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Articles in the field of agricultural economics, suitable for publication in the journal, will be welcomed.

Articles should have a maximum length of 10 folio pages (including tables, graphs, etc.) typed in double spacing. Contributions, in the language preferred by the writer, should be submitted in triplicate to the Editor, c/o Department of Agricultural Economics and Marketing, Pretoria, and should reach him at least one month prior to date of publication.

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# SOCIALIST ENTERPRISE FORMS IN AGRICULTURE V: THE STATE ENTERPRISE AS AN ECONOMIC ENTITY\*

by

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## THE CONCEPT OF THE SOCIALIST ENTERPRISE

The concept of the enterprise is in a historical sense a product of capitalism. The size, organisational compositions and concrete functions of enterprises have changed a great deal in the course of time, but socialist economists still brand capitalist enterprises today as areas where capitalist exploitation can take place.<sup>1</sup> This view may be traced back to Marx's surplus value theory.

Before discussing socialist enterprises, the concept of the enterprise must be defined, with the properties that occur in one form or another in both the capitalist and socialist enterprises.

An enterprise may be described as a fundamental economic unit of the developed goods and money system, in which the right of ownership is divided and in which production takes place independently of other organisations or of the households of those concerned. It takes place in such a way that the cost of investment is covered by the realised incomes. It always holds *risk elements and the direct* purpose of an enterprise is profitability.<sup>2</sup>

## THE NATURE AND NATIONAL ECONOMICAL IMPORTANCE OF SOCIALIST ENTERPRISES

The socialist enterprises - theoretically at least - in contrast with the capitalist enterprises, are not based on individual profit, but rather on the basis that the workers combine their work capacity in order to produce with the help of production agents that are jointly owned, so as to unite the

interests of a planned economy and their individual interests in a rational way.

The enterprises are therefore regarded as the vehicles of the fundamental socialist communal relationships and also as centres for the functioning of joint right of ownership and individual interest.

Theoretically speaking, the traditional Soviet type enterprises work towards the maximisation of output, whereas private enterprises try to maximise profit. This view is naturally only hypothetical.

Private enterprises are not always geared purely to the pursuit of profit.<sup>3</sup> It is also often maintained that in the many big private enterprises the marketing department tries to maximise the volume marketed, the production department to minimise average costs, the staff department to maximise average labour productivity and the accounts department to minimise declared profits. Notwithstanding this, however, the profit maximisation hypothesis is a useful simplification for economic analysis.<sup>4</sup>

There are also cases where the Soviet and satellite states' enterprises do not work towards maximisation of output, but specialise mainly in export trade. However, this is the exception.

The business economics effect of a pursuit of maximisation of output compared with profit maximisation will be discussed with the help of Figure 1.

It is accepted that the firm's scope of business is not big enough to influence the price of the product or inputs. Product price, average income and marginal income are therefore equal.

If a price  $P_1$  is obtained for the product, profit is maximised at the production level  $q_1$ , where marginal cost and marginal income equal one another. However, the firm can produce more without showing a loss. At the level of output  $q_2$  average cost and average income will be equal and no profit is shown. If more than  $q_2$  is produced, the enterprise will show a loss. The production level  $q_2$

\* Based on an M.Sc. (Agric.) thesis by T.I. Fényes, University of Pretoria.

therefore represents a top limit; a firm that wants to maximise output will therefore produce  $q_2$ .

This analysis has so far covered only micro-economic aspects. Macro-economic aspects must, however, also be considered. The total product supplied by an industry is determined by the number of firms and the production by each firm. A big increase in total production will lead to the creation of unsaleable surpluses or to lower product prices. It may be expected that such surpluses will convince the authorities to lower prices even in a planned economy. In a country where industrial development receives high priority this would affect agriculture in particular because it is important to such a country that the urban population be fed cheaply and that industrial raw materials of agricultural origin be obtained at a relatively low cost.

Such a development would have an effect both on the production supplied by existing enterprises and on the number of enterprises entering the industry. If the price drops to level  $P_2$  on Figure 1, the profit maximising output dropped to  $q_4$  and the top limit for non-loss-creating production to  $q_5$ .

The effect on the number of firms arises from the necessity for an already existing firm to be able to cover only variable costs in order to continue production, whereas a new firm would also have to be able to cover fixed costs. Lower product prices would therefore curb the entry of more firms.

If all enterprises in an industry produce more than the production level associated with profit maximisation, it should therefore lead to price decreases, a smaller number of enterprises in the industry and consequently probably also to lower total investment. To a socialist state with capital shortages such an eventuality would be attractive. However, it might also lead to unemployment problems.

