Economic Democracy: Towards a Feasible Socialism for the 21st Century

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*Power to the People!*

- Protest slogan

*The victory of democracy, the creation of democratic social and political organizations, is the indispensable precondition for the realization of socialism.*

- Eduard Bernstein ([1899] 1993, p. 157)

*The task for a modern industrial society is to achieve what is now technically realizable, namely, a society which is really based on free voluntary participation of people who produce and create, live their lives freely within institutions they control, and with limited hierarchical structures, possibly none at all.*

- Noam Chomsky (qtd in Albert & Hahnel, 1991a, p. 13)
Part One: Introduction
Chapter 1
Introduction

1 Introduction

In these days it is easy to be cynical about political democracy. Skeptics point to low levels of turnout in national elections, the degree to which money corrupts the process, the difficulties of mass participation in large and complex systems, the lack of opportunities for participation at local levels, as well as the informal hierarchies that emerge even in the most democratic of organizations. But despite this skepticism, one fact emerges as practically indisputable: almost all regular people, in every corner of the globe, prefer democracy to the lack of it. Since 1900 the number of democracies (understood simply as countries with multiple competing parties and universal suffrage) has exploded: from zero to twenty-two by mid-century to 119 by the year 2002 (Warren, 2002). The recent wave of democratization following the Arab Spring reminds us that there is every reason to believe that this trend will continue.

Facts like this should remind us that for all its limitations, democracy is hugely important. In 1994 millions of black people in South Africa formed huge lineups waiting in the rain and shine for three days to cast their votes for the first time in their lives. It was the culmination of a struggle that the African National Congress and others had been fighting for over 80 years.1 In 2010, millions of Egyptians took to the streets, occupying Tahrir square, risking jail, mistreatment and even torture, in a defiant call for democracy that finally brought down a dictatorship of thirty years. Of course these people had heard all the reasons why some are skeptical about democracy; they were as familiar as could be with anti-democratic attitudes and arguments. But their actions spoke louder than words that notwithstanding its limitations democracy is worth fighting for.

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1 The South African case is interesting since in certain respects the high hopes that the ANC had about the power of political democratization to transform the country have been disappointed. Although everyone would agree that political democracy has brought a range of vitally important improvements to the lives of the average person, it is also true that the hopes for political transformation have been undermined in many respects by the continuation of private economic power and massive economic inequality (Klein, 2007). Political democratization, in other words, has crashed headfirst into the wall of private economic power.
Why is it exactly that over the last 150 years so many people, from England to Egypt, have risked life and limb struggling for democracy? On the one hand, a central motivation is that democracy provides basic formal equality. It gives all adults regardless of status or stature an equal formal say in the structuring of their laws, poor as much as rich, blacks as much as whites, which is why it is incompatible with systems like apartheid. On the other hand, people fight for democracy because of the basic civil liberties that it provides. For democracy to work citizens need to be able to talk freely, to meet and form groups, to criticize the government and so on – so political democracy and basic rights (free speech, free assembly, freedom of conscience, etc.) go hand in hand (Bobbio, 1987). In a more general sense, and one that we will refer back to frequently, democracy provides two essential kinds of freedom: accountability and self-determination. Accountability prevents the government from acting in secret or throwing dissenters in jail. It forces the government to pay attention to the needs of the people – which is why democratic states never have famines (A. Sen, 1999). Moreover, democracy provides the freedom of self-determination, allowing the population to collectively map out their basic priorities for the future. This is why the democratic drive to decide one’s future oneself goes hand-in-hand with struggles to overthrow outside or elite interference, be it colonialism, racial domination, military dictatorship, landed gentry, or any other force that prevents popular self-determination.

