Worker Cooperatives In America

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Workers' Cooperatives: The Question of Legal Structure

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INTRODUCTION: THE SETTING AND THE PROBLEM

What is a workers' cooperative? In a general sense, a workers' cooperative is a firm controlled and operated by the people who work in it.

There are several different types of firms that are called *worker cooperatives* or *worker-owned firms*. In some cases, such as the original Vermont Asbestos Group (VAG), the firm simply has a conventional ownership structure where a majority of the owners are employees. In many of the urban centers and college towns across the country, there are a number of loosely structured, worker-run *collectives* or cooperatives which might be legally organized as partnerships, statutory cooperatives, nonprofit corporations, or for-profit corporations. In the Pacific Northwest, there are eighteen or so workers' cooperatives in the plywood industry, most of which are legally organized under the cooperative statutes of Oregon and Washington. Daniel Zwerdling's survey *Democracy at Work* (1978) is an excellent illustration of the diversity of worker-run businesses in the United States and Europe.

This diversity reflects, in part, the wide variety of origins of worker-controlled businesses. Many are established by young people seeking an alternative to the materialistic and authoritarian structure of ordinary businesses. Others are the result of worker buyouts following plant closings where no conventional buyers could be found. Yet others are set up by retiring business owners who have no interested heirs and/or who want to reward employees for their past efforts.

The diversity in the legal forms of organization reflects the lack of any coherent, widely used legal code for workers' cooperatives. The general cooperative statutes in the various states are applied across the board to consumer, marketing, housing, and workers' cooperatives (see, for example, National Economic Development Law Project 1974). These statutes are oriented primarily toward agricultural marketing cooperatives, with a secondary focus on housing and consumer cooperatives (with barely a mention of worker cooperatives). The statutes tend to be archaic, to be poorly thought out, and to represent a rough compromise of cooperative and conventional corporate attributes.

Workers' cooperatives are sometimes classified as *producers' cooperatives,* but that classification also includes the numerous marketing and processing cooperatives of independent agricultural producers (e.g., Land O' Lakes, Agway, Ocean Spray). The agricultural cooperatives are not worker controlled and indeed are quite conventional from the employees' viewpoint. To the employees who process milk and produce butter, cottage cheese, and other milk products in a dairy cooperative's plant, it may matter little if the absentee owners are simply investors, individual dairy farmers, or agribusiness dairy farms.

The first statute specifically for workers' cooperatives was recently (May 1982) passed in Massachusetts (see Ellerman and Pitegoff 1983; Pitegoff 1982). This statute, drafted by the Industrial Cooperative Association, provides a statutory basis for the Mondragon-type internal-capital-account structure for workers' cooperatives. This paper will outline the legal theory behind this type of legal structure.

Many different legal structures for worker cooperatives have, in effect, been tested—and the time has come for a preliminary appraisal of the various legal structures. Worker-run businesses often face large internal and external difficulties (see Gamson and Levin, chap. 9, this volume) which may threaten their very survival. I will argue along with Jaroslav Vanek (1975*a*, 1977*c*) that some legal and financial structures used in worker-run firms have inherent flaws that will, in the course of a generation, almost inevitably lead if not to the outright demise of the company, then to the gradual or sudden degeneration of the firm back to a conventional company. Vanek has aptly termed them "mule firms," since they are sterile hybrids of conventional and cooperative forms that cannot reproduce themselves for another generation. The employee-owned corporations, such as VAG, and to a lesser extent the traditional workers' cooperatives, such as the plywood co-ops, are examples of mulelike firms.

In addition to presenting an analysis of this structural degeneration problem, I will propose a solution. This legal structure for workers' cooperatives can be and is being implemented in the United States today, for example, in the cooperatives assisted by the Industrial Cooperative Association such as the Workers' Owned Sewing Company of Windsor, North Carolina, and the Cedar Works in Ohio.

The best examples of worker cooperatives are, however, not in the United States but in the Basque region of northern Spain, the Mondragon industrial cooperatives (Gutierrez-Johnson and Whyte 1977; Oakeshott 1978; Thomas and Logan 1982; Ellerman 1982*c*). The first industrial cooperative of the complex was established in the city of Mondragon in the mid-1950s. Today, there is a system of about 85 industrial worker cooperatives with over 18,000 worker-members. The range of industrial products includes refrigerators, stoves, machine tools, and electronic equipment. The complex has its own technical school which offers college-level courses in engineering and other technical subjects for the workers and young people of the region. The Mondragon group also has its own social security system and an advanced research center to stay abreast of recent technical developments (e.g., printed circuits, microprocessors, robotics, CAD/CAM, and solar technology).

