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information. Without copyright and patent monopolies, peer production by self-employed information and entertainment workers would likely be the norm in software, music, and publishing. (It's probably no coincidence, by the way, that industries dependent on such "intellectual property" monopolies are the main profitable sectors in the global economy. It's a case of artificial "comparative advantage," created by state-erected barriers to the diffusion of knowledge and technique. The most profitable industries are those whose profits amount to rents or tolls for access to artificial property.)

The problem is not hierarchy in itself, but government policies that make it artificially prevalent. No doubt some large-scale production would exist in a free market, and likewise some wage employment and absentee ownership. But in a free market the predominant scale of production would likely be far smaller, and self-employment and cooperative ownership more widespread, than at present. Entrepreneurial profit would replace permanent rents from artificial property and other forms of privilege. Had the industrial revolution taken place in a genuine free market rather than a society characterized by state-backed robbery and privilege, our economy today would probably be far closer to the vision of Lewis Mumford than that of Joseph Schumpeter and Alfred Chandler.

artificially expensive the choice to repair an old car or appliance as an alternative to buying a new one. This facilitates a business model based on planned obsolescence, large production runs, and "push" distribution.

"Intellectual property" also artificially promotes hierarchy even in industries where the minimum level of capitalization has ceased to be an effective barrier to self-employment. One of the original justifications for corporate hierarchy was that the enormous scale of even the minimum capitalization, in entertainment and information, was an entry barrier: To start a newspaper, radio station, movie studio, publishing house, or record company required, at minimum, an outlay of several hundred thousand dollars. As a necessary result, media and entertainment were concentrated in the control of a few gatekeeper corporations.

Revolutionary Change

But as Yochai Benker observed in *The Wealth of Networks*, the digital revolution has reduced the cost of the basic item of capital equipment — the personal computer — to under a thousand dollars. And supplemental equipment and software for very high-quality desktop publishing, sound editing, podcasting, and so on can be had for a few thousand more. The ability to replicate digital information on the Internet, at zero marginal cost, renders the corporate dinosaurs' marketing operations obsolete.

The gatekeepers' only remaining basis for power is the state's "intellectual property" monopolies — which explains why Microsoft, the RIAA, and MPAA have pursued such draconian copyright legislation to protect themselves from market competition. The intrusive DRM (digital rights management) used by Microsoft and the entertainment companies, and the legal penalties for circumventing it, in effect outlaw precisely what computers are made for: the replication and exchange of digital

In an article in last June's *Freeman*, I applied some ideas from the socialist-calculation debate to the private corporation and examined the extent to which it is an island of calculational chaos in the market economy. I'd like to expand that line of analysis now and apply some common free-market insights on knowledge and incentives to the operation of the corporate hierarchy.

F. A. Hayek, in "The Use of Knowledge in Society," used distributed, or idiosyncratic, knowledge — the unique situational knowledge possessed by each individual — as an argument against state central planning.

Milton Friedman's dictum about "other people's money" is well known. People are more careful and efficient in spending their own than other people's money, and likewise in spending money on themselves more so than in spending money on other people.

A third insight is that people act most efficiently when they completely internalize the positive and negative results of their actions.

The corporate hierarchy violates all of these principles in a manner quite similar to the bureaucracy of a socialist state. Those at the top make decisions concerning a production process about which they likely know as little as did, say, the chief of an old Soviet industrial ministry.

The employees of a corporation, from the CEO down to the worker on the shop floor, are spending other people's money, or using other people's resources, for other people. Its managers, as Adam Smith observed 200 years ago, are "managers rather of other people's money than of their own."

By its nature, the corporation substitutes administrative incentives for what Oliver Williamson called the "high powered incentives" of the market: effort and productivity are separated from reward. As Ronald Coase observed some 70 years ago,

> If a workman moves from department Y to department X, he does not go because of a change in relative prices, but because he is ordered to do so. …

It can, I think, be assumed that the distinguishing mark of the firm is the supersession of the price mechanism.

So why is all this the case? Why does the corporation systematically abandon the basic knowledge and agency benefits of a free market, and rely on the same kinds of central planning and bureaucratic incentives that free-market advocates rightly attack on the part of the state? Why does the corporation function, internally, as an island of nonmarket operations?

