the choice individuals make between markets and hierarchies. The overall centralization rate which characterizes that structure also defines the dominant type of

The Fundamental Question

141

human relations, market transactions or subordination. In turn, the organization of the society resulting from those individual choices affects all aspects of people's life and the characteristics of the civilization.

What then are the determinants of individuals' choice between working independently on markets and being subordinates within hierarchies? As usual in economic analyses, the costs and rewards will be the main determinants. Individuals will opt for the most efficient and thus the most profitable mode. Markets and hierarchies will develop until their efficiency falls to the same level of the other production mode.

The more or less general adoption and development of either of those two basic mechanisms within a society thus depend on their cost differentials, which mainly result from the way they use information: markets use a lot of it and hierarchies much less. In the latter, only the decision maker consumes information that he then shares with the other agents. Conversely, on markets, each participant must collect his own information and only for himself.

Thus, in a society where information is rare and costly, hierarchies are a more economical production mode as they require little information. On the contrary, in a society where information is plentiful and cheap, markets can develop as each participant can obtain cheaply the information that he needs to produce and adjust its output to that of its competitors. The "theorem of organization" can thus define the organizational structure and the centralization rate of a whole society according to the availability of information in this society (Chapter 6).

As a consequence, the evolution of politico-economic systems depends directly of the economics and technology of information. A society with little information will be centralized, hierarchical, statist, and even totalitarian. Conversely, a society with abundant information will be decentralized, commercial, egalitarian, individualistic, democratic and liberal. The impact of information on the organizations is the key to understanding the evolution of societies' social order over the twentieth century.

But can that analysis also be applied to the other basic trends of the twentieth century, those that affected the general framework of all contemporary societies, the nation-states, whose size and relations have changed so profoundly over that period?

Well, it can, as our analysis of nation-states' systems shows in Chapter 7. The geographical dimension of nation-states depends on the numerical dimension of public organizations and private companies. Nowadays, an average state employs around 10 to 15 percent of its working population, a little more than 2 million people with whom it controls and provides public services to an average population of 30 million inhabitants (the median dimension of a state is only 6 million inhabitants) over an average area of around 270,270 square miles.

Like in other firms, the size of this administrative hierarchy depends on the availability of information. When information is rare, large states have a cost advantage over the smaller ones, because they amortize the purchase cost of a given information over a larger number of constituents. It is this economy of information sharing that gives their superiority to the largest states.

When information is abundant and cheap, even the smallest states can buy it, so that large states do not benefit from a significant cost-spreading effect. And as small states can answer better the demands of populations that are smaller and more homogenous, they have an advantage over bigger ones. Like big firms, large states will thus disintegrate, fall into pieces, reduce their overall size, and small states will blossom.

But the relations between states also depend on whether the general trend which affects them all is towards upsizing or downsizing (Chapter 8). From conflictual in the first case, they become neutral or peaceful in the second case. Unexpectedly, the availability of information thus defines the structures and evolution of the "world state industry" and governs peace and war between nations.