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# Worker Cooperatives as Based on First Principles

## ABSTRACT

The purpose of this paper is to go back to the first principles of democracy and private property, and to show that they are violated by the conventional firms based on the employment relations and are satisfied by the legal form of a worker cooperative. The conventional bundle of rights in a corporation is analysed and then shown how it is changed and reparsed in a worker cooperative according to those first principles.

## KEY-WORDS

WORKER COOPERATIVES; JURIDICAL PRINCIPLE OF IMPUTING RESPONSIBILITY; DEMOCRATIC THEORY

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## 1. Introduction

The advanced industrialized countries in the world today are supposed to be based on the principles of democracy and private property. Yet in the conventional corporations, where people spend much of their lives, the governance is not democratic even in theory and the property structure directly violates the principle upon which private property is supposed to be based: people getting the fruits of their labour. This highly anomalous situation requires some analysis to recover the basic principles of democracy and private property, and to apply them to the workplace.

## 2. Refounding private property on the responsibility principle

### *2.1 The application to the products of labour*

At least since the time humanity moved beyond primitive animism, it has been recognized that only persons can be responsible for anything. Things are not responsible agents; responsibility is always imputed back through an instrument to the human user. A basic function in seemingly any legal system is the determination in trials or other judgments as to who was in fact responsible for some misdeed so that the legal responsibility in terms of liabilities and penalties can be appropriately assigned. Responsibility works both ways; there is also the question of who was responsible for certain beneficial results. People should have the legal responsibility for both the positive and negative results of their deliberate actions, the "fruits of their labor". The theory of property is concerned with correctly assigning those rights and liabilities whenever new property is produced and old property is consumed, used-up, or otherwise destroyed.

That responsibility principle is essentially primordial. In the *Two Treatises on Government,* John Locke did not invent it. But Locke is usually associated with explicitly applying that principle to the theory of property, particularly the questions of property creation. This is the Lockean principle of "getting the fruits of your labour". The economic activities of production and consumption differ from exchange in that they inherently involve the initiation and termination of property rights; exchange does not. In production, the services of land, persons, and capital (to use the classical trinity) are the "inputs" that are used-up in the process of producing the products or "outputs" to be sold to the customers.

But there is a problem when production is organized under the employer-employee relationship as opposed to say a family farm or small artisan-operated workshop where people are working for themselves. All the human beings who work in a productive enterprise, working employers or employees, are jointly *de facto* responsible for using up all the inputs to the process, but *none* of those liabilities are legally assigned to the employees. Similarly that jointly responsible human activity produced the products or outputs, but *none* of the initial property rights to the produced outputs are assigned to the employees. Instead, the employees are legally treated as only the suppliers

of one of the "inputs", labour services, and thus they are only one of the "outside" parties to whom the liability for that used-up input is owned, a liability usually paid off as wages and salaries.

When all or the overwhelming number of the responsible human beings involved in a joint productive activity have *zero* legal liability for the used-up inputs and *zero* legal ownership of the produced outputs, then it is somewhat problematic to give an "account" for the activity in terms of the responsibility principle. Hence the economics profession, whose social role is to given an account for the system, has developed a whole theory, marginal productivity theory, which applies the responsibility principle metaphorically to both persons and things to show that all the "inputs" in competitive markets will be priced according to their marginal productivity. By refocusing on the price paid to input suppliers, the whole question of who is to appropriate the liabilities to pay the input suppliers and to appropriate the produced assets is not even raised[1].

### *2.2 The inalienability of responsible human actions*

Now everyone knows that the responsibility for human actions cannot be transferred like a commodity. The simple example of a hired criminal emphasizes the *de facto* inalienability of responsibility. A hired killer might tell the judge that he "sold" his actions to his employer. He voluntarily agreed to "perform certain actions in return for agreed upon compensation" (the standard description of the labour contract), and that is the extent of his legal involvement. But the judge would no doubt be unmoved by this argument that the employer should have the sole legal responsibility. Of course, any contract to commit a crime is illegal but the hired killer is charged, along with his employer, with murder, not making an illegal contract.

