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FROM HERE TO THERE; or, If Cooperative Ownership Is So Desirable, Why Are There So Few Cooperatives?

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INTRODUCTION

In this paper[1] I want to discuss a well-known but poorly understood problem: how can socialists reconcile the observed paucity of cooperatives in capitalist societies with their alleged superiority on normative grounds? If cooperatives are so desirable, why don't workers desire them? If one's ideal of socialism is central planning, it is clear enough that it cannot emerge gradually within the womb of the capitalist economy. If instead it is something like market socialism, it is not clear that a discontinuous transformation of society is required. If workers want (market) socialism, they can start up here and now. If they don't, doesn't it prove that they do not want it?

I shall proceed as follows. Section I argues that the usual explanation – that cooperatives are not economically viable or that workers prefer working in capitalist firms – is not necessarily correct. The explanation may lie elsewhere, in endogenous preference formation, adverse selection, discrimination, or externalities.

Section II is concerned with the variety of cooperative arrangements. Only rarely do we find cooperatives in their pure form, with all workers and only workers having equal ownership rights. Non-working owners, non-owning workers and unequal distribution of shares are frequent. When the deviations become sufficiently large, the firms cease to become cooperatives in any meaningful sense.

Section III extends the argument of Section I by surveying the causes of cooperative failure. Some fail by success: profitable cooperatives often attract or turn into private ownership. Others fail outright, partly because they tend to be established under unfavorable circumstances and partly because of intrinsic difficulties of management.

Section IV considers the issues of optimality, stability and accessibility. First, workers' preferences are taken as homogeneous and exogenous. Later, issues of heterogeneity and endogeneity are introduced.

[1] This article draws heavily on the Introduction in eds. Jon Elster and Karl O. Moene, *Alternatives to Capitalism* (Cambridge: Cambridge University Press, forthcoming).

I. Why Are There So Few Cooperatives?

On any definition of a cooperative, there are very few of them in contemporary capitalist societies. If we do not count the Israeli kibbutzim, the Mondragon group in Spain is the only large cluster of worker-owned firms.[2] In other countries there are worker-owned firms in many industries, but, with a few exceptions, they are small taken individually and insignificant in the aggregate. My guess is that if a moderately stringent definition is adopted (see II below), they represent less than 1 percent of the total work force of these countries. Many of them are short-lived, being desperate attempts by workers to save firms in adverse market circumstances.

I shall briefly mention some frequently cited explanations of the paucity of worker-owned firms. Some suggest that cooperatives will not be set up in the first place, others that they tend to be driven out of business by more competitive capitalist firms.

(i) Workers do not want to participate in the decision-making of the firm. They prefer a life of private consumption over one of active participation. (ii) "[W]orking men prefer to work where they can obtain the best wages and the most comfortable place, while at the same time they also prefer to invest their capital where they think it will bring the greatest interest or dividend, whether that place be the one in which they are employed or elsewhere."[3] Risk-averse workers, in fact, would prefer not to invest their savings in any single firm, but to have a diversified portfolio.[4] Moreover, *if* they invest all their capital in their own firm, their risk-aversion will make for inefficient behavior. (iii) Workers lack the technical competence and market expertise which are required for successful management in a complex and constantly changing environment. (iv) Participatory decision-making is inherently costly and inefficient, not because bad decisions are made (this was argument iii), but because horizontal integration is more time-consuming than vertical.[5] (v) Cooperatives generally wait too long before they lay off workers during recessions, generating bankruptcies that would have been avoided by a capitalist enterprise. (vi) Cooperatives have bad incentive properties. Workers have no motivation to work hard unless supervised by a manager who is motivated to make them work hard. A manager has no motivation to

[2] Around 1980, the Mondragon system included 70 cooperative factories with a work force of more than 30,000 cooperators, and a credit cooperative bank with 93 branches and 300,000 deposit accounts. See Henk Thomas and Chris Logan, *Mondragon* (London: Allen and Unwin, 1982), p. 1.

[3] Letter from William Nuttall to Auberon Herbert (1877), cited after Benjamin Jones, *Co-Operative Production* (London, 1894, reprint New York: Augustus Kelley, 1968).

[4] Jacques Drèze, "Some Theory of Labour Management and Participation," in his *Essays on Economic Decisions under Uncertainty* (Cambridge: Cambridge University Press, 1987), p. 375ff.

[5] Oliver Williamson, *Markets and Hierarchies* (New York: The Free Press, 1975), ch. 3.

make workers work hard unless he is also the residual claimant.[6] For similar reasons, the incentive for investment and innovation is much weaker in a cooperative than in a capitalist firm.

My main task here is not to refute or question these explanations, but to suggest some alternative lines. Let me, nevertheless, comment briefly on each of them, not to argue that the cited obstacles have no explanatory power, but to suggest that they need not be insuperable.

