

A Note on Bureaucracy

Ludwig von Mises

THE EFFECT OF BUREAUCRATIZATION is most apparent in its representative—the bureaucrat. In a private enterprise, the hiring of labor is not the conferring of a favor, but a business transaction from which both parties, employer and employee, benefit. The employer must endeavor to pay wages corresponding in value to the labor performed. If he does not do this, he runs the risk of seeing the worker leave his employment for that of a better-paying competitor. The employee, in order not to lose his job, must in his turn endeavor to fulfill the duties of his position well enough to be worth his wages. Since employment is not a favor, but a business transaction, the employee does not need to fear that he may be discharged if he falls into personal disfavor. For the entrepreneur who discharges, for reasons of personal bias, a useful employee who is worth his pay harms only himself and not the worker, who can find a similar position elsewhere. There is not the slightest difficulty in entrusting to the manager of each department the authority to hire and fire employees; for under the pressure of control exercised over his activities by bookkeeping and cost accounting he must see to it that his department shows as great a profit as possible, and hence he is obliged, in his own interest, to be careful to retain the best employees there. If out of spite he discharges someone whom he ought not to have discharged, if his actions are motivated by personal, and not

The Austrian economist Ludwig von Mises (1881-1973) was professor successively at Vienna, Geneva, and then New York University. This is an excerpt from his book Liberalism, first published in 1927 in Germany and to be reissued in November by the Foundation for Economic Education, Irvington-on-Hudson, New York, and the Cobden Press.

objective, considerations, then it is he himself who must suffer the consequences.

In a bureaucratic organization things are quite different. Since the productive contribution of the individual department, and hence also of the individual employee, even when he occupies an executive position, cannot in this case be ascertained, the door is wide open to favoritism and personal bias both in appointment and remuneration. The fact that the intercession of influential persons plays a certain role in filling official positions in the civil service is not due to a peculiar baseness of character on the part of those responsible for filling these posts, but to the fact that from the very outset there is no objective criterion for determining an individual's qualification for appointment. Of course, it is the most competent who ought to be employed, but the question is: Who is the most competent? . . . [A]n element of arbitrariness is necessarily involved in comparing the qualifications of different individuals.

The Growth of Credentialism

In order to keep this within the narrowest possible limits, one seeks to set up formal conditions for appointment and promotion. Attainment to a particular position is made dependent on the fulfillment of certain educational requirements, on the passing of examinations, and on continued employment for a certain period of time in other positions; promotion is made dependent on years of previous service. Naturally, all these expedients are in no sense a substitute for the possibility of finding the best available man for every post by means of the calculation of profit and loss. It would be supererogatory to point out in particular that attendance at school, examinations, and seniority do not offer the slightest guarantee that the selection will be correct. On the contrary: this system from the very outset prevents the energetic and the competent from occupying positions in line with their powers and capabilities. Never yet has anyone of real worth risen to the top by way of a prescribed program of study and promotion in due course along the established lines. Even in Germany, which has a pious faith in her bureaucrats, the expression, "a perfect functionary," is used to connote a spineless and ineffectual person, however well intentioned.

Thus, the characteristic mark of bureaucratic management is that it lacks the guidance provided by considerations of profit and loss in judging the success of its operations in relation to the expenses incurred and is consequently

obliged, in the effort to compensate for this deficiency, to resort to the entirely inadequate expedient of making its conduct of affairs and the hiring of its personnel subject to a set of formal prescriptions. All the evils that are commonly imputed to bureaucratic management . . . are the result of this one fundamental deficiency. . . .

A public enterprise conducted with an eye to maximizing profits can, to be sure, make use of monetary calculation as long as most business is privately owned and hence a market still exists and market prices are formed. The only hindrance to its operation and development is the fact that its managers, as functionaries of the state, do not have the personal interest in the success or failure of the business that is characteristic of the management of private enterprises. The director cannot, therefore, be given freedom to act independently in making crucial decisions.

But, in fact, it is only seldom that a public enterprise aims at nothing but profit and sets aside all other considerations. As a rule, it is demanded of a public enterprise that it keep in mind certain "national" and other considerations. It is expected, for instance, in its procurement and sales policy, to favor domestic as against foreign production. It is demanded of state railways that they set a schedule of rates that will serve a specific commercial policy on the part of the government, that they construct and maintain lines that cannot be profitably operated simply in order to promote the economic development of a certain area, and that they operate certain others for strategic or similar reasons. When such factors play a role in the conduct of a business, all control by the methods of cost accounting and the calculation of profit and loss is out of the question. The director of the state railways who presents an unfavorable balance sheet at the end of the year is in a position to say: "The railway lines under my supervision have, to be sure, operated at a loss if considered from the strictly commercial point of view of profit-seeking private enterprise; but if one takes into consideration such factors as our national economic and military policy, one must not forget that they have accomplished a great deal that does not enter into the calculation of profit and loss." Under such circumstances the calculation of profit and loss has clearly lost all value for judging the success of an enterprise, so that—even apart from other factors having the same tendency—it must necessarily be managed quite as bureaucratically as, for example, the administration of a prison or a tax bureau.