When Ronald Coase (1937) described the hiring or renting of human beings as the "legal relationship normally called that of 'master and servant' or 'employer and employee'", he used a modern British law book on the employment relation. That law book explains the case of the hired criminal as follows:

> "All who participate in a crime with a guilty intent are liable to punishment. A master and servant who so participate in a crime are liable criminally, not because they are master and servant, but because they jointly carried out a criminal venture and are both criminous." (Batt, 1967: 612).

When the venture "they jointly carried out" was not a criminous venture but an ordinary productive enterprise, then it is hard for our liberal scholars and social scientists to argue that employees suddenly become non-responsible instruments "employed" by their "employer". But since the Right and Left agree on not mentioning of the institutionalized violation of basic responsibility principle (applied to the products of labour) that should be the foundation of the private property system and other legal imputations—just the usual head-butting between "social ownership" and "private ownership" of the means of production[2].

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[1] See Ellerman (2016) for more analysis of property rights and marginal productivity theory.

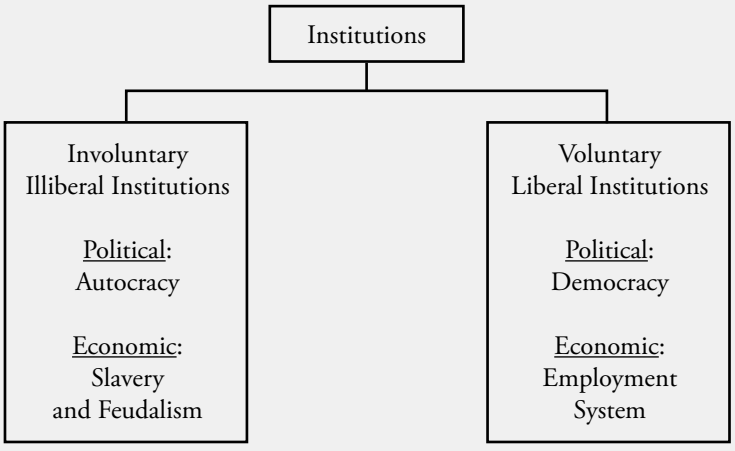
[2] For a book-length treatment of the labor theory of property and related questions, see Ellerman (1992).

## 3. The consent-versus-coercion misframing

Although our main focus is on property rights, it may be helpful to briefly mention the parallel analysis of contracts.

A basic misframing shared by the Right and Left is the framing of issues in terms of consent versus coercion. Then the Right takes the high moral stand in favour of consent and contract as opposed to systems based on inherited status, divine rights, patriarchy, or totalitarian coercion. "Legitimate government must be founded on the consent of the governed" (Tomasi, 2012: 5)[3]. And the Left accepts the framing but argues that some contractual institutions, like wage labour, are not "really" voluntary and are more akin to feudalism and slavery.

**Figure 1. Standard liberal coercion-versus-consent dichotomy**




But here classical liberalism suffers from intellectual amnesia. From Antiquity down to the present, the sophisticated defences of political autocracy and even individual slavery have been based on consent.

For instance, the codification of Roman law in *Institutes* of Justinian gave three ways slavery could be legitimate and all had the incidence of consent and contract. One was an explicit contract. Another was a case where a person had by their own actions committed a crime worthy of capital punishment (e.g., being a prisoner in a war against Rome) and who then voluntarily agreed in a plea bargain to a lifetime of slavery instead of the capital punishment. And the third rationale is where a child of a slave mother is raised for eighteen or so years using the food, clothing, and shelter provided by the master, and this debt needs to be paid off through work (all the while accumulating more debt to the "company store") or some other payment that would be a buy-out or manumission from this debt peonage.

