

## Self-Driven Economic Evolution and Darwinism

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IJMSSSR 2019  
VOLUME 1  
ISSUE 2 MARCH – APRIL

**Abstract** – A historical materialist argues that the socio-political structure of society, the ideals and policies of a nation and the distinctive facets of a civilization are mainly shaped by the structural conditions under which production is carried on. Put differently, a historical materialist thinks of the socio-political structure of society, the ideals and policies of a nation and the distinctive facets of a civilization as mainly shaped by the conditions of production. This paper analyses this issue against the backdrop of the contractual origin of the firm as theorised in Alchian and Demsetz, 1972. According to the author, an employee-managed system is a new production mode with a distinctive potential for outperforming capitalism which, contrary to AD's opinion, has failed to materialise because of the predominance of economics over politics – in full accord with the core assumption behind the materialist conception of history. An issue discussed is also the cultural roots of historical materialism.

JEL Classification: P13, P, J54, D4

**Keywords:** historical materialism, cooperative firms, method

### 1. Introduction

Authors who look upon the materialist conception of history (or sociological materialism) as the true mainstay of marxism include Bernstein (1899, p. 30) and Vygotskij, who described it as the 'brilliant formula' with which Marx and Engels made their debut in social science in the early 1840s, well before Marx developed his theory of value and surplus value<sup>1</sup> (see Vygotskij 1967, p. 5). Lenin rated it as 'one of the greatest achievements of scientific speculation' (Lenin, 1913, p. 477) and Godelier explained its importance by highlighting a far-reaching difference between the approaches of pre-Marxian historians and Marx-'s method: whereas the formers' favourite focus points were political events or religious and philosophical ideas – he argued – the latter's innovative approach to political history (or the history of ideas) turned the spotlight on prime causes and the agents behind them, as well as on the interrelations between man, nature and a horde of actors grouped into castes, orders and classes (see Godelier 1982, p. 332).

Engels himself reckoned the materialist conception of history as the core of Marxism (see Engels, 1859, pp. 202-03) and Antonio Labriola went so far as to argue that Marxism ultimately boiled down to historical materialism (see Labriola, 1902, p. 16). Aron, for his part (1970, p. 178), saw the gist of Marxism in the theory of modes of production, which he held to be inextricably bound up with historical materialism (for a comparable view, see Rodinson, 1969, pp. 13-18). The claim that historical materialism is the true cornerstone of Marxism was also advanced in a well-known book by Cohen (see Cohen, 1978 and 2000).<sup>2</sup>

<sup>1</sup> It is widely held that the earliest systematic attempt at theorising a materialist conception of history dates back to *The German Ideology*, i.e. to 1946 (see, *inter alia*, Buchanan 1982, p. 27),.

<sup>2</sup> Orfei (1970, p. 271) reports that Antonio Labriola described the materialist conception of history as 'an effective means of splitting the huge and extremely complex working mechanism of society into its simplest constituent parts'. From the perspective of Kautsky, for instance, the key points of Marxism were the materialist conception of history and the idea of the proletariat as the driving force behind the socialist revolution (see Geary, 1974, p. 85). Conversely, in the opinion of Croce historical materialism was 'neither a philosophy of history nor a philosophical approach proper, but rather an empirical interpretative canon, a recommendation to historians for them to focus on economic activity and give it the attention its major place in human life entitles it to' (see Croce, 1896, pp. 1-19 and Labriola, 1942, p. 292).

The core idea behind the materialist conception of history is that the true underpinning of each social order is a specific mode of production. In this paper I will analyse this issue against the backdrop of the contractual origin of the firm as theorised in Alchian and Demsetz (AD) 1972. Put differently, a historical materialist thinks of the socio-political structure of society, the ideals and policies of a nation and the distinctive facets of a civilization as mainly shaped by the structural conditions under which production is carried on (see Schumpeter, 1941) and will consequently agree with Engels that “policy and its history are to be explained from the economic relations and their development, and not vice versa” (Engels 1885, p. 1086).

Considering that the importance of the materialist conception is called into question by many authors even today, in this paper I will analyse this issue against the backdrop of the contractual origin of the firm as theorised in Alchian and Demsetz (AD) 1972.

