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School of Economics

FOCUS PAPER

Economic Democracy by Donald A R George

Workers' cooperatives are at least as productive as their capitalist counterparts, and yet they account for a relatively small proportion of GDP in most countries. Donald A R George describes research which aims to explain this paucity of workers' cooperatives by reference to their financing and property rights structures.



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Most Western societies are proud of being political democracies, but democracy rarely operates within the firm. Democratic governments, in principle, can be criticised freely and are answerable to those they seek to govern. By contrast, managers are not, in general, answerable to those they seek to manage, and even the mildest criticism can be dangerous.

In capitalist firms the “right to manage” is linked to the ownership of capital and includes the right to:

- decide what and how much to produce
- decide on how the product is priced
- decide what techniques of production to adopt
- decide what research and development to carry out
- decide on making new investments and scrapping existing ones
- allocate workers to tasks
- allocate internal rewards such as promotion
- hire and fire workers

“ The form of association... which if mankind continue to improve, must be expected in the end to predominate, is not that which can exist with capitalist as chief, and workpeople without a voice in the management, but the association of the labourers themselves on terms of equality, collectively owning the capital with which they carry on their operations, and working under managers elected and removable by themselves. ”

John Stuart Mill
Principles of Political
Economy, 1848

A self-managed (or labour-managed) firm is one in which:

- the right to manage rests with workers not owners
- management is democratic not hierarchical
- workers' rewards are linked to the firm's performance in some way (perhaps by a share of profits, revenue or income per worker), and not by a fixed wage.

The most obvious examples of self-managed firms under capitalism are workers' cooperatives. The empirical evidence (see e.g. Fakhfakh et al, 2012) shows that cooperatives are at least as productive as their capitalist counterparts, and their members report a high quality of working life. However, cooperatives account for only 3% - 6% of GDP in most Western countries. In a “free market” economy there is apparently nothing to stop workers forming a cooperative if they believed it would offer benefits superior to those available in a conventional capitalist firm. These facts lead to the notorious “Pangloss Theorem”: What



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is, is optimal and its corollary: No reform is necessary or desirable. Doesn't the paucity of workers' cooperatives under capitalism prove that this form of business organisation must somehow be fatally flawed? There are many objections to the Pangloss Theorem which lie outside the scope of this short paper. Nonetheless, the puzzling paucity of workers' cooperatives under capitalism calls for some explanation. The literature contains a well-developed set of hypotheses (some of which have been tested empirically) relating the problems of workers' cooperatives to their financing and property rights structures. For example, theory suggests that external finance and individual property rights should generate better performance than internal finance and collective property rights. This raises an immediate issue for cooperatives. Under capitalism, equity finance is not available to cooperatives because it would transfer some control rights to outside owners, thus violating the principle that the right to manage rests solely with workers. But relying entirely on debt would impose excessive risk on cooperative members.

References

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My 1993 book *Economic Democracy* analysed the relationship between the financing and property rights structure of workers' cooperatives, and their economic behaviour and performance. There have been significant additions to the literature since 1993, as well as developments of the cooperative business model. I am currently (January 2016), therefore, in the early stages of a research project designed to re-visit these issues. Cooperatives in Italy, Australia and New Zealand display wide variation in their financing and property rights structures. They therefore provide a useful source of data on these issues. The proposed methodology of the study will be centred on the estimation of augmented production



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functions for workers' cooperatives, in labour embodied and disembodied forms. This approach requires first distinguishing member-labour from non-member labour, and defining a vector of augmenting variables, chosen to reflect the issues listed above. Examples might be variables which reflect the extent of collective v. individual ownership, the extent to which finance is internal, or a dummy variable to reflect tradable membership. The research will be conducted in cooperation with colleagues at EURICSE (European Research Institute on Cooperatives and Social Enterprise, University of Trento, Italy), University of W Australia (Perth, Australia) and NZ Coops (Auckland, New Zealand).

I am the academic lead of a MOOC (massive open online course) project on cooperatives being developed together with colleagues from the University of Edinburgh Business School, the James Hutton Institute and the University of St. Andrews Management School. The research project described above is likely to generate spin-off benefits for the MOOC. The MOOC team believes that there is widespread interest around the world in cooperatives as an alternative to the capitalist corporation. We further believe that economics and other social sciences can focus and sharpen the debate on cooperatives. Having taken the course, students will be better placed to participate in public discussion on cooperatives, or to join a cooperative or even start a new one.

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