At the hub of the complex is an institution, the Caja Laboral Popular (Bank of the People's Labor), which includes a credit union with over 200,000 members, a computer center, and an Empresarial Division (Entrepreneurial Division). The Empresarial Division represents the institutionalization and socialization of entrepreneurship (Ellerman 1982*c*). It has over 100 staff members who assist worker-groups to systematically launch new cooperatives (about five new co-ops a year under present plans) and who provide technical and managerial assistance to the existing Mondragon cooperatives. With the exception of one ill-fated fishermen's co-op, no Mondragon cooperative has ever failed.

The legal structure I recommend is of the same general type as the legal structure of the Mondragon cooperatives. While one can hardly claim that the phenomenal success of the Mondragon cooperatives is due to their legal structure, the structure has complemented and reinforced, rather than hindered, the other positive factors, such as the solidarity of the Basque nation, the inspiration of the founder, Father Arizmendi, the rare combination of idealism and technical competence present, the industrial tradition of Mondragon, and the comparatively recent development of the market for consumer durables in Spain.

There is such a multiplicity of factors affecting cooperatives that it is always difficult to single out any particular elements as being responsible for any given success or failure. Indeed, any attempt to design a proper legal structure solely by extrapolating from past successes would be underdetermined. Facts are always viewed in the light of theory. The question of legal structure is no exception. In particular, the model legal structure considered here is based on theory and is derived, in its broad contours, from first principles. The application of the legal structure has been much refined in practice and will continue to be honed as more experience accumulates.

CORPORATIONS: INVESTOR-OWNED OR COOPERATIVE

The principal legal forms of business organization are proprietorships, partnerships, and corporations. The main legal difference between a corporation on the one hand and a partnership or proprietorship (a one-person partnership) on the other hand is that a corporation is a separate legal person from its members, whereas a partnership is not a legal person separate from the partners as individuals. Since the partnership is not a separate legal or artificial person, the business debts of the partnership are ultimately the personal debts of the partners. The partners are said to have *unlimited liability* for the business debts. For this reason, a partnership is an unsuitable legal form for a workers' cooperative.

Since a corporation is a separate legal person, a member or shareholder has no more liability for corporate debts than he or she has for, say, a neighbor's debts. Lawyers call this *limited liability* but, in fact, the shareholders as private individuals have no liability at all for corporate debts.

Just as the liabilities of a corporation are not the personal debts of its members or shareholders, so the assets of the corporation are not the individual property of its shareholders. Instead of directly owning the corporate assets or directly bearing the corporate debts, the shareholders have a certain bundle of rights attached to their corporate shares. These rights consist essentially of the right to control the corporation by voting to elect the board of directors and the right to receive value from the corporation in the form of dividends while the stock is held and in the form of capital gains when the stock is sold at a higher price. The total value that accrues to the shareholders can be analyzed as the sum of the net book value or net worth (assets minus liabilities) of the corporate assets plus the value of the present and future economic profits (see the "book plus profits formula" in chapter 12 of Ellerman 1982*a*). Hence the bundle of rights attached to conventional shares is:

voting rights + economic profit rights + net book value.

If we define

membership rights = voting rights + economic profit rights,

then we have the following equation:

conventional share rights = membership rights + net book value.

Enough concepts have now been developed so that we may properly characterize both a conventional corporation and a worker cooperative corporation. A corporation is investor-owned or capitalist if the membership rights (defined above) are property rights, that is, rights that are transferable and marketable. In contrast, a corporation is a workers' cooperative (or self-managed firm) if the membership rights are personal rights attached to the functional role of working in the company.

The membership or citizenship rights (e.g., voting rights) in a democratic political community are an analogous example of personal rights. These rights may not be bought or sold, and they are attached to the functional role of residing in a particular community. A workers' cooperative corporation is a democratic work-community, an industrial democracy, which assigns membership rights to the people who work in it, just as a township or municipality is a democratic living-community which assigns the voting rights to the people who live or reside in it.