In my estimation, a system of employee-managed system is a new production mode with a distinctive potential for outperforming capitalism which contrary to AD’s opinion has failed to materialise because of the predominance of economics over politics – in full accord with the core assumption behind the materialist conception of history. The importance of historical materialism is consequently twofold: on the one hand, it opens up a new perspective on history (see Benedetto Croce 1896); on the other, it tells us why the transition from capitalism to socialism is slow to become a reality. Specifically, the observation that developments that would be in the interests of society do not necessarily become a reality justifies the argument that the real is not necessarily ‘rational’ and the resulting conclusion (which is not Croce's) that historical materialism is a new form of philosophy of history. As far as I can see, Croce's argument that “as soon as the materialist conception of history is stripped of its teleological and providence-related overtones, it proves to be unable to further socialism or any practical purposes in life” (1896, p.15) is unwarranted because the materialist conception of history does tell us clearly why socialism has failed to take the place of capitalism down to our days.

A preliminary issue to be discussed at this point is the cultural roots of historical materialism.

According to Fromm, the first philosopher to develop a correct understanding of the unconscious was Spinoza, who described men as aware of their desires, but ignorant of the springs from which they originate. In other words, although men like to think of themselves as free individuals, they barely are since they are spurred on by unconscious drives. In all probability – Fromm argues – Marx was influenced by his in-depth study of Spinoza’s *Ethic*. There is general agreement that Marx was greatly influenced by Hegel, specifically by his argument that men are but puppets on the stage of history, that they advance the ends of history ‘without their knowing’, and that the strings of their actions are actually pulled by the Idea (or God). It was thanks to the dual influence of Spinoza and Hegel – Fromm concludes – that Marx succeeded in offering a precise and correct idea of the function of conscience and the objective factors by which it is governed (see Fromm 1962, pp. 118-120).

This said, let me spell out that the importance of the materialist conception of history lies in its ability to shed light on the reason why the power wielded by capitalists in business firms is of hindrance to a democratic transition to socialism.

## 2. Alchian and Demsetz’s Theory of the Firm

AD’s pioneer contribution is the theory of the contractual origin of the firm. In a 1972 article they wrote (p. 77): “It is common to see the firm characterized by the power to settle issues by fiat, by authority, or by disciplinary action superior to that available in the conventional market. This is a delusion.” According to AD, therefore, a firm draws its origin from contracts and its authority and disciplinary powers are strictly determined by the clauses of agreements which are freely negotiated between parties in the marketplace. An entrepreneur telling his employees what to do is comparable to an individual consumer who will order the commodities he needs from a grocer’s as long as he deems it fit and will cease to buy his provisions from that supplier if his orders are not satisfactorily performed.<sup>3</sup> To look at the manager as continually engaged in organising, directing or assigning workers to individual tasks within the firm, they argue, is misleading because the entrepreneur’s real task is to negotiate contracts on terms that will prove acceptable to both parties (see, also, Nozick 1974, pp. 160ff).<sup>4</sup>

<sup>3</sup> The idea that neither the employer nor the employee are obliged to protract their contractual relationship indefinitely in time induced AD to argue that long-term employment contracts are not an essential attribute of the firm (see Alchian & Demsetz 1972, p. 777). In point of fact, Williamson has provided evidence that in later years Alchian did reconsider this point (see Alchian 1984, pp. 38-39; Williamson 1985, p. 53, note 11 and Williamson 1986, pp. 241-42).

<sup>4</sup> This amounts to a criticism of Coase’s theory of the firm which is shared by Hart (see Hart 1989) but was dropped by Alchian at a later stage (see below).

If this is true, where does the difference between the employer/employee relationship and the corresponding customer/grocer relation lie? In the fact – AD answer – that a firm is (a) a team which carries on production activities and (b) an organisation in which a central agent enters into contracts with all of the remaining team partners.<sup>5</sup>

In an effort to discourage employee shirking, each firm establishes a specific corporate function responsible for supervising and monitoring the performance of individual team partners. This is the task of the entrepreneur, or monitor, the above-mentioned central agent who hires and dismisses team partners, enters into contractual agreements with them and sees that all of them perform their tasks to the best of their abilities. But who will monitor the monitor? In ‘classical’ capitalistic firms this problem is solved by empowering the central agent to appropriate the balance between revenues and costs, since this creates an incentive for the entrepreneur to discipline team work at a high level of efficiency. As AD put it, the reason why the classical capitalistic entrepreneur is allowed to appropriate the firm’s profit, i.e. the difference between revenues and costs, is not so much the greater risk proneness of those who go into business (as Knight argued in his celebrated 1921 contribution),<sup>6</sup> as the consideration that this is the most appropriate way of remunerating a person monitoring and measuring the commitment of the team partners to their tasks.<sup>7</sup>

