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Worker Participation: Lessons from the Worker Co-ops of the Pacific Northwest, J. Pencavel (Ed.). Russell Sage Foundation, New York (2001). 117 pp., Paper, \$12.95, ISBN: 0-87154-655-8

This is a gem of a little book. It takes advantage of the natural experiment that went on in the Pacific Northwest of having a sizable number of worker cooperatives and conventional firms (unionized and not) in the same sector (plywood production) so that a reasonable comparative economic analysis could be made. In addition to productivity analysis, the book looks at some of the academic controversies about the “Illyrian” or labor-managed firm (LMF). The book also discusses to a lesser extent a group of labor-intensive counterculture-oriented reforestation worker co-ops that came and went during the 1970s and 1980s. The book is written for a wide audience and successfully presents the economic analysis for the intelligent general reader. The tone of the book is open, honest, and fair-minded even though the author is clearly sympathetic with these experiments.

On the whole, the productivity results and other conclusions are positive to the worker co-ops. Those who think that the labor-managed firm literature has formulated the right questions might take this book as giving the best testimony that can be extracted from the cooperative experience of the Pacific Northwest.

Having said that, the book can also be taken as illustrating the limitations of the conventional approach even when applied by a sympathetic observer. Conventional economics was developed to describe and extol the virtues of conventional firms so it should be no surprise that it does not well-formulate questions about democratic firms. Instead, we might take the discussion of workplace democracy as an engine of discovery about some of the limitations of the orthodox viewpoint. I will examine three topics: the “objective” of a democratic firm, the methods of handling risk, and capital structure problems:

- (1) One of the few virtues of the assumption of maximizing net income per worker-member in the LMF was that it allows academics to turn the crank on the usual comparative statics machinery. Otherwise the assumption and its various anomalies (discussed by Pencavel in 53–6) have almost nothing to recommend them.¹ As Pencavel emphasizes (62), membership would hardly be a short-run variable in a membership-based democratic firm. With mem-

¹ Since “the market value rule for current decisions within a firm applies to the market value of the equity of the current owners and not to the total market value of the firm” (Fama, E., Miller, M.H., 1972. *The Theory of Finance*. Holt, Rinehart and Winston, New York, fn. 14, p. 84), one can produce Ward-style anomalies in a conventional firm by assuming current owners could respond to an output price increase by selling some assets (thus reducing output) to buy back some shares at the pre-increase share price.

bership fixed and the working day variable, there is no rationale to maximize net income per labor-hour and the members' preferences are immediately involved. Moreover, given the multi-dimensional decisions facing the members in a democratic firm, there is no reason to expect an economically specified "objective function." Even in the conventional firm, once controlling shareholders also work in the firm then, as noted by Scitovsky² long ago, utility is involved and simple profit-maximization is not the maximand. But such a utility-based analysis stays within the confines of a welfarist approach. Socio-economists from John Stuart Mill to Amartya Sen have emphasized the active development of human capabilities, and democratic cooperatives would seem the ideal site for that difficult-to-formalize objective.

- (2) On risk reduction, Pencavel takes the usual view that diversification is the means (71–2) to the neglect of the dual method. Since co-op members have less diversification than hired workers, he concludes that co-op members are more risk tolerant rather than seeing that they may be using another method of reducing risk. When one cannot control the risk of baskets tipping over due to shocks, then overall risk is indeed reduced by diversifying one's eggs into many baskets. But the dual method (in the sense of series–parallel duality) arises when one can better control the results of the shocks by focusing one's resources and attention on a few baskets. Risk is reduced by putting all one's eggs in a few baskets and then watching and controlling them with great care. For instance, in biology when an organism has little control over the risks faced by offspring, then it will tend to use an "r selection" strategy of diversifying its reproductive resources into many offspring as with fish and insects. But when an organism has a great deal of control over its environment and thus the risks faced by its offspring, then it uses a "K selection" strategy (like mammals) of concentrating its resources in a few offspring and watching them very carefully.

Conventional economists seeing only the diversification strategy conclude that family farmers are risk-tolerant gamblers or that risk-averse farmers should diversify by selling their land, invest the proceeds elsewhere, and then get themselves hired back as farm managers. But one of the options for members in a democratic firm (a family farm being a special case) is that they might switch to a "K selection" strategy of reducing risk by better controlling the response to shocks—in contrast to employees who do not have that control over the workplace and thus will tend toward the sort of "r selection" diversification approach that economists understand so well.

- (3) The capital structure problems such as the Furubotn–Pejovich horizon problem or the mule problem in traditional co-ops are real problems in co-ops and self-managed firms (unlike Ward's "Illyrian firm-anomalies"). But the point is that the horizon and mule problems have been solved—yet this is not made clear in the book. Take the horizon problem. Suppose a professional partnership needs to retain some of the net earnings allocated to the partners according to their labor in order to finance some capital acquisition to be amortized over a period of years. Without special attention, a partner on the verge of retirement would not be around to amortize their asset—hence a horizon problem. How do partnerships handle it? They have capital accounts so that the retained net earnings are recorded in each partner's capital account like an internal debt for future payout independently of the partner's time horizon with the firm. The Mondragon industrial cooperatives independently developed the same internal capital account mechanism—as did the Industrial Cooperative Association (ICA) in

² Scitovsky, T., 1951. *Welfare and Competition*. Irwin, Chicago.

America.³ Pencavel describes the reforestation co-ops as having a fixed membership fee paid coming in and repaid on exit which would imply a horizon problem. My understanding is that some of those co-ops had an ICA-style internal account system but the lack of significant reinvested capital may have rendered both the horizon problem and its solution moot points.

The plywood co-ops like some other employee-owned firms such as many SALs (*Sociedad Anonima Laboral*) in Spain have a different capital structure problem so that they, like mules, tend not to reproduce themselves (as employee-owned companies). With the capital structure of internal capital accounts, each member's membership rights (e.g., voting rights and share in the net returns) are independent of the amount in the member's capital account. The membership rights are based solely on labor in the firm while the rights to recoup the membership fee and the retained earnings are carried by the capital account. The key is that the two separate functions are handled by two separate instruments. The plywood co-ops tried, in effect, to have one instrument (the membership shares) serve both functions and thus they ended up in distorting one or the other of the functions. With the capital account structure, the accumulated retained capital is eventually paid back by the company like any other debt. But if the instrument that is supposed to carry that value is the retiring member's share, then the capital that is actually returned to the member will be a function of what an individual new member can pay. And the membership rights of the new member will be less associated with labor than with being able to raise the money to buy out an exiting member.

Economists understand that one instrument cannot, in general, satisfy two separate functions. For instance, many of the Spanish SALs seem to browbeat retiring members to sell their shares at what young replacement workers can manage to raise. This helps to crudely associate the new worker's membership rights with labor but it distorts the capital rights of the retiring workers. The opposite tendency was found in the plywood co-ops (73–4). If worker-buyers cannot be found for the shares at anything like the value of their capital rights, the new workers are hired as non-members and then the founding generation may sell out the whole company so that the mule co-op does not reproduce as a co-op. Here again, this is a solved problem. Two instruments are needed to carry the two sets of rights: membership rights attached to labor and capital rights (to recoup membership fees plus retained earnings) carried in the internal capital accounts.

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³ See, for example, Ellerman, D., 1986. Horizon Problems and Property Rights in Labor-Managed Firms. *Journal of Comparative Economics* 10, 62–78. Pencavel's mention of debt on p. 74 seems to confound the (unmentioned) internal capital account system with Vanek's no-retained-earnings, all-external-debt pure rental firm.