Personal rights are rights that are assigned to the person of an individual because the individual qualifies for them, for example, by having a certain functional role, such as residing within the city limits of a municipality. Any such right that is assigned to all and only those who have the qualifying role cannot be treated as a property right, that is, as a salable right. If it were, the buyer might not have the qualifying role, and if the would-be buyer did have the qualifying role, then he or she would not need to buy the right. Hence personal rights and property rights are fundamentally different types of rights.

One acid test to distinguish between personal and property rights is the inheritability test. When membership rights are personal rights assigned to a functional role, the rights are extinguished when a person ceases to play that role. When a person dies, the voting rights he or she may have had as a citizen, a co-op member, or a union member are not transferable to the person's estate or heirs (since those were personal rights). However, if the person was a shareholder in an investor-owned corporation, the shares, as pieces of property, would be inherited by the person's heirs.

Many of the different characteristics of investor-owned corporations and worker cooperative firms result from the fact that the membership rights are transferable property rights in the one case and personal rights attached to the functional role of working in the firm in the other case. For example, when the voting rights are assigned to a functional role, then a person either has that role or not and, thus, either is a member and has the vote or not. There is no possibility of being a "multiple-member" and casting multiple votes. Hence the one-person/one-vote principle is followed in a political or industrial democracy. However, when the membership rights are marketable property rights, then anyone with sufficient wealth can buy many shares, be a multiple-member, and cast many votes. Thus the multiple voting in an investor-owned corporation, in violation of the one-person/one-vote rule, is a result of the membership rights being marketable commodities.

The workers' cooperative differs from the conventional, investor-owned corporation not simply by reallocating the traditional bundle of ownership rights but by restructuring the bundle so that the membership rights become personal rights assigned to the worker's role.

EMPLOYEE-OWNED CORPORATIONS

This understanding of the structural differences between investor-owned and self-managed firms can now be used to analyze an employee-owned corporation—which is often confused with a workers' cooperative or self-managed firm. An *employee-owned corporation* is an investor-owned corporation (that is, the membership rights are marketable property rights) where most of the membership rights are the property of the people who also work in the company, the employees. Sometimes the employees directly own the shares (e.g., the original Vermont Asbestos Group) and sometimes the shares are held in a trust, an Employee Stock Ownership Plan (ESOP), with the employees as the beneficial owners (e.g., the South Bend Lathe Company). In either case, the employees have membership rights solely because they directly or indirectly own the shares, not because they have the functional role of working in the company. This fundamental structural difference between an employee-owned corporation and a workers' cooperative corporation reflects a difference in the basic principles behind the two legal structures, and it has practical consequences.

First, consider the practical consequences of the investor-owned legal structure of a corporation that is directly employee-owned. Since the employees' voting rights are based on share ownership, the one person/one vote principle is, in general, violated. The managers and wealthier employees usually buy more shares and get that many more votes. For example, in the original Vermont Asbestos Group some employees owned no shares, most owned a few, and at least one white

collar employee owned one hundred shares. Employees holding one or two shares are somewhat less than enthusiastic to participate in membership meetings when fifty to one hundred of them can be outvoted by one employee owning one hundred shares.

The profit distribution is equally lopsided. Profits are distributed as dividends or retained in the company, in which case they might accrue to the shareholder in the form of capital gains (appreciated share price). The dividends are distributed on a per-share basis, so the dividend distribution follows the allocation of shares. When retained profit appreciates the share price, a "rising tide lifts all the ships," so the distribution of capital gains also follows the historical distribution of shares. Hence, those who could afford to buy more shares in the first place will get the lion's share of the fruits of the enterprise. The inequality in voting rights and the inequity in the profit distribution tend to create disaffection and disillusionment among the less well-off employees, as they see the power and wealth gravitating toward a small group within the company (usually the managers).

The long-term problem with employee-owned corporations is that they embody degenerative tendencies, so they don't remain employee-owned for very long. If the company fails as a business, there is no long term. If the company succeeds as a business, the shares will appreciate in value, sometimes quite dramatically. The managers and older employees will eventually want to realize their capital gains by selling their highly appreciated holdings. If the company is to remain employee-owned, then the new employees entering the firm will have to buy the shares of departing employees. But it is virtually impossible for new workers to buy the large holdings of retiring employees. Hence those shares would tend to be sold to outsiders. As time passes, the normal turnover in the company makes it less and less employee-owned. The employees' disaffection may well have a direct detrimental effect on the business. Eventually an individual, a group, or a corporation may make a takeover bid. The disaffected employees, having witnessed the gradual erosion of employee ownership in their company, would probably jump at the chance to at least get some cash out of the matter. Like a mule, the firm cannot reproduce itself across generations. The conventional treatment of membership rights as marketable property rights in an employee-owned corporation is somewhat like a time bomb that will eventually lead to the demise of the employee ownership of the company.