(i) It is true that participation can be strenuous and be shunned for that reason. It can also, however, be very rewarding. Collective decision-making can be a form of self-realization which, like all such activities, is rewarding *because* it is strenuous.[7] (ii) The argument against putting all one's eggs in one basket points to a serious problem. In a cluster of interlocking cooperatives, like the Mondragon one, it can to some extent be alleviated by some balancing-off between successful and less successful firms.[8] (iii) Competence and expertise can be hired. The expertise necessary to identify the experts differs by orders of magnitude from the expertise of the latter. (iv) Participatory mechanisms can be more or less time consuming, depending on whether they take the form of direct or representative democracy. Ultimate control is fully compatible with delegation or abdication of current authority. (v) The same argument can be used to counter the objection from reluctance to layoffs. The cooperative can authorize a manager to decide when and how many workers shall be laid off, the selection criteria having been chosen ahead of time by the cooperative itself. (vi) Disincentives for work can be reduced by mutual monitoring of workers by each other. Disincentives for investment can be overcome by a combination of individual shareholding and collective investment decisions. Disincentives for innovation present a more serious problem. If the lure of entrepreneurial superprofits is indispensable for innovation, as Schumpeter argued, cooperatives might be expected to be rather sluggish. Against this it must be said that corporate capitalism, with its highly routinized innovative procedures, does not seem to be less dynamic than entrepreneurial capitalism.[9] Finally, as a comment on all the efficiency-

[6] Armen Alchian and Harold Demsetz, "Production, Information Costs, and Economic Organization," *American Economic Review*, vol. 62 (1972), pp. 777–95.

[7] See my "Self-Realization in Work and Politics," *Social Philosophy and Policy* vol. 3 (1986), pp. 97–126.

[8] Hugh Thomas and Chris Logan, *Mondragon* (London: Allen and Unwin, 1982), pp. 155–58.

[9] The studies surveyed in Morton I. Kamien and Nancy L. Schwartz, *Market Structure and Innovation* (Cambridge: Cambridge University Press, 1982), pp. 76–84, indicate that there are clear economies of scale in innovation, at least up to a certain point. The patterns are complex, however, and there are many exceptions.

related arguments, empirical studies suggest that cooperatives are at least as productive as their capitalist counterparts.[10]

Any serious discussion of cooperative ownership would have to face these problems in much greater depth than is possible here. I set them aside because I want to focus on another possible source of problems for the cooperative. It could be that the isolated cooperative in an otherwise capitalist economy suffers difficulties that would not arise within a fully cooperative context.[11] This could happen in four ways: by endogenous preference formation, adverse selection, discrimination, and externalities.

Endogenous preference formation could be an obstacle to cooperatives if the presence of this type of firms is a necessary condition for the desire to have them. The mechanism might operate at two levels. First, it might influence the desire of the worker to join a cooperative. Secondly, it could affect his desire to live in a cooperative economy. The former might block individual moves towards socialism; the latter might block political movements to the same goal.

Adverse selection is somewhat related to endogenous preference formation. As noted by Louis Putterman, "reform experiments might attract unstable individuals, excessive risktakers, and people lacking in pragmatic orientation."[12] The easy reply would be to say that such people would be attracted only to inherently unviable enterprises. But there is an alternative explanation. In any society, going against the current in any endeavor requires qualities which do not always make for success in it. As Tocqueville pointed out: if people who marry for love in aristocratic societies tend to have unhappy marriages, it is not because marriage founded on love is inherently

[10] Cooperative firms usually have lower turn-over rates than capitalist firms. See Thomas and Logan, *Mondragon*, p. 48; Michael Conte, "Participation and Performance in U.S. Labor-Managed Firms," eds. Derek Jones and Jan Svejnar, *Participatory and Self-Managed Firms* (Lexington: Lexington Books, 1982), pp. 213–38. They have lower rates of absenteeism – see Thomas and Logan, *Mondragon*, p. 49ff; Christopher Gunn, *Workers' Self-Management in the United States* (Ithaca: Cornell University Press, 1984), p. 143 – and virtually no production losses from strikes. Other things being equal, all of these should increase productivity. Since other things may not be equal, we must turn to direct studies of productivity. Both the Mondragon cooperatives and the well-known American plywood cooperatives have an excellent record, superior to conventionally organized firms, over a long period (Thomas and Logan, *Mondragon*, ch. V; Conte, "Participation and Performance"). Similar but more ambiguous findings with respect to Britain are given in Derek Jones, "British Producer Cooperatives, 1948–1968: Productivity and Organizational Structure" in Jones and Svejnar, eds., *Participatory and Self-Managed Firms*, pp. 175–98.

[11] Conversely, it could be that a cooperative performs *better* in a capitalist environment than in a cooperative one. It may be able to attract exceptionally motivated workers. It may receive assistance from ideological support groups. And it may be able to take a free ride on the innovative activities of capitalist firms. I neglect these possibilities here, not because I think they are unimportant, but because they cannot help us understand why there are so few cooperatives.

[12] Louis Putterman, "Some Behavioral Perspectives on the Dominance of Hierarchical over Democratic Forms of Enterprise," *Journal of Economic Behavior and Organization*, vol. 3 (1982), pp. 139–60, at p. 152.

unstable, but because it takes a certain stubbornness to go against social conventions and because two stubborn people are not likely to form a happy union.[13]

Discrimination is a more important problem.[14] In the present context, the problem is one of unfair competition – by underselling cooperatives or by blocking their access to credit. Robert Nozick states categorically that the latter obstacle will not arise: "[D]on't say that it's against the class interest of investors to support the growth of some enterprise that if successful would end or diminish the investment system. Investors are not so altruistic. They act in their personal and not their class interests."[15] This statement, while plausible in part, is too strong. The plausible bit is that investors, or capitalists in general, do not act in their class interest. The less plausible claim is that they act out of their purely personal interest. One hundred years ago, another political philosopher supported a cooperative lockmaking firm which was the victim of collusive underselling and similar practices by its capitalist rivals:

