

FOREWORD

The wave of democratization at the end of the twentieth century, the fall of the Soviet Union and the nearly total disappearance of communism were all major economic, political and strategic changes of our time, and they all raise the question: why now?

Those changes lead us to ask as well why preceding developments and events occurred as they did. Why did we see what eventually became almost universal rejection of democracy and free markets during the twentieth century? Why should the basic qualities of societies newly-enriched by unprecedented benefits of production and by spectacular progress in social organization be rejected? They were, after all, the consequences of the intellectual and scientific achievements of the Enlightenment and of the Industrial Revolution. In the most advanced countries in 1900 they were uncontested.

Following the First World War nearly every nation discarded the democratic form of government they had prized prior to 1914. They restricted their free and open markets to the benefit of authoritarian, and in some cases totalitarian regimes, and to a greater (and on occasion to a lesser) extent, they endorsed centralized, state-controlled economies. Even Liberal America (in the classic sense of the term) expanded the role of the federal government and federal regulations

during the 1930s, while supporting the creation of giant corporations at the same time.

This is the development brilliantly argued by Jean-Jacques Rosa, professor of economics at the Institut d'Etudes Politiques de Paris. It tipped the balance of power toward the "visible hand" of administrative hierarchies, as described by Alfred Chandler, to the detriment of the "invisible hand" of the free market, as described by Adam Smith. This process, so concluded Joseph Alois Schumpeter in a book entitled *Capitalism, Socialism and Democracy* (1942), would result inevitably in the replacement of capitalism by socialism. He may have held out hope that socialism could remain democratic, but facts discredited any such confidence. Socialism, like its right-wing counterpart, fascism, abolished real democracy and suppressed more or less entirely, depending on the country and the time, the mechanism of competitive markets.

On the eve of the Second World War surviving liberal democracies represented a small minority in the world, and even they had begun to embrace more centralized economic practices, which included heavier taxation, thus alarming classic Liberals. Some explained it as a consequence of crises and wars. But following 1945, writes Rosa, the movement seemed to be anchored even more firmly and continued its progress, without slowing, as much in Great Britain, as in the United States and Europe. The author is aware, of course, that the resumption of free trade among western countries was not without its own countervailing effects, but it was a trade, highly regulated as well as subsidized, of far less significance than the questions raised in this volume.

Why, asks Rosa, if democracy is the worst possible system with the exception of all the others (to paraphrase Winston Churchill), was it abandoned by nearly every country in the world between the 1920s and the 1960s? Why did this development take place across the entire political spectrum of the left, the middle, and the right? Why, if state-controlled economies are as inefficient as free market economists con-

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tend, did they remain the dominant system for almost three quarters of the twentieth century—until the tide began to turn away from social democracy and interventionism under the leadership of Margaret Thatcher in Great Britain in the 1980s, until Ronald Reagan, on becoming the new president of the United States in 1981, diagnosed the State as the problem and not the solution, and until the dramatic opening of the Berlin Wall in 1989 and the ensuing collapse of communism in the early 1990s?

Intellectuals in general, whose natural predilection is to attach commanding importance to the role of ideas, are prone to assert that “bad ideas” and blind, nationalist passions have been at the root of dramatic “errors” committed by the people and their leaders in their choice of economic and political systems. They thus claim credit for all of the good that resulted from the transformations of the 1980s and 1990s, and consider themselves responsible for the “ideological” victory that forced those changes. They never explain, however, why classical liberalism—the concept of the invisible hand—which was dominant at the end of the nineteenth century, was later repudiated almost everywhere. Where is the explanation of the role played by intellectuals in this transformation?

For some it is tempting to argue that new socialist thinking took intellectuals by surprise in an ideological war for which they were unprepared. But that is far too glib an explanation, unless we ignore that Adam Smith and other classical economists had presented convincing arguments more than a century before against the interventionist and statist practices of the mercantilists and other devotees of Colbert. Indeed, the explanation for the defeat of liberalism, as well as for its recent success, is a challenge to the intellect for which the response is still outstanding.

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It is these questions to which Rosa devotes himself in this remarkable book. What are the causes—in general terms, of course, since they

affected all nations simultaneously but in varying degrees—of the defeat and subsequent success of liberalism and democracy?

Rosa finds what he calls a “grand cycle” in social organization of the twentieth century. It concerns not only political organization but also the role played by the corporation in the organization of economic production. In this regard he cites the conclusions drawn by Adolf Berle and Gardiner Means in the 1930s which pointed to the expanding scope of corporate concentration (*The Modern Corporation and Private Property*, 1932); in other words, the extraordinary movement toward a hierarchical structure of production that took place in the U.S. in that decade.