A classic essay by C. L. Dickinson, "Free Men for Better Job Performance," was reprinted in the same issue as my article. Dickinson described the harmful effects of the managerial revolution and the bureaucratic style of corporate governance. He quoted Douglas McGregor (The Human Side of Enterprise): "Many managers agree that the effectiveness of their organizations would be at least doubled if they could discover how to tap the unrealized potential present in their human resources."

Unfortunately, the structural preconditions of the present system rule out, from the start, an organization which can tap that potential. The system starts from the legacy of a historical process (called "primitive accumulation" by radical historians of various stripes) by which the land was stolen on a large scale from the peasantry in the early modern period. The process included the enclosure of open fields, the legal nullification of copyhold and other traditional tenure rights, and the Parliamentary Enclosures of common land.

As Murray Rothbard observed, whenever we witness a majority of peasants paying rent to a small class of "owners" for access to the land they cultivate, it's a safe guess the cultivators are the rightful owners and the landlords' "property rights" are some sort of feudal legal fiction stemming from conquest or privilege. The effect of

less costly to simply monitor the contractually specified "ins" and "outs" going across firm boundaries than to monitor the internal use of inputs within the production process. The contracting party has no need to worry about the internal efficiency of the production process because it has effectively outsourced the responsibility for decisions on how best to organize production to those engaged in production. And the other firm, if cooperatively owned by self-managed workers, is uniquely qualified to organize production most efficiently given the specified ins and outs. Both the authority to organize production, and the productivity benefits from doing so in the most efficient manner, have been internalized by those who have the most direct knowledge of the production process.

But — again — the state's intervention in the market raises almost insurmountable barriers to this form of organization. The state artificially promotes hierarchy at the expense of markets by subsidizing the input costs of large-scale enterprise and by protecting large corporations against the competitive ill effects of inefficiency. It subsidizes long-distance transportation and thus artificially inflates market and firm size. Its differential tax advantages for corporate debt and capital depreciation (or more accurately, its differential tax penalties on those not engaged in such activities) encourage mergers, acquisitions, and excessively capital-intensive forms of production with high entry costs. Its cartelizing regulations, in addition, limit competition in product features and quality. Thus the boundary between hierarchy and market is artificially shifted so that the dominant firms are far larger, more hierarchical, and more vertically integrated than they would be in a free market.

The state's so-called "intellectual property" laws, especially, are a powerful force for cartelization. Many oligopoly industries were created by controlling patents (for example, AT&T was based on the Bell patent system) or exchanging them (GE and Westinghouse). Patents also enable corporations to restrict the supply of replacement parts for their goods and thus render mation for consideration by a single group of decision-makers. In a self-managed enterprise, the same elected management that considers the relative prices of different productive inputs, and the price of the finished product, is also experienced in the actual production process in which the inputs are used. They are most qualified, of all people, to decide both the relative priority by which productive inputs ought to be economized, and the most effective technical methods of organizing production in order to economize those inputs (that is, combining Mises's "entrepreneurial" and "technical" functions without the intermediation of several layers of pointy-haired bosses).

Just as important, unlike a production unit within a corporate hierarchy, the production workers within an independent producers' co-op fully internalize all the costs and benefits of their production decisions. Unlike the case within a corporate hierarchy, there is no conflict of interests resulting from the decision-making by managers who stand to reap the benefits of increased productivity while workers suffer only the increased burden of speedups and downsizing. For a self-managed production unit, any decision concerning production methods will be a tradeoff of costs and benefits, all of which are fully internalized by the decision-makers.

From an outside perspective, on the other hand, contracting firms are able to make a virtue of necessity in treating a particular stage of production — organized as a separate firm — as a black box. The outside contractor and the internal corporate hierarchy, equally, are ignorant of goings-on inside the black box. The difference is that an outside contractor, unlike the apparatchiks in a corporate hierarchy, has no need to know what's happening in the internal production process, and no power to interfere with what he doesn't understand. So long as the inputs (likely in money terms) are specified by contract and the outputs are verifiable and enforceable, what goes on inside the box isn't the contractor's problem.