> I beg to enclose a subscription of £10 to aid, as far as such a sum can do it, in the struggle which the co-operative platelock makers of Wolverhampton are sustaining against unfair competition on the part of the masters in the trade. Against fair competition I have no desire to shield them ... but to carry on business at a loss, in order to ruin competitors, is not fair competition. In such a contest, if prolonged, the competitors who have the smallest means, though they may have every other element of success, must necessarily be crushed through no fault of their own ... I am now convinced that they ought to be supported against the attempt to ruin them.[16]

Local group interest can override personal interest, as abstract class interest cannot be expected to do. The Wolverhampton employers did not fear the abstract principle of worker ownership: they were afraid of losing their workers, or of having to pay them more. It is impossible to assess even approximately how much such discrimination, or the anticipation of it,[17] has contributed to the difficulties of cooperatives. My conjecture is that it has been quite important.

[13] Alexis de Tocqueville, *Democracy in America* (New York: Anchor Books, 1969), p. 596.

[14] To pursue the analogy, Tocqueville also notes that people who marry for love in societies where this is rare tend to attract hostility, which in turn generates bitterness and unhappiness.

[15] Robert Nozick, *Anarchy, State and Utopia* (New York: Basic Books, 1974), p. 252–53.

[16] John Stuart Mill, as quoted in Jones, *Co-Operative Production*, p. 438.

[17] If a supplier believes that the bank will discriminate against the cooperative, he will accept only cash on delivery. If the bank believes that suppliers discriminate, it will offer credit on less favorable terms. What a firm may not do out of ill-will, it may do out of (possibly unfounded) suspicion of the ill-will of others.

Finally, isolated cooperatives could be disadvantaged (i) by the negative externalities created by capitalist firms or (ii) by their failure to internalize positive externalities generated by themselves. An instance of (i) is the set of "opportunistic externalities" created by the presence of wage labor and investment capital in the economy. In a capitalist environment, successful cooperatives will be tempted to employ some workers on a wage basis in order to increase their ability to adjust flexibly to changes in market conditions. In so doing, however, they may end up losing both the intangible benefits from working in a democratic enterprise and any tangible productivity benefits that may arise from the intangible ones. Also, cooperatives might be tempted to issue outside shares to attract new investment capital, wrongly believing that this will not threaten their identity as cooperatives. These are *opportunistic* externalities because they arise through the permanently available opportunity of hiring labor and capital. They are opportunistic *externalities* because they are negative side effects of the activities of capitalist firms. One might argue that creating opportunities cannot harm anyone, as long as there is no compulsion to use them and as long as other options are not foreclosed. Against this, it seems clear to me that we often refrain from making available to people (including ourselves) opportunities that they might want to exploit out of a desire for short-term gain, although doing so is sure to harm them in the long run.[18]

Another example of (i) is the "collective bargaining externality" identified as follows by Peter Jay: "Insofar as the crucial advantage urged for the labour-managed economy is that it would cause collective bargaining ... to wither away, so dissolving the catastrophic dilemma of high unemployment or accelerating inflation, that cannot be tested by examining the experience of individual co-operatives in a capital-managed economy where the general need for trade union organization and collective bargaining is bound to be strongly felt."[19]

An example of (ii) could be the "entrepreneurial externality" created by cooperatives. In a democratically-run enterprise, entrepreneurially gifted individuals will not just make good decisions: they will also educate their fellow workers. If the workers who have benefited from the education leave the firm and take a job in a capitalist enterprise, their training is made available to other firms free of charge. Even if the cooperative is driven out of business because the private return to its activities is below that of the typical capitalist firm, the social return may be higher for the cooperative than for the capitalist firm. True, capitalist firms are also vulnerable to leakages of this

[18] See my "Weakness of Will and the Free-Rider Problem," *Economics and Philosophy*, vol. 2 (1985), pp. 231–66.

[19] Peter Jay, "The Workers' Cooperative Economy," ed. Alasdair Clayre, *The Political Economy of Co-Operation and Participation* (Oxford: Oxford University Press, 1980), pp. 9–45, at p. 40.

kind, but the problem is more serious for cooperatives because the workers they train are, on the average, more valuable.

Another suggested example of (ii) is the "political externality" created by cooperatives.[20] If members of cooperatives make better political citizens and if civic spirit is a public good, cooperatives generate diffuse benefits not captured by the price mechanism. Against this, one may object, first, that for many people economic participation will reduce, rather than enhance, their participation in political affairs. To paraphrase Oscar Wilde, there are only so many evenings to go around. Second, it is doubtful whether participation in economic decision-making will have these positive effects in other arenas unless it is regarded as valuable in its own right. The spill-over effects of participation are essentially by-products.[21]

Of these, I believe the opportunistic and the entrepreneurial externalities to be the most important ones. The former is illustrated in III below. The latter is somewhat speculative, but I believe it could be quite important. Cooperatives may have a leavening effect in the economy that, precisely because it is not internalized, detracts from their economic success.

I do not claim to have demonstrated that the observed paucity of cooperatives is due to endogenous preference formation, adverse selection, discrimination, or externalities. I have indicated, albeit very briefly, why the explanations usually put forward are not watertight – at least in their present form. It is not proven that cooperatives fail because they are less attractive to workers or less efficient than capitalist firms. And I have tried to make a case for the prima facie plausibility of a different explanation, which emphasizes interaction with the environment rather than intrinsic features of the cooperative. Further implications of that argument are examined in IV below.