This process of aging and deterioration in a mulelike employee-owned corporation will normally take place within a generation (fifteen to twenty years), that is, by the time the original founding group retires. In the case of Vermont Asbestos Group, favorable external events led to sharp asbestos price increases shortly after the employees had formed the company and purchased the assets from the GAF conglomerate in 1975. There was a 100 percent dividend the first year, and the retained profits were sufficient over three years to increase the book value of the shares from $50 to around $1,800 per share. These superprofits seemed to act as a hot house to accelerate the process of aging and deterioration. Instead of taking a generation, the process took only three years. Several manufacturing and venture capital firms were prepared to make offers, but the disaffected workers preferred to sell enough of their shares to a local businessman until he could handpick a new board of directors and install himself as the president and chairman of the board.

There have been a number of recent examples of partial and indirect employee ownership through Employee Stock Ownership Plans (ESOPs). The present form of the ESOP was established by the Employee Retirement Income Security Act (ERISA) of 1974 (see, for example, Stern and Comstock 1978). As in a pension plan, the corporate contributions to an ESOP are exempt (as deferred labor compensation) from the corporate income tax. But, unlike an ordinary pension plan, an ESOP invests in the employer's stock, which makes an ESOP into a new vehicle for employee ownership but a risky substitute for a pension plan.

The principal novelty lies in the "leveraged" ESOP, wherein the ESOP gets a bank loan that is guaranteed by the corporation. The ESOP uses the money to buy stock from the corporation, and then the stock serves as collateral for the loan. The company's periodic cash contributions to the ESOP are funneled through to pay off the bank loan. A tax break is captured because the company contributions count as deferred labor compensation, so the company pays back both the principal and interest on the loan with earnings that are deductible from taxable corporate income. Usually only the interest can be deducted as an expense. As the loan is paid off, the shares become vested in the employees' names. The employees do not acquire direct ownership of their shares until they terminate their employment with the company or retire. The value of the employees' shares is in large part counterbalanced by the diluted value or foregone gain on the part of existing shareholders.

The chief architect of this plan was a corporate lawyer, Louis Kelso, who has coauthored books entitled *The Capitalist Manifesto* and *How to Turn Eighty Million Workers into Capitalists on Borrowed Money*. The conservative but populist aspects of the plan appealed to Senator Russell Long, who pushed the ESOP legislation through Congress. ESOPs are usually established by corporate managers or owners who are interested in the tax benefits, and who are not particularly interested in transferring any power or control to the employees. The shares

must be distributed in proportion to pay, so the distribution of votes and profits is as skewed as the wage and salary differentials within the company.

It is difficult to predict the long-run prospects for ESOPs since they have not, as yet, been around for a generation and since the legislation is still evolving. If desired, it does seem possible to structure some democratic attributes into an ESOP or, at least, an ESOP containing 100 percent of the shares. One-person/one-vote might be attained by having a two-tiered voting structure (require the trustees to vote the shares in accordance with the members' one-person/one-vote decision) or possibly by using voting and nonvoting shares. By allocating shares to workers in accordance with labor compensation, the ESOP structure does move toward transforming the membership rights from property rights into personal rights assigned to the functional role of working in the firm. In these ways an ESOP can be restructured in the direction of a worker cooperative corporation.

This discussion of investor-owned corporations which are directly or indirectly employee-owned serves to outline the practical problems in these firms and to differentiate employee-owned firms (including ESOPs without co-op attributes) from workers' cooperatives. There is some confusion between these two types of firms since, in both cases, the workers are the "owners." For many purposes, it may not be important to emphasize the distinctions. But, aside from the principles involved, it is of practical importance to understand the difference when observers jump to the conclusion that "worker ownership doesn't work" after observing the perfectly predictable degeneration of employee-owned corporations back into conventional, investor-owned firms. An employee-owned corporation is the counterfeit of a workers' cooperative.