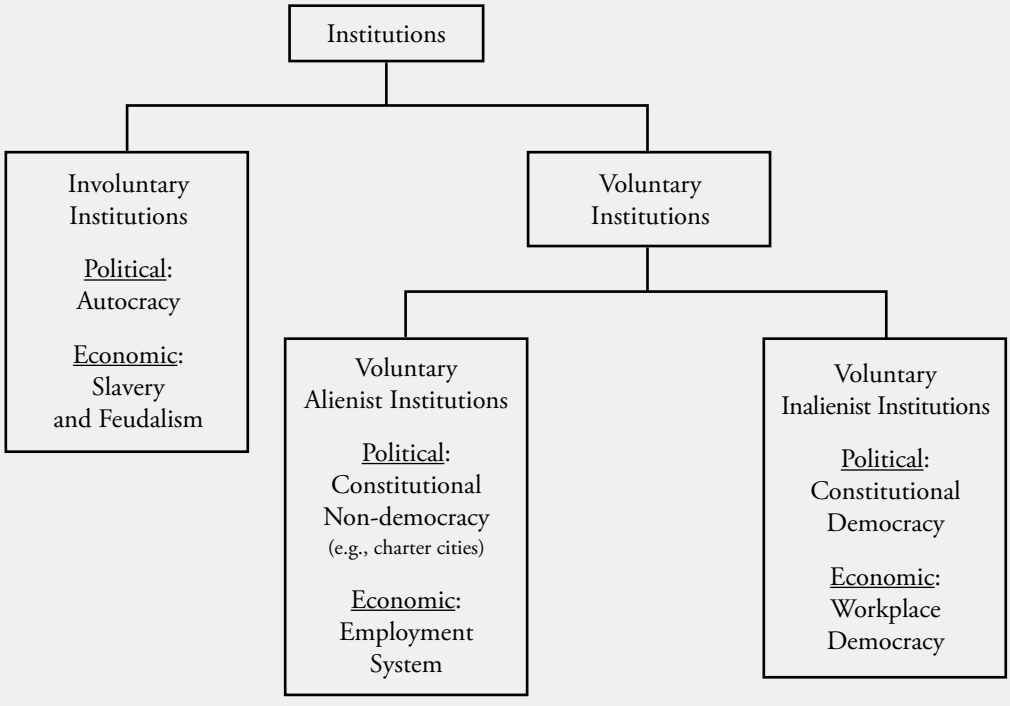
[3] John Tomasi (2012) may be used as a representative and recent restatement of classical liberal thought—although Robert Nozick (1974) was also a classic (if extreme) representative.

On the liberal idea of government based on the "consent of the governed", the great legal scholar, Otto von Gierke showed that at least by the Middle Ages, "there was developed a doctrine which taught that the State had a rightful beginning in a Contract of Subjection to which the People was party…. Indeed that the legal title to all Rulership lies in the voluntary and contractual submission of the Ruled could therefore be propounded as a philosophic axiom" (Gierke, 1958: 38-40). For instance, where monarchy existed as a settled condition, then the sophisticated legitimation was not by Locke's carefully chosen foil, the patriarchy of Filmer, or by the Church's Divine Right, but by the implied contract of subjection that had been vouchsafed by the prescription of time.

Since the sophisticated defence of all stripes of autocracy could be viewed as based on a social contract of subjection, the *pactum subjectionis*, what then is the defining characteristic of democracy that seems to escape our classical liberal scholars? The relevant distinction is not the contrast of coercion versus consent (or status versus contract etc.), but the distinction between:

1. contracts that alienate and transfer the right of self-government, [4] and
2. contracts that only delegate authority to representatives to govern in the name of the governed.

**Figure 2. The reframing in terms of alienable versus inalienable human rights**




[4] It might be noted that this alienation violates the de facto inalienability of responsible agency that is used later in connection with the workers' inalienable responsibility for the fruits of their labor.

Again Gierke traces this contrast between a *pactum subjectionis* and a democratic constitution.

> "This dispute also reaches far back into the Middle Ages. It first took a strictly juristic form in the dispute [...] as to the legal nature of the ancient *translatio imperi* from the Roman people to the Princeps. One school explained this as a definitive and irrevocable alienation of power, the other as a mere concession of its use and exercise. [...] On the one hand from the people's abdication the most absolute sovereignty of the prince might be deduced, [...] On the other hand the assumption of a mere *concessio imperii* led to the doctrine of popular sovereignty" (Gierke, 1966: 93-94).