II. Varieties of Cooperative Production

What is a cooperative? The answer might seem obvious: a cooperative is a firm in which the workers own the means of production and have full control over all economic decisions. Yet the answer, as it stands, is ambiguous and incomplete. It fails to capture the variety and complexity of existing cooperatives. I shall not here propose a formal definition, but only point to some ways in which cooperatives can differ.

A basic problem is whether to define cooperatives in terms of ownership or in terms of control over decisions. These do not always go together. In Yugoslavia, self-managing enterprises do not have full ownership of their means of production. In particular, they are legally forbidden to disinvest, i.e.,

[20] Carole Pateman, *Participation and Democratic Theory* (Cambridge: Cambridge University Press, 1970).

[21] See ch. II of my *Sour Grapes*.

to sell capital goods or let the capital stock run down.[22] In a study of British cooperatives, Derek Jones found that, even in firms in which workers did not own a majority of the shares, they had a majority on the governing board of the firm, because elections follow the principle "One man, one vote," rather than "One share, one vote."[23] Jaroslav Vanek has argued that the optimal arrangement for a cooperative is to be financed fully by outside non-voting equity capital, so that income accruing to workers would come to them *qua* workers and not *qua* capital owners.[24] Conversely, the formal conditions for worker ownership may be fulfilled without effective workers' control. In some of the American firms in which workers have gained a majority of the shares by employee stack ownership plans (ESOP), the unequal distribution of shares among employees prevents the great majority of workers from having any effective influence on decisions. (These firms follow the principle "One share, one vote."[25]) Empirical studies of cooperatives and participation have explored both ownership and control as independent variables, the main dependent variables being productivity, job satisfaction, and earnings.

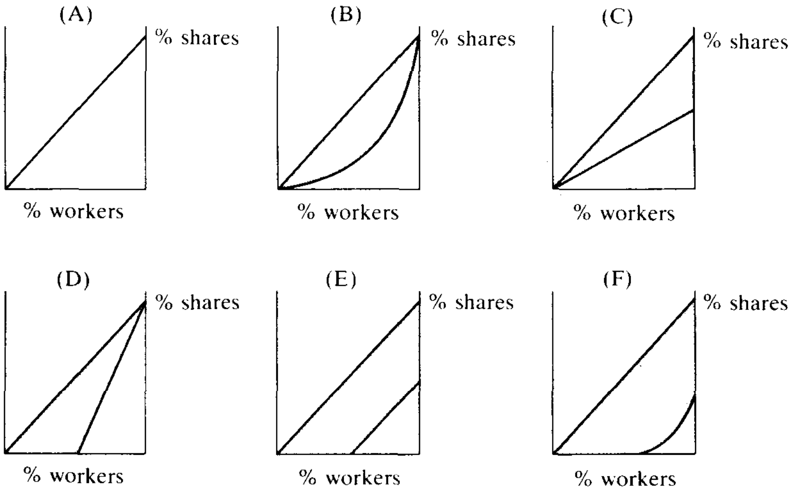
To consider the ownership problem more closely, we may distinguish between several different structures. The firm can be based (i) wholly on leased capital goods, (ii) on outside non-voting shares, (iii) on voting shares with the principle "One shareholder, one vote," (iv) on voting shares with the principle "One share, one vote," (v) on collective ownership of the firm's assets by the workers, or (vi) some combination of the above. Of these (i), (ii), and (v) are uncontroversially and unambiguously worker-controlled. To assess (iii) and (iv), which are the more frequent forms, we first define the ideal cooperative as one in which all workers and only workers hold equal shares in the firm. The ideal can be subverted in three ways. First, workers may own unequal amounts of shares. In type (iii) firms this is not a source of unequal influence on decision-making, but it can be a source of unequal incomes if workers receive interest on their capital holdings. Second, some shares may be held by outsiders who don't work in the firm. Third, the firm may employ some workers who are hired for a wage and who do not hold shares in the firms. The more one (or several) of these obtain, the more the firm differs from the ideal cooperative type and approaches the capitalist firm.

[22] Stephen Sacks, *Self-Management and Efficiency: Large Corporations in Yugoslavia* (London: Allen and Unwin, 1983), p. 76.

[23] Jones, "British Producer Cooperatives," p. 179.

[24] Jaroslav Vanek, "The Basis Theory of Financing of Participatory Firms," ed. Jaroslav Vanek, *Self-Management* (Harmondsworth: Penguin Books, 1975), pp. 445–55.

[25] For details about ESOP, see Keith Bradley and Alan Gelb, *Worker Capitalism: The New Industrial Relations* (Cambridge: M.I.T. Press, 1983) and Note, "Worker Ownership and Section 8(a)(2) of the National Labor Relations Act," *Yale Law Journal*, vol. 91 (1982), pp. 615–33.



These distinctions can be stated more vividly by constructing a Lorenz curve for cooperatives.[26] In the diagrams above the percentage of workers is shown along the horizontal axes and the percentage of shares in the firm along the vertical. A point (x,y) in the coordinate system indicates that the x percent of the workers with the smallest number of shares have a total of y percent of the shares. The heavily drawn lines represent the Lorenz curves for different types of cooperatives. Figure A represents the ideal system, where all and only workers hold shares and the distribution of shares among them is absolutely equal. Figure B represents a "deviation of the first kind." Here all and only workers hold shares, but some hold more shares than others ("skewed ownership"). Figure C represents a "deviation of the second kind," in which all workers hold shares, but there are some non-working shareholders ("diluted ownership"). Figure D represents a "deviation of the third kind," in which only workers hold shares but there are some non-shareholding workers ("restricted ownership"). Figure E represents a combination of the second and the third type. In Figure F all three deviations occur.