THE NORMATIVE PRINCIPLES EMBODIED IN WORKERS' COOPERATIVES

The structure of a workers' cooperative or self-managed firm is sometimes recommended on the pragmatic grounds that it provides for workers' control without the suicidal tendencies implicit in conventional employee ownership. However, there are also normative principles involved, and a thorough appreciation of the structure of a workers' cooperative requires an understanding of these principles. I noted previously that a workers' cooperative was a corporation where the membership rights (voting plus profit rights) are personal rights assigned to the functional role of working in the company, rather than commodities or marketable property rights. I shall examine separately the two principles behind this treatment of the voting rights and the profits rights.

The first normative principle, the assignment of the voting rights to the workers, is based on the *democratic theory of government:* all and only the people who are to be governed by a government should have the vote in electing that government. This principle of democracy or self-government is built into the structure of an organization by attaching the voting rights to elect the government or management to the functional role of being governed or managed by the organization. In short, self-government means that the ultimate right and power to govern must be assigned to the functional role of being governed.

There are many outside interests that might be affected by the activities of the firm. The outside parties (e.g., consumers, capital suppliers, and local residents) should have effective indirect or negative control rights to veto or otherwise constrain the activities of the firm in order to protect their own legitimate interests. Positions on the board of directors will not effectively protect outside interests since two or more interest groups cannot each have a majority or controlling position on the board.

The question of assigning the voting rights to elect the board is the question of who should have the direct or positive control rights to ultimately make the policies and decisions of the firm. The democratic principle of government assigns those direct control rights to the people who fall under the command, authority, and jurisdiction of the firm's management, that is, to the governed. The consumers, the suppliers of capital or other material inputs, and the local residents are not managed by and do not take orders from the managers of the firm. Only the people who work in the company, the workers, have that functional role. Hence the application of the democratic principle of self-government to a corporation entails that the voting rights should be assigned to the functional role of working in the company.

The second normative principle is the *labor theory of property* applied to the production process. The labor principle states that people should have the rights to the (positive and negative) fruits of their labor. The products or outputs of a firm are the positive fruits of the labor jointly performed by all the people working in the firm. The used-up nonlabor inputs, such as the consumed raw materials and intermediate goods and the expended services of the machines, buildings and land, represent the negative fruits of labor. From the legal viewpoint, it is the corporation itself as a legal entity that owns the produced outputs and is liable for the used-up nonlabor inputs. Since the labor theory of property states that the workers should jointly appropriate the positive fruits (the produced outputs) and be jointly liable for the negative fruits (the used-up nonlabor inputs) of their combined labor, the labor theory implies that the workers should *be* the corporation, that is, the workers should be the legal members of the corporation.

In terms of market value, the net value of the positive and negative fruits of the labor jointly performed by the workers is the revenues minus the nonlabor costs, which equals what is usually called the *wages* plus the *profits.* Since the wages and salaries already accrue to the workers, the labor theory implies that the rights to the remaining value of the fruits of their labor, namely, the rights to the profits, should be assigned to the workers.

Hence the democratic principle of self-government and the labor theory of property imply that, in a corporation, the voting rights and the rights to the revenues net of nonlabor costs (wages plus profits) should be assigned to the functional role of working in the company. Since the wages already go to the workers, a corporation can be tranformed into a workers' cooperative by changing the membership rights (voting rights plus profit rights) from salable property rights into personal rights attached to the workers' role.

In contrast to the case of an employee-owned corporation, the worker-members of a workers' cooperative are, in the generic sense, neither employees nor owners. The worker-members are not employees because they do not sell their labor; they sell the fruits of their labor. Instead of being employees of a workers' cooperative corporation, the workers *are* the corporation; it is their legal embodiment. The workers, in their corporate body, own the positive fruits of their labor (the produced outputs) and are liable for the negative fruits of their labor (the used-up nonlabor inputs). Instead of selling their labor for a wage or salary, the worker-members are selling their outputs in return for the revenues and are paying the costs of the nonlabor inputs. The labor income of the worker-members is not the market value of their labor as a commodity but is the net market value of the positive and negative fruits of their labor (revenues minus nonlabor costs).

The worker-members are also not owners because the membership rights are not property rights. Any right attached to a person's functional role cannot also be treated as a marketable property right. Like the citizenship rights in a political democracy, the membership rights in an industrial democracy are attached to the functional role of being governed or managed, so they are personal rights that cannot be bought or sold. The rights are held, not owned. The workers are members, not owners. Workers' cooperatives have worker-members, not employee-owners. Unlike a conventional corporation, a workers' cooperative is not a piece of property. It is not privately owned, it is not publicly owned, and it is not even "socially owned"—since it is not a piece of property to be owned at all. It is a democratic social institution.