If the ideal contract is Ian R. MacNeil's "sharp ins by clear agreement, sharp outs by clear performance," then it is far simpler and

the assorted "land reforms" of the early modern era was to transform the landed oligarchy's "property" in feudal legal fiction into a modern freehold right and reduce the rightful owners to at-will tenancy. The result of these expropriations was to drive the majority of peasants off the land, deprive them of independent access to the means of production and subsistence, and force them into the wage-labor market—at the same time as their former property was consolidated into the hands of the plutocracy.

As the industrial revolution developed in England, further accumulation of wealth by the owning classes was fostered by state-enforced unequal exchange, the result of coercive state restrictions on the free movement, free association, and freedom to bargain of the laboring classes. These included the Laws of Settlement (a sort of internal passport system restricting the movement of labor in search of better wages) and the Combination Laws.

Subsidizing Centralization

The state's entry barriers, like licensing and capitalization requirements for banks, reduce competition in the supply of credit and drive up its price; enforcement of artificial titles to vacant and unimproved land has a similar effect. As a result, labor's independent access to capital is limited; workers must sell their labor in a buyer's market; and workers tend to compete for jobs rather than jobs for workers.

State subsidies to economic centralization and capital accumulation also artificially increase the capital-intensiveness of production and thereby the capitalization of the dominant firm. The effect of such entry barriers is to reduce the number of employers competing for labor, while increasing the difficulty for small property owners to pool their capital and create competing enterprise.

The cumulative legacy of these past acts of state-assisted robbery, and ongoing state-enforced unequal exchange, determines the basic structural foundations of the present-day economy. These include enormous concentrations of wealth in a few hands, the absentee ownership of capital by large-scale investors, and a hired labor force with no property in the means of production it works.

Necessarily, therefore, the absentee owners must resort to the expedients of hierarchy and top-down authority to elicit effort from a workforce with no rational interest in maximizing its own productivity. Oliver Williamson's concept of "satisficing" is relevant here. Workers have an interest in maintaining just enough productivity to keep their jobs and increasing it enough to earn whatever limited administrative rewards are available, but no rational interest in maximizing it per se, because any additional increase in productivity beyond the minimum will likely be appropriated by management.

Hierarchy necessarily results in the divorce of effort from reward, and of productive knowledge from authority. Each rung of authority interferes in the efforts of those who know more about what they're doing; each rung of authority receives only information filtered from below based on what it wants to hear; and each rung of authority is accountable only to those higher up the chain of command who are even more unaccountable and out of touch with reality. The hierarchy, in short, is a textbook illustration of the zero-sum situation that results from substituting power for market relations.

The obvious solution, the worker cooperative, would — by uniting knowledge with authority and reward with effort — slice through the overwhelming majority of the hierarchical corporation's knowledge and agency problems, like a sword through the Gordian knot. The distributed knowledge of those engaged in production would be applied directly to the production process on their own authority, without the intervention of suggestion boxes and "quality improvement committees." The problem of socially engineering the wages and benefits system so as to "encourage people to work" would disappear; the elimination of privilege

and unearned income, and the receipt by labor of its full product, would tie reward directly to effort.

But this solution is ruled out by the system's structural starting assumptions: concentrated wealth and absentee ownership. So the hierarchical corporation is adopted as a sort of Rube Goldberg expedient, the most rational means available given fundamentally irrational presuppositions.

Market Outside, Planning Inside

The corporate hierarchy also interferes with efficiency in another way: by substituting planning for market relations. Internally the corporation replaces market exchange with central planning. The simulated prices used by its internal accounting system, necessarily, are largely fictitious. Even when they use outside market prices as a proxy, the conditions under which those outside prices are set do not match the relations of supply and demand within the corporation. But more often, internal transfer prices are assigned to goods for which there is no outside market, like intermediate goods unique to a firm; in that case, the prices are based on cost-plus markup. As Seymour Melman has observed in the case of Pentagon contractors (*The Permanent War Economy*), cost-plus pricing creates perverse incentives to maximize, rather than minimize, costs.

The ideal, in terms of efficiency, is the allocation of goods entirely by a genuine price mechanism, with a minimum of vertical integration. Insofar as the production process involves a series of discrete, severable steps, the best way of avoiding information and incentive problems may be to relate the separate steps to one another by contract—especially if each step, organized under a separate firm, takes the internal form of a worker cooperative.

Each step, although a black box to those outside, is from an inside perspective ideally suited to aggregating all relevant infor-