Even in a socialist state dynamic considerations may, however, result in individual

firms not striving for output maximisation in the short term. The propositions have been static so far and have not taken time into consideration. Output maximisation in the long term implies growth of an enterprise. In its turn, growth requires further investments that may be financed by profits or by outside organisations. Particularly where capital is limited, a considerable part of the investment would have to be financed from profits. This implies that with a price level of  $P_1$ , an output less than  $q_2$  - for example,  $q_3$  - will be aimed at by the firm. The more a long-term aspect is stressed the closer  $q_3$  will be to  $q_1$ . In turn this will lead to a bigger number of enterprises in the industry.

It therefore appears that output maximisation is in reality a combination of long and short-term aspects and that great emphasis on long-term maximisation could lead to an attempt to maximise profit in the short term.

A higher production level will also result in a greater employment of labour within the relevant enterprise.

### THE ENTERPRISE AS A FACTOR OF THE REGULATED MARKET

The general criterion that goods production is based on the market changes to a degree in a socialist economy (and even in capitalist countries there is also a trend in this direction) in the sense that here we are dealing with a regulated instead of a free market. Planned market conditions have briefly the following influence on the functioning of the enterprise:<sup>5</sup>

- (a) Decisions and plans at government level take priority over enterprise plans and decisions. The reasoning is that the priority given to the national plan on the market and decisions at government level over the enterprise decisions must eventually result in a socialist market being protected against those risk elements

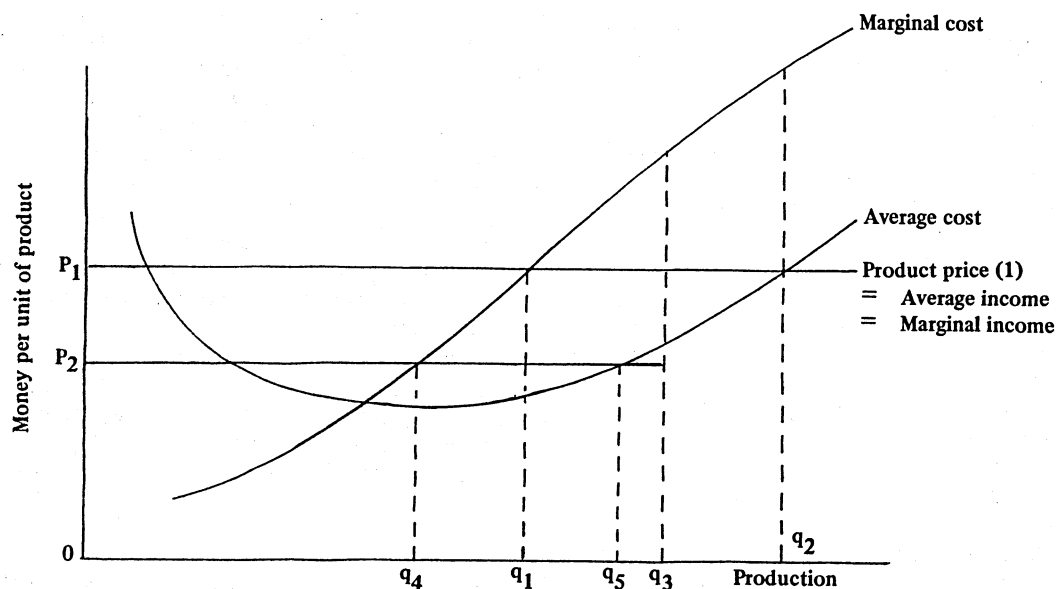


FIG. 1 - Representation of production possibilities

that in capitalist circumstances result in unemployment and cyclic changes in the production and earnings because of large-scale political and financial speculations of internal and foreign capitalists.<sup>6</sup>

- (b) The problem category in which decisions are taken at government level is - theoretically at least - clearly distinguished from jobs for which decision making occurs at enterprise level.

The first group includes tasks where the decision affects the whole community, its development, composition, etc., whereas problems in the second group include jobs related to the functioning and co-operation of enterprises. In this last-mentioned case the power of decision making and the acceptance of responsibility rest entirely with the enterprise leadership. It must be mentioned here that if the framework of decisions taken at government level spreads further at the cost of enterprise decisions, it will mean that the authorities take more direct business decisions; this in turn will lead to the narrowing of the functioning of the market mechanism. One can speak of a real market only if the decision making by the participating parties is free.

If the market is not a real market, its regulation cannot be an important instrument in planned control of enterprise activities. So the socialist economists accept the necessity for the existence of a real market - as a point of departure - and they want to build on this to perfect the functioning of the market with planned regulation.<sup>7</sup>

If, on the other hand, decisions at enterprise level are extended to include decisions with macro-economic content, it would strengthen spontaneity and weaken the power of planned control.