The civic republican scholar, Quentin Skinner (1978) has emphasized the same contrast between alienation and delegation. Democratic theory is in fact based not on the courageous liberal stand against coercion and in favour of the consent of the governed nor on the critique of a *pactum subjectionis* as not being "really" voluntary. Democratic theory is based on a critique of the contracts of alienation as alienating that which is inalienable (Ellerman, 2005; 2010; 2015)[5].

The theory of inalienable rights descends from the Reformation (inalienability of conscience) and the Enlightenment through the abolitionist, democratic, and feminist movements to modern times. The basic idea is as simple as the consequences are profound. Due to the factual status as being mature person of normal capacity, people qualify for certain basic rights *qua persons* (or *qua humans*, if one prefers the human rights terminology). The argument was that any rights one has *qua* person are inalienable, even by a *really* voluntary contract and for whatever compensation, since after the contract is signed and "validated" by the legal authorities, then person still qualifies for the same rights on the same grounds *qua* person. Hence, the pretended legal alienation was inherently invalid, and those *qua*-person (or *qua*-human) rights are inherently inalienable.

Of course, a legal system can still "validate" such a contract and count obedience to one's master, sovereign, husband, or employer as "fulfilling" the contract, and then legally enforce the consequences in a type of legalized or institutionalized fraud. But as a result of the aforementioned social movements, voluntary self-sale contracts, nondemocratic pacts of subjection, and coverture marriage contracts have all been abolished in the advanced democracies. Only the system of human rental contracts remains[6].

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[5] The disconnect between classical liberal thought and democracy is clearly visible in the debate on charter cities (as advocated by Paul Romer, the new Chief Economist of the World Bank), "free cities", or start-up cities which are newly built cities run by a foreign country, a corporation, or a group of rulers where people would indicate their consent to alienate their self-governance rights by voluntarily moving there and where they are free to leave at any time. The disconnect is shown by the strong libertarian support for such nondemocratic municipal governments like in old Hong Kong or modern Dubai.

[6] "The commodity that is traded in the labour market is labour services, or hours of labour. The corresponding price is the wage per hour. We can think of the wage per hour as the price at which the firm rents the services of a worker, or the rental rate for labour. We do not have asset prices in the labour market because workers cannot be bought or sold in modern societies; they can only be rented. (In a society with slavery, the asset price would be the price of a slave)" (Fischer, Dornbush and Schmalensee., 1988: 323). Americans say "rental car" and the British say "hire car" but they mean the same thing. A rented person is a hired person, an "employee".

Classical liberal thought has done its job well to get much of the Left to use the consent/coercion framing and to quibble about what is "really" voluntary (or whether the payment is big enough to compensate for all the "alienated labour-time")—as if the whole institution for renting people would be acceptable if only people had other choices (like a guaranteed basic income or suitable self-employment) or were paid higher human rentals[7].

This inalienable rights critique is not a choice in the liberal buffet because the contractual foundation for the governance of what most people do all day long, namely the employment contract, is an alienation contract. The employer is not the delegate, representative, or trustee of the employees and does not manage in the name of those managed. Hence the liberal insistence on the consent-versus-coercion framing is required so that the "legal relationship normally called that of 'master and servant' or 'employer and employee'" (Coase, 1937: 403) and political democracy will appear on the *same* side of consent-versus-coercion framing, whereas they are on the opposite sides of the alienation-versus-delegation framing (see previous diagrams).

## 4. Re-constituting the corporation from first principles

### *4.1 The responsible corporation*

There have been a few—very few—social commentators who have pointed out the roots of the institutionalized irresponsibility in the absentee-owned joint stock corporation. In his 1961 book aptly entitled *The Responsible Company*, George Goyder quoted a striking passage from Lord Eustace Percy's *Riddell Lectures* in 1944:

> "Here is the most urgent challenge to political invention ever offered to the jurist and the statesman. The human association which in fact produces and distributes wealth, the association of workmen, managers, technicians and directors, is not an association recognised by the law. The association which the law does recognise—the association of shareholders, creditors and directors—is incapable of production and is not expected by the law to perform these functions" (Percy, 1944: 38; quoted in Goyder, 1961: 57).