In other words, one of the main reasons that people in the West are skeptical about democracy is simply that they have forgotten how terrible the alternative is. But there is a second, more justifiable, reason for skepticism, which is that democracy in practice has to a large extent betrayed its promise of real equality. A large part of the appeal of a democratic society is the promise of equality, the idea that all will be able to equally partake and participate in social life. Aristotle articulated the hope in the power of democracy like this: “For if indeed freedom and equality are most of all present in a democracy, as some people suppose, this would be most true in the constitution in which everyone participates in the most similar way” (1998, p. 110 [1291b34]). However, Western states have now had political democracy for a hundred years, yet the expectation that this would lead to deep, substantive equality, has nowhere been realized. Not even close. To take one example, the US has had universal suffrage (at least among whites) for
over ninety years, yet Bill Gates has sufficient wealth to employ 236,000 of his fellow citizens. To update Tocqueville, one might say that although the surface of American society is covered with a layer of democratic paint, one can still see, particularly in the economy, the old oligarchic colours breaking through ([1835] 1945, Vol 1, Chap 2.). As societies have evolved it’s not surprising that feelings of skepticism and disillusion have accompanied this disjuncture between democracy in theory and inequality in fact, resulting in widespread political apathy. With this in mind I want to suggest one intriguing possibility: it’s not quite right to say that democracy has failed in its egalitarian objectives, since it has not yet been comprehensively tried. A genuinely democratic society cannot quarantine democracy in its political structures, it must spread beyond formal political structures into the economy itself, since it is the economy that is the root of much social inequality. I want to suggest the hypothesis, which I hope to substantiate throughout, that only when political democracy evolves to include economic democracy will our societies have any chance of establishing meaningful equality for all.

While struggles for political democracy were a central issue for much of the 19th and 20th centuries, I suspect that the 21st century will witness similar struggles, but this time for economic democracy. This is not to say that economic democracy is any kind of utopian vision – as we will see, democratizing the economy contains many of the same limitations and constraints as political democracy. Yet for all that, it is still much better to have it than to not have it. At the end of the day it likewise offers the promise of real concrete improvements for the population at large.

2 The Democratic Paradox

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2 Based on Gates’s 2011 wealth of roughly $59 billion, divided by the median personal income for American adults of roughly $25,000.
3 Of course, the economy is not the root of all inequalities. The institutional changes I discuss here do not directly address other systemic inequalities such as patriarchy, homophobia, racism, or ableism.
4 Interestingly, the struggles for political democracy launched in the Middle East by the Arab Spring of 2010 have now inspired a mass movement, particularly in the Western countries, for more economic democracy in the form of the Occupy movement.
Societies in the West are fervent about their democratic credentials. Our politicians give speeches extolling the virtues of democracy, our self-conception of being citizens in a democratic state is deeply ingrained in our identity. And yet, despite this, a central part of society, the economy, has very little democracy in it at all. Workers do not elect the managers of their firms. Bankers do not allocate finance with any accountability to the communities in which they operate. Investment decisions are not made with any participation of the citizenry. It’s like we have erected a wall down the middle of society, and said in this half, the economy, there is no need for democracy, while at the same time insisting on calling society as a whole “democratic”. So we must ask ourselves: is this acceptable?

Another way to see the paradox is to recall that a fundamental democratic principle is that public power should be accountable to those who are affected by it, i.e. the public. This is a basic safeguard against tyranny and one of the most fundamental rationales for having democracy at all. Yet in a variety of ways, managers, employers, investors and financiers clearly exercise power too. Their decisions have *massive* social and public consequences – from a manager’s decision to lay off a thousand workers, to a corporate decision to invest in dangerous deep sea oil extraction, to bankers’ decisions to provide risky sub-prime mortgages and resell them as complex debt instruments – these decisions have undeniable public consequences. Yet in stark contrast to our political system we do not demand that these people be accountable to those affected in any standard democratic way. How is this justifiable?

These are thus the central questions that motivate this study: does a commitment to democracy, which many of us share, imply that we should be open to expanding it into the economy? Can we truthfully call ourselves democrats while at the same time maintaining an economy along traditional capitalist lines?

