Journal of Economics

Zeitschrift für Nationalökonomie

Vol. 49, 1989

ISSN 0931-8658

Springer-Verlag Wien New York

Journal of Economics
Zeitschrift für Nationalökonomie

Contents

Articles

Book Reviews

Contributors

Weitzman, M. L.: *Das Beteiligungsmodell (The Share Economy). Vollbeschäftigung durch flexible Löhne.* (Sonderband der Reihe "Wirtschaftswissenschaft im Spannungsfeld von Theorie und Politik") 209 S. Frankfurt – New York: Campus Verlag. 1987.

This is the German translation of a by now famous book which has been published in English in 1984. Weitzman proposes in this book a microeconomic remedy for the macroeconomic stagflation problem. To make such a kind of proposal is, I think, in itself a significant advance regarding policy recommendations. The usual arguments between the "Keynesians" and, well, the others on whether we should stimulate the economy, or better not risk inflation, became somewhat insipid after a decade of wear and tear. They do not touch the simple question of why we cannot have both price stability and full employment to begin with. Weitzman does not answer this question either, but he proposes a change in the rules of the game which are intended to cure the stagflation disease even if we don't know its cause.

His proposal is profit sharing: each firm in the economy should be required to remunerate its workers with a certain fraction of its profits in addition to fixed wage payments, which are to be reduced accordingly. In the long run, workers will be concerned with their overall income, irrespectively of whether this comes from residual or fixed payments, and the same holds true for the firms. As a result, such a change would not affect long-run supply and long-run demand in the economy, and, hence, long-run equilibrium. In particular, the long-run marginal revenue product of a worker will be equal to his income. (The flashy term for that is isomorphism between wage and share economies.)

In the short run the wage and the share parameters are fixed, however, and the firm will compare the short-run marginal revenue product of a worker with the fixed wage per worker, since a fixed share of profits must be paid to the workforce anyhow. As the fixed wage of a worker is only a part of his income, it is much below his long-run marginal revenue product. Weitzman assumes implicitly that the short-run marginal revenue product is not too much below the long-run marginal revenue product. If this holds true, each firm will have an incentive, in the short run, to hire more workers, and all job seekers which might appear on the scene will immediately swallowed up by the firms. Horst Siebert, in his comment, describes this aptly as the "vacuum-cleaner effect". Thus unemployment cannot grow by feeding on itself. It even cannot take root. In other words: although a wage economy and a share economy will settle down at the same long-run equilibrium position, they react quite differently to short-run shocks. The wage economy reacts, according to Weitzman, through quantity adjustments first, and only thereafter through prices, whereas a share economy paralyzes effects of shifting marginal revenue products of labor on the quantity of labor employed from the outset. Each worker's income reacts inversely to changes in the employment level of his firm in the short run, and this makes it so attractive for each firm to employ more workers, but this device cannot be used to reduce labor costs in the long run since the workers will leave those firms which offer insufficient pay. (This absorption of unemployed labor in the short run works, of course, only within limits: the smaller the share parameter, the smaller will be the region of automatic stabilization.) Such as profit-sharing system has the beneficial "macroeconomic externality" of reducing unemployment. This externality is not taken into account by the microeconomic agents. They have incentives to settle for fixed-wage contracts. Thus the profit sharing system must be enforced.

The task of the book is to explain this idea to the non-specialist. In that, it succeeds extremely well. It should not be taken as a learned contribution, since its purpose requires to simplify, and even over-simplify, the presentation of arguments, but it is perhaps for that reason that the book conveys Weitzman's vision better than his more technical papers which should be considered, however, as the basis for any serious evaluation even if they are less fun to read. (See *Quarterly Journal of Economics* 52 [1988]: 216—217, 223 for some references.)

The first three chapters develop the idea that firms are price-takers for inputs and price-makers for outputs. Firms are faced with downward-sloping demand curves and maximize profits. Thus they fix prices such that expected marginal revenues and marginal costs are equated. Since prices are higher than marginal revenues, prices exceed marginal costs and firms are eager to sell additional output at the posted price. Weitzman aptly describes this as a "buyer's paradise", but we should keep in mind that the buyers may pay more for that comfort than they would like to pay.

If firms were monopsonistic competitors for labor inputs, we would have a "worker's paradise" by the same argument, but Weitzman unfortunately assumes this away. Firms are conceived as price-takers for labor inputs. They hire workers until their marginal revenue product equals the wage rate. This makes them indifferent between hiring or not hiring an additional worker at the prevailing wage. Although firms are eager to sell more at the posted price, they are not at all eager to hire more workers at the ruling wage rate, but a share system would establish the same eagerness to hire new workers at the ruling conditions (i.e. for given wage and share parameters) as we find it regarding supply.

The following chapters develop this vision in various ways. It is argued that we don't really understand the stagflation problem; that inflation is detrimental mainly because the public feels it is, rather than because it is really harmful; and various remedies like tight money, price controls or indexing are also explained. The central theme is, of course, profit sharing — how it might be administered and how it will change the modus operandi of a capitalist economy in a fundamental way.

The book has proved to be excellent for teaching purposes. Students become usually very enthusiastic at the beginning and turn somewhat equivocal after a while, and the same holds true, as a rule, for professional economists. The idea needs much more elaboration and critical evaluation, especially with regard to the connection between long-run and short-run equilibrating processes, the underlying implicit postulates on mobility, its compatibility (or rather incompatibility) with co-determination, etc. It is beyond my scope to contribute to this discussion here. I fear, however, that Weitzman's ideas will not gain the kind of careful attention they actually deserve. There have been too many instances where various systems of profit-sharing have been proposed, but interest always faded after a while. The very influential German Council of Economic Advisers (Sachverständigenrat) recommended profit-sharing forcefully in 1975 for instance, albeit for reasons different from those given by Weitzman. Among the numerous contributions which were written at that time there are also some proposals which are very close in spirit to Weitzman's proposal. (See, for example, FitzRoy, F. [1979]: "Wage Contracts and Risk Sharing by Implicit Firm Indexing." Discussion Paper, International Institute for Management Berlin.) But all this had no lasting impact on economic policy. Weitzman's proposal is, on the other hand, tightly argued and forcefully presented to academics as well as to the public. If he succeeds in pushing this issue — and I hope he will! — this will make an interesting case about under which conditions economic ideas may influence economic policy.

It has certainly been a good idea to make this book also accessible to the German public. The translation is adequate. Siebert's comment is helpful. He takes this book as evidence, however, against a saying by Goethe to the effect that the Germans are very skilful in rendering science incomprehensible. Here I cannot follow.

E. Schlicht, Darmstadt, F.R.G.