In short, AD’s central thesis is that the entrepreneur is he who takes upon himself the task of watching team partners at work and that a fair remuneration for this task is an income which increases in a direct proportion to the performance of the team.<sup>8</sup>

In the opinion of AD, this explains why firms preferably organise themselves along capitalistic, rather than cooperative lines (see AD 1972, p. 786). If profit – AD argue – were equally apportioned among the workers instead of being entirely appropriated by the person in charge of watching others at work, the former would be induced to work both harder and better, but the monitor would have a lesser incentive to perform his tasks properly. As a result, productivity losses from a lower level of control would probably exceed the gains from the reduced benefits that individual workers would draw from working less or less hard.<sup>9</sup> Even more so, in a firm which apportions all profits among its workers (as is the rule in cooperatives) and does without a specialised monitoring function AD hold it reasonable to assume that productivity levels would slow down despite the greater interest of workers in the efficient functioning of their firm (see, also, Jensen & Meckling 1979, p. 485).<sup>10</sup>

Before discussing AD’s approach in greater detail, let me mention that according to some authors the reduced incentive to work in cooperatives is actually unrelated to the control issue. Whereas the workers of capital-owned enterprises are induced to increase their inputs by the awareness of a proportional link between their incomes and their individual marginal productivity rates, in cooperatives the partners’ incomes are strictly determined by the way the firm’s residual is apportioned among them (see, for instance, Williamson 1980).

### 3. Is Alchian and Demsetz’s Approach Acceptable?

Ever since its formulation by Alchian and Demsetz, the idea of the contractual origin of the firm has gained wide currency. AD’s agency theory describes the firm as a ‘nexus of contracts’ and agency as the relationship whereby one person, termed the principal, directs his agent to perform a task for his account (see AD 1976 and 1979, pp.

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In the words of Arienzo and Borrelli (2011, p. 58), over these past years “the employment contract has turned, from a relationship between unequals, into a relationship between individuals negotiating a commercial deal on equal terms.”

<sup>5</sup> Some authors describe cooperatives as hybrids blending market attributes with hierarchical mechanisms (see Valentinov & Fritzsche 2007, Menard 2007 and Chaddad 2012), but while this view is probably relevant to farming cooperatives, it does not extend to producer cooperatives operating in industry.

<sup>6</sup> Models which vest monitoring functions in tendentially risk-neutral individuals were theorised by Kihlstrom & Laffont (1979) and Eswaran & Kotwal (1989).

<sup>7</sup> Demsetz himself revealed that the greater part of his own and Alchian’s line of reasoning in the 1972 paper was based on suggestions drawn from Knight (Demsetz, 1988b, pp. 163-164, note 6).

<sup>8</sup> In Demsetz’s words, the main aim of the 1972 paper was to relate different firm organisation modes to different monitoring requirements (see Demsetz 1988b, p. 153). In the minds of those thinking that the ‘who will monitor the monitor’ issue is AD’s main contribution, the answer is appointing a residual claimant with a self-monitoring incentive, i.e. concerned with monitoring at a high level of efficiency (see Eswaran & Kotwal, 1989, p. 162). Does this necessarily entail appointing a residual claimant? This issue will be addressed below.

<sup>9</sup> On the scant efficiency of shareholder control or control by a large group of persons, see Hart, 1995, pp. 682-83.

<sup>10</sup> Jensen & Meckling’s claim (1979) that a democratic firm structure may weigh on efficiency in terms of weakening the authority of the managers over the partners by whom they are appointed re-echoes Bernstein’s argument that upon the abolition of the capitalistic ownership structure without concomitant organisational changes the firm’s organs would dissolve through loss of their common convergence point (see Bernstein, 1899, p. 159).