### 3 The Argument
The central goal of this book is to place the economy under a democratic microscope. In other words, to analyze the core parts of the economy in a comprehensive manner in order to ask whether it is desirable to expand democracy in such places. In doing so we will investigate both the theory and practice of economic democracy. The economy is studied in three sections: workplaces, the market, and finance/investment. These areas constitute the main cornerstones of the economy. Workplaces, finance and investment institutions are the main loci of economic influence and power (the market ties them together), and so are the most important points on which to focus our analysis. In each of these sections, one chapter investigates the normative and theoretical side of the question, i.e., should this aspect of the economy be democratized? Would the pros of doings so outweigh the cons? And one chapter investigates the practical and empirical side of the question, i.e., do the democratic alternatives work well in practice? Do their benefits outweigh their costs? How could transition occur from the institutions that exist today to more democratic institutions that might exist tomorrow?

In a nutshell the basic argument is the following: capitalist societies in the West today contain extremely unequal amounts of wealth. This unequal wealth is translated through several main mechanisms into unequal access to decision-making power. Those with substantial wealth have power in many ways, but their wealth is translated into socially relevant power (i.e. sustained relationships of power over other people) in three main areas.

(i) Workplaces – in these associations, the power of owners and managers directly affects the freedom of the internal workers.

(ii) Finance – the power of financiers to provide/restrict credit makes the economy grow or falter in ways which directly affect the freedom of the nation’s citizens.

(iii) Investment – the power of businesses to invest/divest likewise causes the economy to grow or falter in ways which directly affect the freedom of the nation’s citizens.
The power that is exercised over workplaces, finance and investment is, I claim, for all intents and purposes political power, since it involves public, sustained relationships of authority and subordination, resulting in fundamentally different levels of freedom for different people. Unaccountable, unequal political power in a democratic society is unjustifiable, and so new economic arrangements should be experimented with in order to allow these sources of power to be accountable to the citizenry on a formally equal basis (cf. C. Pierson, 1992).

Developing these arguments means challenging some common taken-for-granted beliefs in modern society: obviously it challenges the belief in a fundamental separation between the political and the economic, as well as the belief that contemporary complex economies necessarily require formal hierarchy (in the sense of having unaccountable top-down power). This, I will argue, is wrong. A non-hierarchical economy is entirely possible and indeed much preferable. Of course, that does not mean that authority structures are unnecessary, or that everyone can participate in every decision, nor that there can be complete equality between decision-makers and decision-takers, but it does mean that there is nothing inevitable about having powerful decision-makers who are unaccountable to those significantly affected by their decisions. The existence of public power without accountability is a throwback to a feudal era; it has no place in a genuinely democratic society.

Chapter 2 situates economic democracy within the main political traditions. In chapters 3 and 4 I analyze workplaces and suggest, with several important caveats, that they be

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5 Throughout this book the term “hierarchy” is understood to refer to an organization that formally institutionalizes inequality in its structure. Power and authority resides in a pyramidal structure or chain-of-command, and is unaccountable to those below. The distinct levels or ranks of people acquire different material, moral, and/or cultural privileges. Examples include, states (like apartheid South Africa, or contemporary Burma), traditional armies and militaries, and conventional capitalist firms. “Democracy” is understood to mean, by contrast, an organizational structure where ultimate authority resides in the membership in an egalitarian one-person one-vote manner. Those at the highest level are elected by and fundamentally accountable to those below. Examples include Western parliaments as well as cooperative firms. Democratic structures can range from representative and pyramidal to flat and participatory. Additionally, it is possible to have “informal hierarchies”, where informal relations of inequality exist within democratic structures, so that power and authority may be officially accountable but practically unaccountable. Most real world democratic structures include examples of this, from patriarchy, to ableism, to the tyranny of the educated and eloquent.
democratized and transformed into workers’ cooperatives. Chapters 5 and 6 examine the
democratic strengths and weaknesses of the market, specifically in terms of the ability to
vote with one’s dollars, and the possibility of shaping the market system to better foster
democratic businesses such as co-ops and credit unions. In chapters 7 and 8 I argue that
the present systems of finance and investment are deeply and problematically
undemocratic. I contend that finance should be democratized through the use of capital
controls, promotion of credit unions, and creation of democratic community banks, and
investment should be democratized through mechanisms of public investment,
particularly at the local level, for example through participatory budgeting. The
concluding chapter – chapter 9 – brings together the strands of all the previous chapters
to offer a vision of what a society with evolved economic democracy might look like. It
is a vision of market socialism which is bottom-up, thoroughly democratic, and
fundamentally different from the state-socialisms of the 20th century. The chapter
describes how the different democratic components – the worker co-ops, the community
banks, the capital controls, the participatory investment structures, and the regulated
cooperative market system – fit together and sustain each other.6