- (c) The market automatism, which serves as an instrument for State guidance, includes permitting limited competition. Each enterprise strives to strengthen its economic position, but as a result of their different capacities they have to act competitively on the market. The well-known advantages of competition are recognised to some extent, but on the other hand they are also restricted. This particular enterprise-market situation is comparable with monopolistic conditions that occur in the Western capitalist national economies, however, with the difference that this regulated situation is specifically created in socialist countries for the purpose of defeating monopolistic tendencies. The regulated market (and restricted competition) have the following main functions:

- (a) The main function of the regulated market - precisely as a result of the possibility of income differentiation - is to act as an incentive for the thrifty use of resources for modernisation and for flexible adaptation to profits.

- (b) The second function is to combat rigidity in production and income relationships. The influence of the market leads to differentiation, but on the other hand it brings about contra-differentiation trends which (according to labour productivity) work towards combating existing income differences and in so doing help towards the establishment, maintenance or improvement of a more advantageous or desirable position.

- (c) Thirdly, there is a balancing function. The above-mentioned tendencies and contra-tendencies are the result of powers that attempt to combat the upsetting of the balance on the market of consumer and production goods and which also exist in the long term on the labour and credit market. It is hoped that the interaction between demand and supply will contribute to restoring the position of balance in production and consumer relationships - at least theoretically.

- (d) The fourth function is the objective control and stimulation of planned singleness of purpose. Depending on the results realised by the market and the centrally planned results, the efficiency of the politico-economic decisions and economic controls may be judged. If there is not the necessary coherence between the plan and the realisation, then the plan was not realistic enough or the execution and control were not all they should have been.

#### THE CHARACTERISTICS OF ENTERPRISE INDEPENDENCE\*

The socialist State enterprise is an organisation based on the market and the independent right of choice and decision making in its functioning and concrete objectives. The freedom of the enterprise in the above connection is, however, never absolute. The determining factors here are the ruling economic and social circumstances and the strength of individual enterprises.

In socialist literature it is often maintained that the probability that new or existing enterprises will keep pace with development of the production apparatus and labour distribution is greater under socialist conditions.<sup>8</sup>

Regarding this, there is obviously confusion among the economists as regards the effect of enterprise organisation and size. It may be expected that a well managed, large-scale production unit, provided enough skill is available, can absorb the

\* In this section State enterprises will be concentrated on, but certain characteristics also apply to collected enterprises.

newest available technology efficiently. It may therefore be expected that large socialist farm units, if well organised and managed, will maintain a high level of efficiency and will apply new technology if it is advantageous. However, this also happens in large-scale capitalist farming enterprises, for example, this was the case with the big tea plantations in Ceylon,<sup>9</sup> sugar and rubber plantations in Indonesia,<sup>10</sup> and abaca and coffee plantations in the Philippines.<sup>11</sup> The lack of popularity of plantation agriculture in these and other countries, was and is not directly linked with their productivity, but is the result of socio-economic and cultural conditions, bound up with the behaviour of plantation owners. Similarly, certain big estates in South Africa - for example, sugar and fruit estates - have proved definitely that big capitalist enterprises can obtain the same advantages from management, labour distribution and better technology as socialist enterprises. Within both frameworks (socialist or capitalist) the emphasis falls mainly on the quality of management.

In both groups, inefficient management would cancel out all the advantages of large-scale production.

It is suggested by some socialist economists<sup>12</sup> that socialist enterprises have the following advantages over capitalist enterprises:

- (a) The broad and long-term scientific planning of a regulated market makes it possible for planning at national and enterprise level to be placed on an optimum basis more easily. This potential advantage is unique to a socialist economy, but as will be indicated later, there are certain stumbling blocks which often mean that these potential advantages cannot be achieved.
- (b) Capital limitations in relation to the establishment and/or expansion of enterprises are not related to the capital strength of private persons, but to the capacity of the whole community.
- (c) The presence of the joint right of ownership makes it simple to make structural adaptations if changed circumstances justify them. Here one thinks mainly of cases where the combining and/or division of enterprises have nothing to do with private ownership of capital.

As against this, the socialist state enterprises have limiting factors that in fact arise from the joint ownership of the production equipment:

- (a) The establishment of an enterprise is not an individual action, but always the result of social decisions. The State gives permission for the establishment of a new enterprise only if its functions and expected standards of efficiency meet the State's socio-economic criteria.<sup>13</sup> In addition, the State sets requirements in connection with the form of the enterprises, namely, what types of products will be produced and marketed and what services will be provided.<sup>14</sup> The requirements in accordance with which

enterprises may be established serve as an important instrument for the planned regulation of the economy and evidently give rise to chronic shortages and also unsaleable surpluses of certain products.