As indicated by Percy and Goyder, the basic solution is the re-constitutionalizing of the corporation so that the "human association which in fact produces and distributes wealth" is recognized in law as the legal corporation where the ownership/membership in the company would be assigned to the "workmen, managers, technicians and directors" who work in the company.

[7] "One can even say that wages are the rentals paid for the use of a man's personal services for a day or a week or a year. This may seem a strange use of terms, but on second thought, one recognizes that every agreement to hire labor is really for some limited period of time. By outright purchase, you might avoid ever renting any kind of land. But in our society, labor is one of the few productive factors that cannot legally be bought outright. Labor can only be rented, and the wage rate is really a rental" (Samuelson, 1976: 569).

### *4.2 The bundle of corporate rights*

We are now in a position to parse the rights involved in a corporation so that we may consider how the rights might be differently structured in a democratic firm based on first principles. We simplify down to the essentials: the voting rights (to elect the board to select the management and to vote on any other questions put to the owners/members) and the economic value rights, which can now be parsed into the net asset value, and the profits rights. The net asset value is for the current time but the voting and profit rights need to be broken down into the current rights and future rights after the current time period (since in a worker cooperative, the current workers are not necessarily the same as the future workers—see below). Thus we have the following taxonomy:

**Table 1. Corporate rights**

| |
|---|
| A. Voting Rights |
| A.1. Current Voting Rights |
| A.2. Future Voting Rights |
| B. Value Rights |
| B.1. Profit Rights |
| B.1.a. Current Profit Rights |
| B.1.b. Future Profit Rights |
| B.2. Net Asset Value |

In the conventional joint stock company, these corporate rights (voting plus value rights) are property rights represented by the common voting shares that may be owned and freely transferred as any other property rights. The point is to see how a worker cooperative or democratic corporation would restructure these rights.

### *4.3 The structure of rights in a democratic corporation*

In a democratic firm such as a worker cooperative, the corporate ownership rights are not only rebundled but are assigned on a different basis. The voting rights are assigned on the basis of democratic principle of self-government. The people working in the firm are the only people under the management of the firm's managers so by the democratic principle, the voting rights to elect those managers (perhaps indirectly through board election) should be assigned to the people working in the firm. Note that this assignment to those people is based on the assumption that those people are playing a certain functional role, i.e., working in the firm. They do not "own" the voting rights as property rights to be held or sold independently of their functional role. It is the

same with voting rights in a political democracy. For instance, the voting rights in a democratic town or municipality are attached to the functional role of residing in the town or municipality.

We call rights assigned to a functional role *personal rights*. Where the entitling functional role is just being a person, then those personal rights are the basic human rights. In a democratic community of work or of residence, then the functional role is working in or residing in the community. In any case, such personal rights may not be sold as alienable property rights since the buyer may not have the entitling role (e.g., the "selling" of voting rights in a city or country to a non-resident or non-citizen would be invalid); and if the "buyer" had the entitling role, then he or she would already have the rights on that basis. That is also why such rights are "one per person", e.g., one-person/one-vote, unlike property rights that can be purchased in any quantity.

The workers in the firm change so the assignment of the voting rights will change with the workforce. The future workers, like the future citizens in a political democracy, do not have to buy their voting rights from the present holders. Hence the separation of the (A) Voting Rights into the (A.1.) Current Voting Rights and (A.2.) Future Voting Rights. It is the (A.1.) Current Voting Rights that are part of the bundle of *Membership Rights* attached to the functional role of currently working in the democratic firm. The (A.2.) Future Voting Rights would be assigned when the future becomes the present.