I shall give some examples of these deviations, drawn partly from contemporary practice and partly from nineteenth-century British experience as summarized in Benjamin Jones's monumental *Co-Operative Production* (1894). The first thing to note is that the ideal form, corresponding to Figure A, is relatively rare. Jones asserts that he knows virtually no cooperatives in which all workers are members and all members

26 This diagrammatic device is taken from N. Mygind, "Are Self-Managed Firms Efficient? The Experience of Danish Fully and Partly Self-Managed Firms." Mimeo, Copenhagen School of Business, January 1985.

workers. Some of the firms he refers to approach the ideal condition, without quite attaining it. Today, the Mondragon cooperatives embody the ideal form, as do the American forest workers' cooperatives.[27]

Deviations of the first kind, corresponding to Figure B, are hard to ascertain, since most sources have no information about the distribution of shares among shareholding workers. When cooperatives follow the rule of "One man, one vote," such inequalities affect only the distribution of income. Under the American ESOP system, shares are distributed to employees proportionally to their salaries, and the voting power is proportional to the number of shares. In practice, this amounts to the management retaining a dominant influence in all important decisions. There is evidence that internal relations in these firms are more conflictive than in ordinary capitalist enterprises.[28]

Deviations of the second kind, corresponding to Figure C, exist but are not among the most common. Benjamin Jones reports a few cases in this category, as does an unpublished Norwegian survey by Karl O. Moene and Tone Ognedal.[29] In his study of British cooperatives, Derek Jones writes that "only in exceptional cases do current workers own a majority of the share capital. In many cases, though, the vast majority of workers are members, and often a majority of members are workers."[30]

Deviations of the third kind, corresponding to Figure D, are quite common. They represent the formation of an aristocracy of labor – of cooperators hiring other workers without admitting them to their ranks. The best-known American cooperatives, the plywood firms of the Northeast, employ hired workers quite extensively.[31] Although some of these are well-paid specialists who are hired for specific jobs, many apparently perform the same jobs as the coop members. Consistently with this practice, the attitude of the members is reported to be individualistic and non-ideological. In nineteenth-century Britain, this organizational mode was quite common and a source of many conflicts, some of which are reported below.

A very frequent case combines deviations of the first, second, and third kind, corresponding to Figure E and Figure F. In nineteenth-century Britain, if we are to believe Benjamin Jones, this was the most common type of cooperative. The main shareholders in most production cooperatives were retail and wholesale cooperative societies. Workers in the cooperatives sometimes had a few shares, but often none at all. Instead, they might get a

[27] Gunn, *Workers' Self-Management*, ch. 3.

[28] Note, "Worker Ownership," p. 620.

[29] "Utbyttedeling og medarbeidereie" ("Profit sharing and employee ownership"), Department of Economics, University of Oslo, 1987.

[30] Jones, "British Producer Cooperatives," p. 179.

[31] Gunn, *Workers' Self-Management*, ch. 4.

bonus from profit-sharing schemes.[32] In addition, there were often some individual non-working shareholders. These firms were thought of as cooperatives because they were owned by cooperatives, not because they were operated as cooperatives.

It might appear desirable to be able to say when ownership of a firm has become so skewed, limited, or diluted that it ceases, for all practical purposes, to be a cooperative. For explanatory purposes, this is probably the wrong question to ask. This being a matter of degree rather than of black and white, we should look for a way to measure the distance from the ideal of different firms. One proposal is to use the Lorenz Curve to construct a "Gini index" of the degree of cooperativeness, as the ratio of the shaded area to the area under the 45° line.[33] This has the advantage of allowing us to rank all deviating types along a single dimension. It is doubtful, however, whether this index is correlated with anything else of much interest. In the diagram, firms B, C, and D have approximately the same Gini index, yet we would expect them to behave in very different ways. The quantitative degree of deviation as measured by the Gini index cannot be expected to have much explanatory power. We must consider the qualitative nature of the deviation from the ideal type, as well as the extent of the deviation.[34] The distance is a vector, not a scalar.

Nevertheless, for normative purposes a stipulative definition may be useful. Minimally, in a cooperative the workers must have a majority of votes at the general meeting, whether it is because they hold a majority of the shares, because they are in a majority among the shareholders, or because outside shareholders lack voting rights.[35] Successively stronger definitions

[32] In light of the current interest in proposals for profit-sharing, I list here some of the practices reported by Benjamin Jones. A fixed dividend to shareholders, ranging from 5 percent to 10 percent, was always paid before any further sharing. The remainder was often split three ways: between shareholders, workers and purchasers. Sometimes it was split two ways, between any two of these three groups. The split could be in equal absolute amounts (one-third or one-half of the dividendum to each group) or in proportion to the amounts represented by each group. In the latter case, a stock-flow confusion was often found: shareholders got the same percentage on their capital as workers on their wages. Sometimes, however, shareholders received the same percentage on their dividends as workers did on their wages or workers received the same percentage on the capitalized value of their labor as shareholders did on their capital. Bonuses could be distributed equally among the workers, or proportionately to their wages. In multi-plant cooperatives, the bonus was sometimes calculated on the cooperative as a whole, sometimes on each plant separately.