470-71).<sup>11</sup> To reduce the inevitable divergence between his own interests and those of his agent and confine the resulting losses – AD argue – the entrepreneur uses the agency contract and the monitoring function. Agency costs include the costs of monitoring, those of co-interesting the agent in the proper performance of the contract and the resulting loss; and the agency contract and the monitoring function are the tools used to minimise such agency costs.

The idea that still needs to be critically explored is AD's claim that the firm exercises no true power. Their thesis that entrepreneur/employee relationship vests in the former just as much power as is wielded by a party entering into contracts in the marketplace has been called into question by theorists who look upon the firm as a hierarchical structure where specific investments are all-important. According to these, AD's view that firing an employee is, to a manager, tantamount to switching over to a different supplier (at least from the perspective that interests us here) is misleading since the costs involved in finding a new job are far higher than those required to secure fresh orders (see, for example, Williamson 1986, pp. 67-70; Dahl 1985, pp. 114-16 and Gould 1985, pp. 206-08).

As argued by Ronald Coase (1960), AD's approach would be correct if no transaction costs were entailed; but in the absence of transaction costs there would be no firms at all and all business operations would be directly transacted in the marketplace. This leads up to a very general argument: if transaction costs were nil, there would be no firms (as said before); but this amounts to saying that "in the absence of transaction costs" firms would become unnecessary and that "any enterprise will operate efficiently regardless of how rights to participate in its management decisions may be assigned" (McCain 1992, p. 206).

One additional criticism of the idea that the employer exercises no power over workers is set forth in analyses showing that certain forms of monitoring associated with the division of labour and other organisational patterns are not only adopted for reasons of efficiency, but also in an effort to strengthen the employer's authority (Marglin 1974, Braverman 1974, Edwards 1979, Putterman 1982 and Bowles 1985).<sup>12</sup> "Wage-labour relationships – Howard & King argue (2001, p. 796) – are one area in which Marx discusses the role of coercion as a coordinating device within fully developed capitalistic systems. His argument hinges on the fact that employment contracts cannot be specified for all contingencies, so that the terms of exchange of labour services for wages are contestable and conflict is endemic".<sup>13</sup>

On closer analysis, though, none of these objections are strong enough to refute either the idea of the firm as a nexus of contracts, or the resulting conclusion that workers must necessarily submit to the authority of their employers.

The reason why I start out from AD's contribution will appear palpably clear as soon as we raise the question if the transition to socialism recommended in this paper can be assumed to materialise 'spontaneously' in situations of corporate failure.

Preliminarily, let me specify that no defaulting enterprise can be turned into a cooperative unless and until its workers conceive the wish to run its operations on their own. To underscore this evident truth, Hobsbawm wrote that "the basic problem of the revolution is how to make a hitherto subaltern class capable of hegemony, believe in itself as a potential ruling class and be credible as such to other classes" (see Hobsbawm 2011, p. 325).

Setting out from Spinoza's and Freud's concordant belief that *intellectual* knowledge is conducive to change only if is, at the same time, *affective* knowledge, Fromm argued that inasmuch as this was true the factors preventing workers from running businesses on their own are an aversion to entrepreneurial risks and the fear to face pecuniary losses (see Fromm 1962, p. 110). Although workers are probably well aware that they are being exploited – he explained – they put up with their subjugation to capital due to the unconscious fear that entrepreneurial risks, once taken, may prove difficult to manage. To explain their plight, he reported a telling example. "Your friend – he wrote (op. cit. pp. 111-12) – has to undertake a trip of which he is obviously afraid. You know that he is afraid, his wife knows it, everyone else knows it, but he does not know it. He claims one day

<sup>11</sup> Rejecting the description of the firm as "a nexus of contracts", Screpanti (2004) and Zamagni (2005) rightly argued that the capitalistic firm is first and foremost "a nexus of employment contracts" and that theoreticians of the "nexus of contracts" hypothesis unduly equate employment contracts with the myriad other agreements entered into by firms, as if they were the same. This argument is perfectly in keeping with the reflections I have been developing in this paper.

<sup>12</sup> In this well-known essay Bowles argued that shirking is both congenital to human nature and greatly dependent on the way production is organised. To account for the greater efficiency of employee-managed firms, he claimed that workers who do not feel exploited have a lesser incentive to shirking than those of a capitalistic firm in which business is not carried on in the workers' interests.