The second normative principle, here called the *responsibility principle*, is just the standard jurisprudential norm of assigning to people the legal responsibility for the results of their deliberate and intentional actions. The intentional actions of the people working in the firm produce the outputs by using up the raw materials, intermediate goods, and the services of the durable goods in the firm. In net terms, the revenue from the outputs minus the non-labour costs for the inputs is the net valued added which can be parsed as: wages plus profits. That is the net value of the assets (outputs) and the liabilities (for non-labour inputs) that the people working in a firm are jointly *de facto* responsible for producing. Hence, by the responsibility principle, they should legally appropriate those assets and liabilities and thus receive the net value added. Since they already receive the wages, the additional value accruing to the people in a democratic firm is the (B.1.a.) Current Profit Rights. Thus, those rights would also be in the bundle of membership rights assigned as personal rights to the functional role of working in the firm. As one might expect, the (B.1.b) Future Profits Rights represent the future positive and negative products that would be assigned to the future workers who produce them.

Thus on the basis of the first principles of democracy and private property (responsibility), we have accounted for all the rights except the (B.2.) Net Asset Value rights.

Current workers will, to be sure, use up the capital services derived from the company's assets and that is why they are held legally responsible for those liabilities, but we are now concerned with the rights to the net asset value. This value represents property assets and liabilities accumulated in the firm by production and exchange activities in the past.

The system of internal capital accounts (or divisible reserves), pioneered by the Mondragon cooperatives (Ellerman, 1990; 2007), is the means of keeping track of that history in a democratic firm so that the net asset value is owed in varying amounts to current and past members. These

accounts should be thought of as like savings accounts within the firm, i.e., as an internal form of debt capital since no "equity rights" (voting or profit rights) are attached to capital in a worker cooperative. Indeed, the internal capital accounts should be interest bearing. The members contributed to that value through any membership fees paid in and through any profits (or losses) retained in the firm rather than being paid out (or assessed in the case of losses). Those net asset rights (B.2.) are property rights, not personal rights. One litmus test to distinguish personal and property rights is inheritability. If a member dies, the voting and profit rights (like political voting rights) do not pass to the person's estate, but the internal capital account balance would be a debt of the company to the estate of the deceased member. In any case, the ending balance in an individual capital account is a debt of the cooperative to the member or member's estate when the member exits from the firm and should be paid out over a period of years.

There may also be a collective or unindividuated account that is part of the net asset rights (B.2.). For instance, when the cooperative is first established, there may be an endowment from the past that the worker-members should not appropriate to themselves in their individual accounts. There is also a self-insurance rationale for such a collective account. Since it is an obligation of the cooperative to eventually pay out a member's individual account, that burden might be lessened by allocating a certain percentage of each year's net income as a self-insurance premium to the collective account. That insurance then "pays off" when a similar percentage of losses are allocated to the collective account. Also small labour-intensive cooperatives without much capital may find it impractical to maintain individual capital accounts.

Another practical consideration is a "roll-over" scheme where each entry in an individual account is paid out, say, eight years after the entry is added—where any losses would be applied to the oldest entries. If an entry has "run the gauntlet" for the eight years, then it should be paid out. This will slowly reduce the balance in the older members' accounts (so they won't bear the bulk of the risk) and increase the balance in the younger members' accounts as the younger members are, in effect, slowly paying out the retained profits of the older members (for more on the roll-over scheme, see Ellerman, 1990). Much experimentation is needed to determine the best way to run the system of internal accounts.

### *4.4 Controversy about capital structure in worker cooperatives*

There are also some controversies about the capital structure of worker cooperatives. In practice, some cooperatives have no internal capital accounts so the whole equity is "social ownership". This may be a holdover from muddled Marxian notions of "social ownership of the means of production" *as if* the members' share of retained net income in their capital account would be "private ownership" having voting and profit rights attached to it—which, as explained above, is not the case.

While the amount in a member's capital account does not affect their share of future profits or voting rights, that amount was built up through the past retention of net income that represented the fruits of their past labour. Therefore "socializing" that value of the fruits of their labour (through

misplaced Marxian moralizing against "private ownership") is an infringement of their rights—usually resulting in members wanting to pay out all net earnings and finance any capital additions with debt. Why should members' forfeit any claim on their earnings that they choose to keep in the firm for a while (e.g., to help get a bank loan for the rest of a capital good acquisition)—earnings they could have paid out to themselves as their individual property?