RESTRUCTURING A CORPORATION AS A WORKERS' COOPERATIVE

The definition of a workers' cooperative or self-managed corporation given above (i.e., the assignment of the membership rights to the workers' role) is a conceptual and generic definition. Aside from the new Massachusetts worker cooperative statute and mirror statutes passed in Maine and being considered in other states (see Ellerman and Pitegoff 1983; Pitegoff 1982), there are no United States statutes at present, cooperative or otherwise, designed to implement this definition of a workers' cooperative. In fact, the old cooperative statutes are rather archaic and poorly designed. Without an appropriate statute, a cooperative as defined herein can still be realized by starting with a stock business corporation or a statutory cooperative corporation, and then reworking the articles of incorporation and bylaws to internally restructure the company so that it will function as a genuine workers' cooperative (e.g., the Industrial Cooperative Association Model By-laws for a Worker Cooperative 1980).

The basic idea of the restructuring is to split apart the conventional bundle of rights attached to corporate shares so that the membership rights can then be treated as personal rights assigned to the functional role of working in the corporation. The conventional bundle of rights attached to corporate shares can be analyzed in two parts: (1) the membership rights (voting rights plus profit rights), and (2) the rights to the net book value or net worth of the corporate assets. The strategy is to have the membership rights attached to the shares and to create a new corporate structure—the system of *internal capital accounts*—to take over the function of carrying the net worth. With that net worth value removed from the shares, the shares can be treated just as carriers of the membership rights, that is, as *membership certificates*, attached to the functional role of working in the firm.

One of the flaws in traditional statutory workers' cooperatives (e.g., the plywood co-ops) is that the co-op shares continue to carry the net book value, so they cannot be used as membership certificates. To give each newly qualified and accepted member a traditional co-op share as a membership certificate would be to make an unwarranted gift of a proportionate part of the net worth to each new member. Thus a new worker is required to buy at least one share to become a member, and this gets to be prohibitively expensive (e.g., $60,000 or more in some plywood cooperatives). Moreover, membership should be designed in such a way that the person qualifies for membership by working in the firm and does not have to buy membership (even though, as specified below, there are financial obligations of membership).

The solution is to split off the net worth or net book value from the shares using a system of internal capital accounts, one account for each member recording that member's share of the net worth. When a person leaves the firm or retires, the balance in his or her account is paid out by the firm over a period of years. A new worker does not have to individually pay off a retiring worker—as would be the case if a new worker had to buy a share with the accumulated value from a retiring member. With the rights to the portions of net worth recorded in internal capital accounts, the shares can then be treated as nontransferable membership certificates issued to new members and collected from exiting members. The new member would not be getting a portion of net worth, since the balance in the new member's account would start at zero.

Rights usually come together with obligations. For example, one does not have to buy the rights of union membership or the rights of political citizenship, but there are union dues and government taxes. In a workers' cooperative, one similarly does not buy membership but there would be a fixed membership investment required of each new member as a financial obligation of membership. That paid-in membership fee would be recorded in the new member's account. At the end of each fiscal year, interest would be added to the account, and the member's share of the retained positive or negative surplus computed after interest on the accounts) would be added to or subtracted from the account's balance. Each member's share of the surplus would be proportional to his or her labor as measured by the hours worked or by his or her pay.

Usually there would also be a *collective account* that is unindividuated in the sense that it never has to be paid back to anyone during the lifetime of the corporation. By having a certain portion of the net worth that never has to be turned over or revolved as the membership turns over, the cooperative is helping to insure that it could eventually pay off the individual accounts. Hence the allocation to the collective account is a form of self-insurance. The individual and collective accounts are adjusted each year to reflect the retained net income, paid-in membership fees, and paid-off accounts so that the sum of the account balances always equals the net worth.