<sup>13</sup> The correct approach is that those who have no option but to do what is crucial to their subsistence or welfare cannot be rated as free (see, *inter alii*, Cohen, 1978).



that he does not feel well, the next day that there is no need to make the trip, the day after that that there are better ways to achieve the same result without travelling, then the next day that your persistence in reminding him of the trip is an attempt to force him; and since he does not want to be forced, he just won't make the trip, and so on, until he will say that it is now too late to go on the trip, anyway, and that hence there is no use in thinking any further about it. ... What has happened? The real motivation for not wanting to go is fear, ... and this fear is unconscious." And due to the attitudes of mind that that Freud terms 'resistances', it is difficult to find a cure that will bring the unconscious to the surface.

These reflections more than justify the assumption that the transition to socialism would be greatly expedited in a nation where the State apparatus should make it its task to ensure permanent conditions of full employment.

As far as the codetermination issue is concerned, in the opinion of Pejovich "the fact that stockholders must be forced by law to accept codetermination is the best evidence that they are adversely affected by it" and "the fact that the law has to mandate the codetermining firm and protect it from competition by alternative organizational forms is evidence of its relative inefficiency" (see Pejovich 1982, vol. iv, pp. 242-43). This inefficiency, he clarified, is proof that the benefits workers draw from codetermination come short of the corresponding disadvantages for stockholders. While it is clear that Pejovich's line of reasoning can easily be extended from codetermination to worker management of firms, its cogency remains doubtful.

Considering that true Marxists look upon socialism as a new mode of production that will become a reality only after the collapse of capitalism, i.e. when society is ripe for such a development, the conclusion prompted by Pejovich's argument is merely the awareness that the general public have as yet failed to develop a correct appreciation of the benefits offered by conversion of capital-owned business firms into cooperatives. But is it reasonable to think that the aversion of workers to entrepreneurial risks will ebb away at the same pace that they secure higher incomes and educational qualifications?

Although the reflections developed in this section have probably put the role of the materialist conception of history in its right perspective, this subject will be taken up again in the subsequent sections of this paper.

#### 4. The Transition to Socialism and the Power of Capital

The shortcomings of representative democracy are well known. In a survey of the 'perverse effects' of democracy, the well-known Italian political theorist Norberto Bobbio argued that the feeling that promises have remained unfulfilled and a disillusionment with universal suffrage originate from the awareness that, "due to the ability of mass media to condition the minds of electors", universal suffrage fails to attain the goal for which it is ultimately intended – "keeping in check the power structure" (Bobbio 1989). A well-known author, Charles Wright Mills, laid stress on the tendency of the masses to cling to values that holders of vested interests had instilled into them by accident or on purpose (see Mills 1959, p. 194). Hence, I can hardly be accused of overstating the truth if I argue, with Raniero Panzieri, that obstacles to progress and risks of a downward spiral in democracy stem from the failure to extend democracy to the workplace, the very seedbed of totalitarian integralism. "It is there that the power of the class of employers puts down roots before extending its range well beyond the factory and shaping the basics of economic and political action across the country, and it is there that the hostility of capitalists towards prospects of a positive evolution of society acts itself out in forms such as oppression and blackmail and ends up by breeding imbalance, unemployment and misery. The place where totalitarianism keeps society and its political institutions under constant check is the factory", and it is there that workers will have to battle "for a new, genuinely democratic power structure capable of overthrowing the dominance of large capitalists" (Panzieri 1975, pp. 122-123; see, also, Vanek 1985, pp. 27-28).

Considering the extent to which the power of money inhibits democracy in the workplace, there can be little doubt that the importance of disempowering capital should not be underrated. The media, press and television, would no longer be subservient to the interests of their owners, nor would they be monopolised by anybody (at least not by a single individual). As mentioned by Marramao, this idea is reflected in Max Adler's distinction between 'political democracy' and 'social democracy'. Although the former is usually described as democratic, he argues, it is nothing but a dictatorship of sorts since the 'general will' it is said to express is in fact a compound of the specific interests of the class in power (and its underlying rationale is the liberalist principle of the atomisation of society into abstract individuals). As for the latter, Adler adds, it amounts to real democracy but can only become reality in a classless society (see Marramao 1980, p. 292). More recently, an advocate of industrial democracy such as Noam Chomsky has argued that "of all the crises that afflict us, I believe this growing democratic deficit may be the most severe" (2009, p 41).