[33] Mygind, "Are Self-Managed Firms Efficient?"

[34] This is the practice followed by Jones, "British Producer Cooperatives."

[35] The last possibility might seem strange. Why would outside investors be attracted to a firm over which they have no control? For all they know, the cooperative might pay zero dividends year after year. A counterargument (Jay, "The Workers' Cooperative Economy," pp. 14–15) is that the cooperative would be kept in line by the knowledge that it may need to attract capital in the future. Unless present shareholders are paid satisfactory dividends, future investors will not be forthcoming. Knowing this, present investors will not be deterred by the fact that the cooperative is formally free to reduce dividends to zero.

would require that all workers who want to buy shares are allowed to do so, or that all workers are required to be shareholders. My intuition suggests that a firm cannot claim to be a cooperative if it employs, on a permanent basis, some workers who are not allowed to buy shares in the firm. A firm in which labor exploits labor is not a workers' cooperative, but a partnership of small capitalists.[36] This is the criterion I shall adopt in the following section.

III. Obstacles to Cooperative Production

For this survey I shall have to go over again some of the ground covered in I and II above, but from a different perspective and, I hope, without too much repetition. I rely heavily on Benjamin Jones's *Co-Operative Production*, since most other writings focus, understandably enough, on surviving firms that have not (yet) been worn down by attrition or metamorphosed by success into something else.

(*i*) *Legal obstacles.* In Britain, cooperatives were not allowed the – decisive – advantage of limited liability before 1862.[37] In the United States, the National Labor Relations Act, based on an adversarial conception of labor-management relations, poses an obstacle to employee participation and ownership.[38]

(*ii*) *Free-rider problems.* Reading Benjamin Jones, one is struck by the absence of a clear understanding of the free-rider problem in cooperative production among the writers he cites: Advocates of the cooperative system (here, taken in a wide sense that also includes profit-sharing) argued that "they must interest a workman in his work, and they could not do that in a better way than by giving him the result of the extra care, skill and energy he threw into his work" (p. 233); that "it was a right thing to do to give bonus, in order to encourage workers, and get them to feel that in proportion to the amount and quality of their work they would receive benefit" (p. 224); and that profit-sharing was a means of "giving the workmen employed an immediate interest in the progressive extension and security of the undertaking" (p. 574). It is assumed throughout that the workforce behaves like one body, being sensitive to collective rather than to individual incentives.

The reality of the free-rider problem is not in doubt, however. It shows itself most clearly in multi-plant cooperatives. Here, the issue was whether the bonus should be calculated for each plant separately, so that only the workers actually responsible for good results should benefit from them, or whether the same bonus should be paid for the whole concern. The advocates

[36] For the idea behind this intuition, see John Roemer, *A General Theory of Exploitation and Class* (Cambridge: Harvard University Press, 1982).

[37] Jones, *Co-Operative Production*, chs. XI–XII.

[38] Note, "Worker Ownership."

of the latter scheme are motivated by a conception of fairness. "You may get an efficient class of workers in the productive departments, and each man do his best; yet through a mistake in the management, they will turn out no profit? Is it fair to give no bonus when this occurs?" (p. 249) Those who argue for a separate bonus, on the grounds of efficiency and proper incentive structures, seem oblivious to the fact that the problem can arise within as well as across divisions. Although the force of collective incentives is larger in small groups that allow members to monitor each other's performance, it takes quite special circumstances for the free-rider problem to disappear altogether.

(iii) Lack of work discipline. The horizontal structure of decision-making in cooperatives has often been perceived as a weakness. Benjamin Jones (pp. 257–58) quotes from a speech by Sir James Kay Shuttleworth to the Social Science Congress in 1863, where he refers to a cooperative which failed because of

> a desire to introduce into the concern the principle of co-operation to this extent, that the shareholders should have the advantage of the employment of their families in the mills. The immediate effect of that was this, that instead of producing stricter discipline and that close attention to the working of machinery, which was so necessary in cotton mills (and he might mention that the discipline of a regiment was inferior in strictness to that of a cotton mill), at their quarterly or half-yearly meetings most vexatious complaints were made by the workers against the overlookers, and an overlooker who had dared to discharge a worker who was a shareholder, was in extreme danger of being dismissed at the next meeting.

Similar complaints were made by the managing director of the Ouseborn Co-Operative Engine Works Company, to explain the failure of the company:

> The times rules of the Ouseburn, including the rule that each day counts its own overtime, the excessive restrictions upon labour from a section of our men, the small proportion of our apprentices, the frequent discussions and deputations, the excessive amount of overtime required to enable us to finish our contracts, and generally, the want of discipline resulting from the impression that every man was his own master – all contributed to increase the cost of production.[39]

Cooperatives took measures to counteract these tendencies, often bending over backwards to avoid anarchy and nepotism. In some firms, a shareholder

[39] Jones, *Co-Operative Production*, p. 454.

could not, while he was a director of the firm, have any relatives employed in it. In many others, workers could not be on the board of directors. More generally, the problem of control has been solved by having indirect rather than direct accountability. Workers "should remember that, although a shareholder, each would have to be subject to a manager as much as if he had not a farthing in the place. All work must be done under the direction of the manager for the time being; there must be one hand, one eye, and one mind. The proper place to complain of a bad manager was to the directors."[40] Admittedly, these solutions were imposed rather than self-imposed. In the nineteenth century, we do not find workers taking steps to prevent themselves from interfering destructively with day-to-day management. In recent cooperatives, including the Mondragon group, constitutional self-binding has been widely used.[41]