In fact, this whole discussion about individual versus collective internal capital accounts (and personal versus property rights) may be too complicated to fit into the simplistic Marxist scheme of "ownership of the means of production". Within that scheme even though a worker cooperative has membership based on labour and even if all capital assets financed by external debt, as long as those assets are owned by the cooperative itself, that is "private ownership of the means of production" and thus capitalism.

> "In such a case, the founders of the firm are indeed entitled to appropriate both the firm's output and the assets they have purchased; and, as soon as the firm is fitted out with the required production equipment, they become the owners of the firm's capital goods although they merely borrowed their capital. Consequently this is a capitalist system proper" (Jossa and Cuomo, 1997: 111).

Thus the Marxist reasoning reaches the silly conclusion that all western worker cooperatives like the Mondragon cooperatives are "capitalist" since the cooperative as a corporate entity (and not the government or "society") owns its own capital assets.

Unfortunately, the Yugoslav system of socialist self-management never advanced beyond that muddled Marxist notion of social ownership, which created a number of problems to say the least. One horizon problem (Ellerman, 1986) was that it removes the incentive for older workers to support any reinvestment of money they could have taken home since they will not be around to use any capital assets thereby self-financed by the company. When the members resisted retaining earnings since that would wipe out their claim on *their* earnings, the state took partial control of their earnings by imposing capital maintenance requirements. Moreover, in the end of the tragic Yugoslav case, the "social ownership" created the legitimation, when political socialism broke down, for the various successor republics to take over the firms and sell them as conventional companies.

Well-structured worker cooperatives, like the Mondragon cooperatives, are *private* democratic organizations, not some sort of quasi-governmental entity.

**Table 2. Comparison of Structure of Rights**

| Rights Structure | Capitalist Corporation | Democratic Corporation |
|---|---|---|
| Current membership rights (A.1. + B.1.a.) | Owned as property rights by shareholders | Assigned as personal rights to the current workers |
| Future membership rights (A.2.+B.1.b) | Owned as property rights by shareholders | Assigned as personal rights to the future workers |
| Net Asset Value rights (B.2.) | Owned as property rights by shareholders | Owned as property rights by the current workers (assuming no collective account) |

In summary, we have seen how all the corporate ownership rights are rebundled and assigned in a democratic firm. The current voting and profit rights are bundled together as the *membership rights* attached to the functional role of working in the firm (in practical terms, usually after a certain probationary period) so the future voting and profit rights would go to future members, and the remaining net asset value rights are captured in the system of internal capital accounts held by the current members. The rights structure in the so-called "capitalist corporation" and the democratic corporation can now be compared point-by-point in the following table.

One important thing to notice is that in the democratic firm, the whole notion of the "ownership" of the company has evaporated. The old debate between private and social ownership of companies has been reframed. It is precisely the application of the private property principle to the *products* of labour that entails the company (implementing that responsibility principle) cannot itself be property. The membership rights are personal rights, not property rights, so a democratic company cannot itself be property. Similarly a democratic town or municipality may own property but is not itself a piece of property.

Hence, we have finally arrived at an analysis very different from the usual treatment of privately owned conventional firms versus worker cooperatives or democratic firms. The democratic firm is a democratic human organization, and it is quite muddled and misleading to describe it as a piece of property that is socially or commonly owned. And its "non-ownership" follows from the private property (responsibility) principle applied to the products of labour.

## 5. Concluding Remarks

We have suggested such a fundamental rethinking of the property rights issue. The current dominant economic system is in fact based on a violation of the principle on which private property is supposed to rest: the same "fruits of our labour" principle that is just the usual juridical principle of imputing legal responsibility in accordance with de facto responsibility. When private property is refounded on that just foundation, then economic enterprises would be re-constituted as democratic firms such as worker cooperatives that are democratic human organizations (not pieces of property to be privately or socially owned).

Re-constituting firms as workplace democracies would reverse the mother of all disconnects, the absentee ownership of companies on the stock market, that has institutionalized the cancer of social irresponsibility on an unprecedented scale, as exemplified in the American form of Wall Street capitalism. With people empowered in their own enterprises, they would then be able to follow their natural self-regard not to foul their own nests and their natural social sympathies to sustain their own geographical communities.

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