With this internal restructuring, based on the internal capital accounts and the share membership certificates, a corporation would legally function as a genuine workers' cooperative. It might be noted that this internal restructuring does not change the external legal categories. For example, while the worker-members do not function as employees or owners as explained above, they nevertheless would still be legally classified as both employees and owners because at present there are no other legal pigeonholes available.[1]

AN ANALYSIS OF ALTERNATIVE LEGAL STRUCTURES

The traditional statutory workers' cooperatives in the United States (e.g., the plywood co-ops) do not detach the net book value from the co-op's shares (i.e., no internal capital accounts, no separation of personal and property rights). The new workers often cannot afford to buy the shares of retiring members, so in order to fill the jobs, new workers tend to be hired as nonmembers. And, if permitted, retiring members might have to sell their shares to outsiders. Sometimes, as the founding members approach retirement with no prospective market for their individual shares, they band together and sell control of the company to a conventional firm in order to capitalize their shares. Indeed, some of the plywood co-ops were sold, while most of those that remain as cooperative have a significant number of nonmember employees. The flawed structure of traditional statutory worker co-ops gives them suicidal or mulelike tendencies not unlike those exhibited by the employee-owned corporations.

The common ownership firms of Great Britain and the Yugoslavian self-managed firms do, in effect, treat the membership rights as personal rights assigned to the functional role of working in the firm. But they do so at the price of eliminating the members' property rights to the net worth, the reinvested fruits of their past labor. It is as if there were no individual internal accounts and only the collective account. Thus the net income or profit rights assigned to the workers are incomplete, since the workers lose any claim on the retained net income. It becomes "common property" or "social property." Misplaced idealism and Marxist ideology notwithstanding, there really is no good reason why the workers should be forced to forfeit the value of the fruits of their labor simply because they reinvest it in the company. This destroys the incentive to invest by retention of earnings as opposed to borrowing. Instead of retaining earnings, it would be rational for the workers to distribute all earnings, deposit a portion in a savings account, and then have the bank loan the money back to the firm.

Some economists (e.g., Furubotn and Pejovich 1970, 1974) have detailed numerous distortions that arise from the treatment of the net worth as social property. However, instead of recognizing the known solution to the problem, they present the problem as an inherent characteristic of self-management. I previously noted how the firm could have access to the earnings without the workers losing their claim, by routing the earnings through external savings accounts. That is impractical, but the practical solution is to move the savings accounts into the firm itself. That is the conceptual origin of the idea

of the internal capital accounts. Moreover, that is the solution worked out and field-tested by the Mondragon cooperatives over the last two decades.

The key to cooperative restructuring is to unbundle the traditional bundle of ownership rights by separating and partitioning the membership rights (evidenced by co-op membership shares) from the net book value rights (recorded in the new internal capital accounts). Jaroslav Vanek has particularly emphasized that all capital financing should be separate from or external to the co-op membership rights (e.g., Vanek 1977c). The unfortunate use of the word *external* might lead one to think that Vanek is calling for co-ops with complete outside financing, that is, with 100 percent leveraged financing. However, Vanek has explicitly recognized the appropriateness of internal financing using "redeemable savings deposits of members" (1977c:186) such as the Mondragon internal capital accounts. Then all capital financing, from outsiders or members, is "external" to the membership rights so that those rights can be assigned to labor, and yet the members can eventually recoup their reinvested earnings.

The use of a proper legal structure, with a set of internal accounts to split the net worth due each member off from the membership shares, is certainly no guarantee of economic success or longevity. But such a structure seems to be a necessary condition for avoiding the self-destructive forces embodied in employee-owned corporations and traditional statutory workers' cooperatives. A proper legal structure is not just important for negative or preventive reasons. The avoidance of the structural degenerative tendencies creates the preconditions for the development of a humane work environment and the growth of internal democracy.

The importance of partitioning the conventional bundle of share rights into the membership rights and the net worth rights cannot be overemphasized. The partition is of such fundamental importance because it allows the membership rights to be transformed from property rights into personal rights (attached to the workers' role), which means that the company itself is transformed from a piece of property to a democratic social institution.[2]

SUMMARY

The theoretical analysis for the various types of legal structures for worker-owned firms can now be summarized according to the treatment of the conventional bundle of ownership rights.

Conventional Capitalist Corporation

(A) Voting rights, (B1) economic profit rights, and (B2) net book value rights.	→	Owned by the shareholders (property rights).

Employee-Owned Corporation

(A) Voting rights, (B1) economic profit rights, and (B2) net book value rights.	→	Owned by the employee-shareholders (property rights).

Traditional Worker Cooperative

(A) Voting rights and (B1) economic profit rights. (B2) Net book value.	→	Partially treated as personal rights held by workers who own one ownership share (property rights).

Yugoslav-type Self-Managed Firm

(A) Voting rights, (B1) Economic profit rights.	→	Membership rights held by the workers (personal rights).
(B2) Net book value rights.	→	Social property.