As the later recipient of the Nobel Prize in Economic Sciences, Ronald Coase, concluded at the time, one must explain why firms, and especially large firms, exist, and how it is they prosper. One must ask why the production of all goods and services is not decentralized, why diverse components are not supplied independently—for example, by individual craftsmen—and why it is not markets that guide their coordination and assembly? The question is posed because most production processes are centralized from inception under the supervision of managers within a corporate hierarchy. Following Coase’s argumentation, the centralized and hierarchal method is more efficient and therefore preferable when transaction costs are high, when the frictions they generate make the usage of markets relatively inefficient. The hierarchy permits reductions in cost by internalizing and limiting the number of transactions. It thus replaces market frictions with management decisions and generates economies in the process.

Rosa relies on this analysis to show what are—and were—the conditions of development of all hierarchies, not only in the corporate setting but also in the realm of public administration, all of which have responded to the same organizational method throughout the twentieth century. For Rosa the essential component of transaction costs is the expense incurred in the acquisition of information, indispensable to any production process. Initially the Industrial Revolution

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greatly increased production and hence transactions, but the production of information did not grow at the same speed. The relative and increasing lack of information forced the development of hierarchies as the most efficient recourse, as opposed to the imperfections of the marketplace. This was the impetus for the rise of giant corporations and hypertrophied public administration at the beginning of the twentieth century.

The subsequent development of hierarchies, so argues Rosa, exerted a profound influence on social and political organization as well. Adherence to hierarchal authority and control are absolutely necessary for the survival of organizations and are, in a manner of speaking, their fundamental values. Freedom and individual liberty endanger their operation as well as their existence. It follows that the natural and necessary ideology of a society of hierarchical production—corporate, political, or social—is anti-Liberal and anti-individual liberty. It is to this hierarchal organization that the famous “isms” of the beginning of the twentieth century owe their success; namely, those of communism, fascism, corporatism, nationalism, and all the collectivist ideologies.

It is in accordance with this conclusion that the author persuasively explains the democratic and freemarket revolution that we are witnessing today. The transformation in communication technology and the revolution in the transmission, storage and processing of information that occurred in the 1960s and 1970s, and the universal use of computers that followed, abruptly decreased the costs of information sharing. Information is now profuse and accessible to anyone, and is no longer the monopoly of executives of major organizations at the peak of organizational pyramids.

The extraordinary explosion in available quantities of information at the end of the twentieth century revitalized the competitive advantages of the marketplace over the hierarchical system. The grand administrative structures imploded. They were replaced by structures more modest, more specialized and much more numerous, appealing

as a consequence to the development among themselves of transactions of increasing importance. The conglomerates that characterized the world of commerce and production until the 1960s, in essence have largely disappeared over the past thirty years, or undergone dramatic transformation.

Large firms have unremittingly “downsized,” in the sense that internal communication is now horizontal and no longer deliberately vertical. The number of hierarchical levels in the chain of command—“middle management”—has been reduced, often from twelve or ten to seven or eight. Average corporate size continues to diminish. Governments are increasingly privatizing heretofore public functions and responsibilities. The most heterogeneous among them, from the perspective of culture and population, are fracturing into groups of smaller states, such as the former Soviet Union, Yugoslavia, and Czechoslovakia. Is this in anticipation of what may also occur in China, while in the meantime secessionist and regionalist movements continue to multiply throughout the world? Is it from this moment on that “small is beautiful” because it is more efficient?

Those approaches—or should one say ideological preferences?—which favor hierarchical management, and in particular statist control, have lost the dominant positions they enjoyed in a world of organized concentrations of power. According to this conclusion, ideologies are no longer the ultimate basis of social organization, but the necessary and contemporary expression of organizational requirements. They are no longer absolute nor universally true, without consideration of place and time. To be of value in any given society, and to be widely accepted, concepts of organization must respond to the prevailing and changing requirements of economic efficiency. Those requirements come from the economic dimensions of technology. This explains why the proponents of liberalism were not heard from in the 1930s, '40s, and '50s, and why their listeners and readers became more receptive to those ideas in the '80s and '90s.

Rosa tells us that the contemporary consequences of this trans-

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formation are universal. They are the revival of individualism, liberalism and even anarchism; the fracture and multiplication of nations, the end of authoritarian regimes and of democratic revolutions, the impoverishment of totalitarianism, the disappearance of grand empires and of aggressive and expansionist nationalism, the relative absence of conflicts between nations but, also, the increase of civil wars and the proliferation of terrorism. The only counter-example that one may invoke, perhaps, is the European attempt to build a federal and centralized state in the form of the European Union. But it is condemned to failure, according to Rosa, precisely because it runs counter to the expected organizational efficiencies of the twenty-first century. It is, indeed, a project of the past, of the twentieth century.

The economic, organizational and technical analysis authored by Jean-Jacques Rosa presents a captivating insight into history, politics, and the ideology of corporations and states at the beginning of the new millennium. His analysis sheds more than just light on the objective conditions necessary for the preservation and diffusion of the values of freedom and democracy in modern societies. It captures the fundamental elements of their politics and history; and, therefore, recalls to life that the future, too, will be made of the force of things.

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