Raising the question if capitalism really guarantees full freedom, Huberman has asked himself: "Do we really tolerate all political and economic dissenting opinions?" And whereas he owns that in ordinary times we do not clap liberals or radicals in jail, he wonders what happens in times of great tension. Isn't it also true – he continues

– that jobs, power and prestige almost always go to those who do not dissent, those who are sound and safe? (see Huberman & Sweezy 1968, p. 74).

Capitalist society is typified by economic inequality, which is also the cause of political inequality. In political life, each of us does cast a vote, but there is little denying that the wealthy are able to secure more political power both because they control media and because they can obtain favours by bribing politicians.

One aspect of the unequal distribution of political power is that issues with which the more disadvantaged part of the population are most concerned will never enter the political agenda. The task of politics is problem-solving, but the power to draw up political agendas is in the hands of the power class. One relevant example is the issue of democracy in the firm. Why has it never been put to the vote or at least earnestly discussed?

Consequently, there are sound reasons for concluding that the transition to socialism is slow to materialise because of the power that capitalists wield in business enterprises.

In abstract terms, stripping power from capitalists should be a major aim of the bourgeoisie, since decisions made in line with the ‘one share, one vote’ principle are incompatible with the principle of democracy to which this class is used to paying lip service. Concerning democracy, Lukàcs remarked that “the fact that a scientifically acceptable solution does exist is of no avail”, because “to accept that solution, even in theory, would be tantamount to observing society from a class standpoint other than that of the bourgeoisie” and “no class can do that – unless it is willing to abdicate its power freely” (Lukàcs 1923, p. 70). The class consciousness of the bourgeoisie – he also commented (*ibid.* p. 80) – is “cursed by its very nature with the tragic fate of developing an insoluble contradiction at the zenith of its powers. Due to this contradiction, it must annihilate itself. Historically, he argued, this tragedy of the bourgeoisie is reflected historically in the fact that even before it had defeated its predecessor, feudalism, its new enemy, the proletariat, had appeared on the scene. Politically – he continued – its strategy was to fight against the organisation of society into layers in the name of a ‘freedom’ which at the very moment of victory could not but generate a new kind of repression that Lukàcs identified with capitalist exploitation, but which I prefer to identify with the exclusion of workers from the right to cast votes in their firms.

The bourgeoisie’s failure to realise that withholding corporate voting rights from workers runs counter its own principles can be explained if we bear in mind that when capitalism was in the ascendant even the ideological exponents of the rising bourgeoisie looked upon the class struggle as a basic fact of history and that “in proportion as the theory and practice of the proletariat made society conscious of this unconscious revolutionary principle inherent in capitalism, the bourgeoisie was thrown back increasingly on to a conscious defensive” (Lukàcs 1923, p. 85).

The inability of the bourgeoisie to acknowledge the importance of power in economic relationships explains the appearance of writings which come up with the entirely unwarranted idea that employers wield no power in the firm.

## 5. The Reasons Why the Materialist Approach to History is so Important

At this point, it is possible to sum up the reasons why the materialist conception of history can be said to be important indeed.

With respect to the starting point of this paper, i.e. Alchian and Demsetz’s idea that such power as is wielded in firms originates from an exchange between employers and workers, let me specify that for the purposes of this paper one need not accept the core idea of the labour theory of value, i.e. the equation of capitalistic production with exploitation. In capitalistic firms and society at large, the transition from capitalism to a system of democratically managed businesses is inhibited by the power that employers wield in production. And this insight is the main proposition of the materialist conception of history. Moreover, the claim that the precondition for organizing society in line with genuinely democratic principles is restricting the power of capitalists exclusively to firms is also proved wrong by the logic behind historical materialism, specifically by the teaching that the power of capital to exercise control over the media, have them circulate just those ideas that are in accord with the existing state of affairs and dictate political agendas that play into the hands of economic actors is the obstacle that stands in the way of the transition to a system of democratic firms in which workers would cease being at the beck and call of capitalists.

## 6. Conclusion

Concluding, the materialist conception of history is important not only because it offers a new canon for historical research, as argued by Benedetto Croce, but also and primarily because it sheds light on the reasons why the transition from capitalism to socialism has failed to materialise to this day.

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