Mondragon-type Worker Cooperative

(A) Voting rights, (B1) economic profit rights.	→	Membership rights held by the workers (personal rights).
(B2) Net book value rights.	→	Internal capital accounts (property rights).

Employee-owned corporations are based on the conventional structure wherein the membership rights are property rights—albeit owned by the employees—so such a company is still a piece of property, a (temporarily) employee-owned piece of property. Industrial democracy cannot develop inside a piece of property. Most "employee-owned" companies do not even attempt to develop an internal democratic structure.

The traditional worker co-ops moved part way toward the treatment of the membership rights as personal rights by allowing shareholders only one vote regardless of the number of shares held and by distributing certain net income ("patronage dividends") in accordance with

labor rather than by reference to the capital invested in shares. But since the net worth is not partitioned off from the shares by a system of internal accounts, the shares continue to function as carriers of net worth. Thus a worker who could not afford to individually pay off the accumulated net worth due a retiring member by buying a share would not receive the membership rights to vote and to receive a portion of the net earnings. The traditional worker co-ops, instead of making the complete transformation, represent something of a confused and sterile crossbreed between an investor-owned piece of property and a cooperative social institution.

The system of Mondragon-type internal accounts takes the function of carrying the net worth away from the shares so that the membership rights, evidenced by the shares, can be fully transformed into personal rights assigned to the workers' functional role. The net worth due to each worker-member, representing the reinvested fruits of their labor, is not thereby sacrificed since it remains a property right evidenced by the balance in the member's internal account.[3] In this manner, a proper legal structure will transform a company from a piece of property into a social institution wherein people will receive the fruits of their labor and have democratic control over their working lives.

NOTES

1. From the present external legal viewpoint, the internally restructured corporation, with share membership certificates and internal capital accounts, would be viewed as a whole set of stock purchase and sale agreements geared to employment in the corporation. After the probationary period, an employee must purchase one and only one share at a preset price (the membership fee) to obtain permanent employment in the firm. The agreement stipulates that the share is nontransferable during the tenure of employment. Upon termination of employment, there is a mandatory sale (a "mandatory call") of the share back to the corporation for a formula price. The formula price is the balance in the shareholder's internal capital account. The price is paid partly in cash and partly in subordinate notes to be paid off over a period of years. This is the external view of the structural transformation which would be described internally or generically as transforming the membership rights from the property rights into personal rights attached to the functional role of working in the firm, while maintaining the worker-members' property rights to their capital reinvested in the firm. The external can only be brought in line with the internal viewpoint by the creation of new statutes and new legal institutions. For the present, the new must be built within the shell of the old.

2. The theme that capitalism treats some nongovernmental social institutions as private property has also been developed by Karl Polanyi (1944) and Carole Pateman

(1975). Indeed, since the development of political democracy in the Western countries, the "public/private" distinction has served to quarantine the democratic germ in the sphere of political government, keeping it from spreading to other social institutions such as business firms. Thus some people argue that big corporations should be democratized because they are really "public," as if the concept of self-determination were only applicable to the public domain. And others defend the corporation against the encroachment of democratic ideals by asserting that it is a "private" firm, as if that were a relevant defense. Even socialists (or perhaps one should say, *especially* socialists) think in terms of the public/private distinction. Instead of rejecting the identification of social or public with the government, and extending direct self-management to the nongovernmental institutions of society, traditional socialism (e.g., Marxist socialism) maintains the equation that *social* equals *governmental* and extends the reach of the government to the formerly nongovernmental institutions of society.

3. Since the balance in each member's account represents a property right, the question of its transferability arises. For example, prior to the termination of membership, could a member be issued subordinate debentures, representing part of the account's balance, which were transferable? The answer could be yes only if enough was left in the member's account to cover future debits. If most or all of the account's balance was turned into a debt note which was then sold by the member to some other party, there may not be enough balance left in the account to cover the losses charged to the member. After such losses, the account would show a negative balance, and any member who leaves with his or her account showing a negative balance would be transferring those losses to his or her coworkers. To prevent that eventuality, a sufficient balance should always be maintained in a member's account to cover future debits. Indeed, one reason for the membership fee is to provide a beginning positive balance in a new member's account which will function as a damage deposit to cover future losses. Thus if a cooperative does not allow most or all of an account's balance to be capitalized as a transferable note, it is not because the balance is not a property right, but because the cooperative has a lien on a part of that property to cover any future debits.

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