- (b) The second limiting factor is related to the forms of financing; both new enterprises and expansions to existing enterprises are financed by communal capital. The State may budget for such expenditure or they may be financed from State loans repayable with interest. These loans are in general low interest rate long-term loans. These two forms of financing may also be applied at the same time. If the decision-making on the expansion takes place at enterprise level the enterprise must finance itself from its own resources.<sup>15</sup>
- (c) The third limiting factor in the functioning of the existing enterprise is related to the principle of distribution according to work done. Here we are dealing with a limiting mechanism which first tries to prevent enterprises paying workers out of relationship with productivity and at the same time tries to ensure that the takings always remain in relationship to the productivity value of the work. Because of the complicated nature of this task, a complicated administrative mechanism is needed to obtain the desired results. The limitation is particularly valid in connection with the distribution of enterprise profits, fixed salary scales and contractual obligations.<sup>16</sup>

These three limiting factors are typical of socialism and result in a situation in which only consumer goods can come into individual ownership; consequently individual persons or groups of people cannot become owners of production equipment and incentive to individual savings is lowered.

#### CHARACTERISTICS OF RISK ACCEPTANCE AND PURSUIT OF PROFIT

The socialist state enterprises also strive for profit and furthermore any production takes place under risk conditions. However, it takes place under conditions that differ considerably from those under which a capitalist enterprise functions. The point of departure of this difference is that the socialist enterprise is a unit of a planned economic framework. From this it follows that certain factors increase the possibility of making a profit and, on the other hand, it limits the economic activities and also the risk probabilities.

In connection with risk:

- (a) The size of the enterprise risk is reduced because in a planned socialist economy it is simpler to predict future events. The enterprises are acquainted with the projections in the national plan (and in fact take an active part in compiling them) and can depend more on economic stability (provided plans are not drastically amended).

(b) Naturally, economic risk cannot be eliminated by socialism. Socialism is a dynamic system that demands a spirit of enterprise. The initiation of big national projects with a view to ending the relative economic backwardness and achieving international standards in certain branches holds certain risk elements. This risk, however, can be divided between the State (community) and the enterprises.<sup>17</sup> This takes place first if financing is done out of the budget or when government loans make provision for risk. Risk is also lowered if the State prescribes wages or if central regulations require building up a risk fund.

In cases, for example, where the fluctuations on the world market may have a detrimental effect on the enterprise the State can counteract this with monetary instruments. Apart from this, the enterprises must take financial responsibility for their decisions. This is necessary for the following reasons:

- (a) Even in a socialist system the management function of an enterprise is mainly economic (and not political, technical or administrative, as previously considered) in nature and enterprise decisions must take market influences into account; management owes responsibility for this to the owners - the State.
- (b) Enterprises have additional responsibilities in respect of minimisation of social losses. This means that the enterprise leadership is in a better position than any other body (for example, ministries, central bureau for planning) to reduce social losses by rational action in respect of planning, execution of tasks and the acceptance of responsibility.

There are differences of opinion on the profit maximisation possibilities of the socialist state enterprises.

Marxist economists<sup>18,19</sup> maintain that the possibilities for profit maximisation are generally bigger in a socialist than in a capitalist enterprise and that the whole economy can grow faster. These economists allege that these possibilities may be so realised with the help of the planning mechanism that certain enterprises, which from the point of view of the national economy must receive priority over others, are assisted to make a relatively larger individual profit.

Western economists, on the other hand, are very sceptical of these statements. The main points of criticism centre on the fact that the theoretical profit maximisation possibilities are neutralised by the relatively low productivity.<sup>20</sup>

Friedman<sup>21</sup> points out that "many intellectuals in the west and probably the great majority of the intellectuals in the underdeveloped countries are firmly convinced that central planning by government is an essential requisite for rapid economic development". What happened in the Soviet Union, however, was another matter; "the rise in the standard of life of the ordinary people of Russia is far less dramatic than the rise in the gross national product or in the index of industrial production."<sup>22</sup>

The typical Western philosophy may probably be traced back to Schumpeter's<sup>23</sup> theory of innovation. What this amounts to is that the conditions under which profit had its dynamic origin are normally at least partly absent in a socialist economic framework. The joint right of ownership, the central planning and the regulated market conditions are obviously limiting factors in the pursuit of differential advantage, innovations, imitation and eventually the technological growth of the whole economy.

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