(*iv*) *Organizational problems.* The organization of cooperatives can create problems for their functioning. In the Ouseburn cooperative, the rule was that every employee must be a shareholder. Quite probably, this explains the small proportion of apprentices in the firm, and the subsequently higher costs of production. Another recurring difficulty is well described in the following account of the downfall of the Woverhampton Plate-Locksmiths:

> The main business of the society during the time of its prosperity was, as its name implied, the manufacture of plate-locks, which were large and rather costly articles, yielding a net profit to the society... of from 18 percent to 32 percent. A society which had succeeded in obtaining a considerable business of this character easily made large profits; but, with the period of commercial depression which followed the coal famine, the demand for these costly articles ceased. There remained to the society, as a source of income, only the manufacture of common locks, which did not yield more than about 9 percent on the turnover. If the business had been carried on by a private manufacturer, he would probably have discharged the workmen for whom, from the falling off of the demand for plate-locks, he could not find profitable employment, and applied himself to develop the trade that remained. But this would have involved on the body of workers who formed the society an amount of self-sacrifice for which they were not prepared. Instead, they worked for stock, in the hope that the demand would revive. As it did not revive before their resources were exhausted, they inevitably came to grief. Debts multiplied upon them: the best workers fell away.[42]

[40] Cited after Jones, *ibid.*, p. 284.
[41] Thomas and Logan, *Mondragon*, p. 28.
[42] Jones, *Co-Operative Production*, p. 443.

The locksmiths, who had survived unfair competition from capitalist firms, were brought down by their inability to adapt to bad times. The converse problem is just as serious: the inability of cooperatives to remain worker-controlled in good times. Successful cooperatives are permanently vulnerable to restriction or dilution of ownership.

An example of dilution is provided by the Rochdale Co-Operative Manufacturing Society, a cotton mill. Although not a cooperative in the full sense, it had a profit-sharing scheme which was very favorable to workers. "[T]he success of the society... attracted to it persons who only cared for the eternal 'divi'. These persons brought into the society their money very rapidly for shares, thus raising the number of shareholders from 200 or 300 to 1,400. It was the new shareholding element that swamped the original promoters of what was then called 'Bounty to labour'."[43] After the bonus on wages had been abolished by the new shareholders, a critic wrote that "Working men, in public meetings or elsewhere, must speak with bated breath in denouncing the oppression and tyranny of capitalists, else someone will point to the rapacity of certain working men in Rochdale, who, on becoming employers of labour, took the bounty off their work-people at the so-called co-operative mill... Nearly all the anti-bountyites are persons who joined the society after it had become a prosperous and paying establishment ... It appears to me to be wrong for persons to enter (invade) a society with whose principles they disagree, and then destroy its constitution."[44]

Cooperatives in the full sense of the term run a similar risk if there is a substantial minority of outside shares and if shares are freely traded. Some worker-shareholders might be tempted to sell at the high price which pivotal shares in a successful enterprise would command. It may be difficult to get access to outside capital without inviting takeovers. On reflection, this is not surprising. One can rarely expect to have one's cake and eat it too.

The problems of restricted ownership are illustrated in a number of boot and shoe cooperatives in Northamptonshire.[45] In the original society, all shareholders were workers, but not all workers who wanted to could become members. The frustrated workers set up two new societies, which in turn began to refuse admission to non-members working for them. These non-members promptly formed new societies, one of which stated that "Our object is to give every competent man a chance who is willing to join, which is not the case with the existing society." With this exception, it is quite clear that the members knew they were onto a good thing, which they did not want to share with others. Differences in bonus between members and non-

[43] *ibid.*, p. 262.
[44] *ibid.*, p. 263.
[45] *ibid.*, p. 402ff.

members can have the same result. In the Co-Operative Padlock Society, "members refuse to elect other workers as shareholders, as it would to some extent reduce their bonus, for half the non-members' bonus is retained and added to the reserve fund."[46]

IV. Accessibility, Stability, Optimality

I now return to my central question: could it be that the relative absence of cooperatives in capitalist societies is due to obstacles that arise precisely because there are so few of them? I shall focus on the problem of externalities and of endogenous preference formation, but many of the arguments also apply to obstacles created by adverse selection and discrimination.

The main externalities I have in mind are the entrepreneurial and opportunistic ones. Cooperatives are less competitive because they cannot internalize the benefits from training. The presence of investment capital and wage labor in the economy can transform cooperatives by leading, respectively, to dilution or to restriction of ownership. To overcome these externalities, collective action and state intervention may be required.

Let us first assume that all workers have identical preferences, which are, moreover, independent of the economic organization of society. I also assume that a fully cooperative economy is collectively superior to capitalism, in the sense that all individuals would be better off if all worked in cooperatives than if all worked in capitalist firms. Yet workers in an individual enterprise might not find it in their interest to take the first step from capitalism towards market socialism. In addition, they might find it in their interest to take the first step away from market socialism towards capitalism. If the externalities have the first of these effects but not the second, we are in the presence of an Assurance Game: both the inferior and the superior system are stable. The superior system is not, however, accessible through actions taken by individual firms acting out of self-interest. If the externalities have both effects, the situation is that of a Prisoner's Dilemma: only the inferior system is stable.[47] Of the externalities identified above, the problems of training costs and of wage labor would not arise in a fully cooperative economy. The risk of ownership dilution could be more real. Workers might want to invest some of their income in other firms than the one in which they work. Firms might welcome outside capital. As a result, capitalist ownership structures could be reestablished, and the cooperative economy gradually unravel.

