We Need Middle-Economics

By Peter F. Drucker in:

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Modern Economics can be traced back to a paper entitled DER STEUERSTAAT (The Tax State) which Joseph Schumpeter published in 1918 while World War One was still raging. As John Maynard Keynes often pointed out, all Keynesian economics are based on this short work.

In DER STEUERSTAAT Schumpeter tried to draw the economic lessons of World War One. Traditional Economic Theory, he pointed out, had focused on the actions of individuals and their organizations *within* a society. Government (that is Der Staat) was seen in traditional theory as separate from, and outside of, the economy. Its laws and actions, whether taxes, tariffs or monopolies had of course profound impacts on economic behavior. But they were not themselves part of the economy any more than property laws or inheritance laws.

World War One, Schumpeter asserted, made government into a major - if not *the* major - protagonist on the economic stage, and into the one whose values, behavior and actions largely determine the values, behavior and actions of individuals and of their businesses became "*re-actors*".

Schumpeter's thesis was by no means universally accepted when it first appeared. In fact, it was largely brushed aside until Keynes discovered it ten years later when he then built his own theory on it. By now however, the basic assertion of DER STEUERSTAAT has become axiomatic in Economic Theory, especially in its Keynesian reformulation.

As a result, modern economic theory has come to have two centers. One is "Microeconomics," the inheritor of and successor to, Keynesian and altogether to pre-Schumpeterian economics. It is concerned with the economic behavior of individuals and their economic organizations, businesses. The other center is "Macroeconomics," concerned mainly with the values, policies and actions of government and their impacts on the economy.

Modern Economics has been successful beyond anyone's wildest dreams. It has been successful as a "discipline," that is a "true science," which is rigorous, quantifiable, and with a Nobel Prize of its own. It has been equally successful as a major policy-making profession in all kinds of institutions, both governmental and non-governmental.

There is Microeconomics and Macroeconomics. There is almost no "Middle Economics." There is no - or only a little - economic theory of society and of social organizations (the Viennese social philosopher Othmar Spann (1878-1950) is one of the few exceptions; but he is practically unknown outside of Central Europe). Yet in the years since World War One, and especially since World War Two, all developed countries have become Societies of Organizations. In all of them, more and more community tasks are being discharged in, and by, autonomous or semi-autonomous organizations such as universities, hospitals and other health care institutions, research centers, industry and professional associations, special-purpose agencies (such as the powerful Japanese Highway Authority) and countless others. Technically speaking, especially in Continental Europe, these organizations are often government owned. But we learned long ago that they will function only if organized as autonomous institutions governed by their own values and directed at their own objectives.

Above all we have learned since World War One that, contrary to everything in the Nineteenth Century believed, *ownership* makes very little difference to how theses institutions function. (Hitler, by the way, was the first one to realize that ownership does not matter as long as one has control, to which insight he owed to support of business and much of his success). We have learned by now that, regardless of ownership, an enterprise has to be run to survive and to prosper according to its own logic and with its own objective goals and measurements.

Recent American experience, by the way, is proof that ownership is secondary. While their executives loudly proclaim "shareholder sovereignty" and boast of short-term results quarter by quarter, America's performing and successful businesses - especially the big ones - are run for the performance and success of the enterprise over a lengthy period of time rather than for the share price; otherwise the share price soon tumbles.

The Society of Organizations has largely been ignored by economists and economic theory. Typical is the work of America's most influential and most popular economists, John K. Galbraith. Galbraith has spent most of his professional life teaching at Harvard, a private university and itself one of the most visible and most influential "NGOs," (non-governmental organization) in the world. Yet Galbraith's best known and most influential book, THE AFFLUENT SOCIETY (1998) knows no Harvard and non-governmental institutions altogether. It knows only government and businesses.

It is now more than eighty years since Schumpeter and his STEUERSTAAT. It is more than seventy years since Keynes responded and developed Schumpeter's insight into the first major economic vision and theory since the mid-nineteenth century, when the Mengers in Vienna and Pareto in Lausanne first freed Economic Theory from Ricardo's narrow concern with the allocation of economic resources and focused economics instead on the creation of new wealth. It is time for the next major step, that is for a Social Economics, an economics of a *society of organizations*.

The problems of the society of organizations are not accounting issues. They are mostly economic issues and require economic theory. What, for instance, are results in an organization? Most economists will answer: In a business, results are the "bottom line" of *profits* and *profitability*. But even in a business, as every consultant knows, profit and profitability are largely determined by *economic* decision, e.g., for instance, how much to spend *today* on future expectations; on what market segment to concentrate on; and what time period - three years? Five years? Seven years? - is most meaningful for a given business and best measures its performance. Even more fundamental decisions, for instance "What is our business?", are also not accounting decisions either, but decisions about society and economics.

Profitability is of course not a goal at all in the vast majority of organizations which are not businesses, such as universities, churches, hospitals, labor unions, and so on. It is not even a measurement. Its lack is a restraint: It it costs too much, we will not be able to do it. These organizations are not supposed to do things just because they are profitable. They are supposed to do things because they further their objectives, which are non-economic objectives. What decides in these organizations what to do?; what not to do?; and what stop doing and when? are not profitable considerations. Nor can activities in these organizations be justified by their profitability. Their measurements follow the mission of the organization. But these organizations also allocate scarce resources and have to hold results against expectations - the basic challenges of economic theory.

There has actually been a great deal of work to develop criteria and measurements of performance and results in non-business organizations. A good deal of the work of Fredmund Malik, (especially in his FUEHREN LEISTEN LEBEN) is concerned with defining and measuring results in non-business organizations and in the society of organizations altogether. We have quite a few tools, e.g., *cost-benefit analysis*. Are we now ready to develop an Economics of the Society of Organizations, something that might be called a Middle-Economics?