The Bureaucratization of Private Firms

No private enterprise, whatever its size, can ever become bureaucratic as long as it is entirely and solely operated on a profit basis. Firm adherence to the entrepreneurial principle of aiming at the highest profit makes it possible for even the largest concern to ascertain with complete precision the part played by every transaction and by the activity of every department in contributing to the total result. As long as enterprises look only to profit, they are proof against all the evils of bureaucratism. The bureaucratization of privately owned enterprises that we see going on about us everywhere today is purely the result of interventionism, which forces them to take into account factors that, if they were free to determine their policies for themselves, would be far from playing any role whatsoever in the conduct of their business. When a concern must pay heed to political prejudices and sensibilities of all kinds in order to avoid being continually harassed by various organs of the state, it soon finds that it is no longer in a position to base its calculations on the solid ground of profit and loss. For instance, some of the public utility enterprises in the United States, in order to avoid conflicts with public opinion and with the legislative, judicial, and administrative organs of the government which it influences, make it a policy not to hire Catholics, Jews, atheists, Darwinists, Negroes, Irishmen, Germans, Italians, and all newly arrived immigrants. In the interventionist state, every business is under the necessity of accommodating itself to the wishes of the authorities in order to avoid burdensome penalties. The result is that these and other considerations foreign to the profit-seeking principle of entrepreneurial management come to play an ever increasing role in the conduct of business, while the part played by precise calculation and cost accounting concomitantly dwindles in significance, and private enterprise begins increasingly to adopt the mode of management of public enterprises, with their elaborate apparatus of formally prescribed rules and regulations. In a word, it becomes bureaucratized.

Thus, the progressing bureaucratization of big business is by no means the result of an inexorable tendency inherent in the development of the capitalist economy. It is nothing but the necessary consequence of adopting a policy of interventionism. In the absence of government interference with their operations, even the largest firms could be run in exactly as businesslike a way as the small ones.

Readings

of particular interest

More Economies of Scale in Regulatory Compliance

Firm Size and Regulatory Compliance Costs: The Case of LIFO Regulations by John C. Hilke (Federal Trade Commission Bureau of Economics, December 1984), 64 pp.

Most businesses use one of two accounting systems to put a value on their inventories. Under the older of the two systems, FIFO (first-in-first-out), items sold from inventory are typically valued at prices prevailing some time earlier. Consequently, when prices of inventory items are rising, firms that use FIFO report higher profits than similarly situated firms that use LIFO (last-in-first-out), a system that values inventories at approximate replacement value. Businesses often regard the extra profits reported under FIFO as an artifact of inflation rather than a sign of real prosperity; in addition, FIFO users pay higher taxes than LIFO users in periods of general inflation like the past two decades. Thus there has been a broad shift toward LIFO since it was introduced shortly after World War II.

Many firms, however, particularly small ones, have still not switched to LIFO. According to this staff report by John Hilke, an economist in the Federal Trade Commission's Bureau of Economics, federal tax regulations that govern the adoption of LIFO have helped slow down the switch. Moreover, by creating economies of scale in regulatory compliance costs, the rules have differentially handicapped small firms. To the extent that FIFO overstates profits, the result may be to distort the tax system and introduce a bias against small firms and against inventory-intensive methods of doing business, resulting in the misallocation of resources.

The main body of the report is an analysis of the response to a 1983 survey of wholesaler-distributors about LIFO regulations and costs.

The survey data confirm indications from the Internal Revenue Service that many firms, particularly small firms, continue to use FIFO. According to Hilke, the survey data indicate that small firms' low rate of LIFO usage is not a result of their clustering in low-inflation and low-inventory industries where LIFO might not make much difference in tax liability.

More than half of the small firms that did not use LIFO in 1983 said that the cost of switching was a very important factor in their decision to stay with the old system. More than 40 percent of the medium to large firms also considered switching costs to be a major reason for avoiding LIFO. Among firms that already use LIFO, perceptions were different: few of them indicated that conversion costs had been much of a deterrent in their decision to switch.

That might suggest that the fears of switching are to some extent groundless and arise from a lack of information. But the data contradict that thesis. Non-LIFO users that are well informed about conversion costs are just as concerned about them as their less informed colleagues.

The FTC study finds that the pattern of conversion costs incurred by LIFO users surveyed provides a reasonable explanation for small firms' concerns about the costs of switching. Respondents reported that the costs of switching totaled more than \$35,000 for the average firm and \$23,000 for firms under \$5 million in annual sales, a figure that is proportionately much more burdensome for these firms; it represents 30 percent of an average year's profits. In effect, the report says, the costs of complying with LIFO regulations or sticking with FIFO seem to act as a regulatory economy of scale that inflicts particular comparative disadvantage on small firms during inflationary periods. The effect seems to hold within the industry subgroups that were studied as well as for firms overall, Hilke says.