If the inferior system is stable, one might want to legislate in favor of the superior alternative, by forbidding or taxing capitalist firms or by subsidizing cooperatives. If the situation has the structure of an Assurance Game, such

[46] *ibid.*, p. 481.

[47] David Miller, "Market Neutrality and the Failure of Cooperatives," *British Journal of Political Science*, vol. 11 (1981), pp. 309–29.

legislation could be a temporary measure. After a while, one might reintroduce the freedom to create capitalist enterprises. If the situation has the form of a Prisoner's Dilemma, permanent legislation would be required. Specifically, legal restrictions on trade in shares might be necessary.

Let us now assume, more realistically, that one system is preferred by most but not all people. Assume that a majority of the workers prefers market socialism over capitalism, while the minority has the opposite preference. We also assume, as before, that nobody wants to make the first move away from capitalism. A pertinent question is whether the majority would prefer a mixed system in which they worked in cooperative enterprises and the minority in capitalist enterprises over an all-capitalist economy. Assume, for specificity, that 70 percent prefer a fully cooperative system and 30 percent prefer a fully capitalist one. There are several possibilities.

(1) The members of the majority prefer a system in which 70 percent work in cooperative firms and 30 percent in capitalist firms over a fully capitalist system. This amounts to saying that the cooperative sector is collectively stable.

(1.1) It might also be individually stable, in the sense that once it has reached 70 percent, no members of the majority are tempted to defect. In this case temporary measures would be sufficient to overcome the externality.

(1.2) If the cooperative sector is individually unstable, a universal and permanent ban on capitalist firms might be necessary, unless the members of the cooperative majority could somehow agree to refrain from steps that would reintroduce capitalism.

(1.2.1) The assumption that members of the majority would defect from the cooperative sector is consistent with the notion that in a fully cooperative economy no members of the majority would be tempted to defect. The presence of the capitalist minority would nevertheless, in the absence of legislation, make the situation unravel: the minority would defect, and thereby create an incentive for the majority to defect.

(1.2.2) The assumption is also consistent with the opposite possibility, that capitalist firms are always individually preferred, regardless of the number of cooperative firms in the economy.

(2) Finally it might be the case that the majority does not prefer a mixed economy over the fully capitalist one. It would then have to force its will on the minority to get rid of the externalities. It might do that in case (1.2) as well, since in that situation members of the majority would, in the absence of universal legislation, have an incentive to present themselves as members of the minority. It might want to do so even if there were no incentive problem, since the majority would always be even better off in the absence of the minority.

Consider finally the problem of endogenous preference formation. It is a truism, but an important one, that workers' preferences are to a large extent shaped by their economic environment. Specifically, there is a tendency to adaptive preference formation, by which the actual mode of economic organization comes to be perceived as superior to all others. There are two distinctions to be made here. First, the object of the adaptive preferences could either be the kind of firm the worker wants to join or the kind of society in which he would want to live. Second, the cause of the adaptive preferences could either be the actual economic organization or the set of feasible economic organizations.[48] It might happen, for instance, that in a socialist regime workers would prefer socialism as long as there was a ban on capitalist firms, but cease to do so as soon as capitalism became legalized. A more robust preference for socialism would survive the legalization of capitalist firms.

The presence of externalities, taken by itself, could reconcile the observed paucity of cooperatives with the theoretical superiority of the cooperative form. Endogenous preference formation, taken by itself, could also reconcile the two. The two mechanisms could also interact, to drive in an even bigger wedge between what workers choose and what would be good for them. Initially, the paucity of cooperatives might be due to externalities. If workers' preferences are shaped by what they observe to be the actual economic arrangement, the values of self-realization, participation, and community will be downgraded, making the formation of cooperatives even more unlikely. Conversely, if these values are not strongly held, the ability to resist temptations from the capitalist environment will be correspondingly weaker.

Conclusion

The main argument of this paper is apparently inconclusive: we just don't know whether the observed lack of cooperatives is due to their inherent inferiority or to interactions with the non-cooperative environment. From this many will argue as follows. Given our ignorance of the efficiency properties of cooperatives, there is no reason to experiment with this mode of ownership. There are, after all, many reforms that *might* have good properties in the large even if they work out badly in the small – but society cannot go ahead and try them out on the basis of a mere possibility. A strong probability of success would be required, to offset the inevitable costs of transition. I would, however, draw exactly the opposite conclusion.[49] The basic argument for cooperatives is one of economic justice. Unless it can be shown that the

[48] For this distinction, see my "Sour Grapes," pp. 121–23.

[49] For an elaboration of the following argument, see my "The Possibility of Rational Politics," *Archives Européennes de Sociologie* XXVIII (1987), pp. 67–103.

cooperative mode is inherently inefficient, it ought to be vigorously pursued. The introduction of universal suffrage provides a useful analogy. Nobody could prove that extension of the suffrage would result in worse decisions, any more than it could be demonstrated that political decision-making would be improved. In consequence, the arguments from justice carried the day.

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