While I think that economic democracy does have significant potential to improve
society, it must be remembered that no reforms are ever costless. Making changes in
social life always involves tradeoffs and the introduction of new costs alongside the new
benefits. It is a central goal of this book to try to illustrate the relative costs and benefits
of democratizing the economy in a clear and balanced manner. In general the main
benefits that flow from increased democracy, at least when the democratic institutions
work well, are those of increased freedom (in terms of accountability as well as self-
determination), increased equality (in terms of formal rights and status), and less
hierarchy, alienation, and powerlessness. Economic democracy also promotes an
important range of corollary benefits from environmental protection to increased

6 Throughout this work, I inevitably look at reforms in three areas (workplaces, the market, and
finance/investment) much more than others. This is of course not to imply that these are the only issues that
matter for left politics. But it is to claim that for a 21st century version of socialism to be desirable, it must
at the very least involve the democratization of core economic power in these areas.
happiness (that flows from the greater equality, cooperation, and trust which democracy brings).

The general costs include the risk of bad outcomes from decisions that uninformed participants may make, the public costs of facilitating the spread of democracy in workplaces and financial institutions, particularly in terms of the higher tax rates for wealthier individuals, and the administrative costs of monitoring public institutions and combating corruption. Additionally, there are important constraints on democracy which are not costs as much as they are recurring limitations that show up again and again in the actual practice of democracy. The most important of these are size, complexity, and unequal participation. Robert Michels (1911 1962) in his classic work on democracy argued that size and complexity inevitably undermine democracy by leading to oligarchy. While Michels thought this was an “iron law”, it’s more accurately seen as a tendency that always exists, but one that, as we’ll see, can be mitigated with appropriate awareness and institutional safeguards. Furthermore, scholars such as Jane Mansbridge (1980) have illustrated the ubiquity of unequal participation (what I call the “tyranny of the eloquent”) that so often undermines the ideal of egalitarian democratic participation. This defect too can be mitigated, even though it remains a constant danger. Being aware of these constraints is important because it sensitizes us to the fact that structures of democracy can all too easily be undermined by informal hierarchies that arise from size, complexity and unequal participation. In the real world deepening democracy is never done once and for all; it is a constantly evolving process.

For all these reasons democracy is both a constant hope and a continual disappointment. Yet it seems to me that in most cases, the benefits of expanding democracy into the economy outweigh the costs of doing so, but of course each of us must ultimately make this calculation on our own.

It is also perhaps useful to say a word about what this book is not about. Economic democracy is not the solution to all economic problems nor the panacea to all economic injustices. In particular, economic democracy is concerned with the social dimension of the economy – considering people as workers and as citizens involved in economic
associations with others. Economic democracy has much less to say about the individual dimension of the economy – much less attention is given to individuals as private consumers. This is not at all to say that such issues are unimportant. Indeed it may well be that the single most urgent need for economic justice today is to provide poor individuals with more consumption power by giving them more money and better public services. Such arguments are undeniably important, but they will not be made here. I sidestep issues of individual economic freedom and unfreedom, not because they are unimportant, but because others have talked about them at length. A discussion of some of the problems of the social relationships within the economy and a potential remedy through economic democracy, is more than enough material for one book.

4 Why Does Economic Democracy Matter?

On September 17, 2011, a small group of protesters occupied Zuccotii park on Wall Street. This tiny gathering sparked a mass movement. Within two months the protests had spread from New York to 951 cities in 82 countries across the world, clearly demonstrating the overwhelming interest and popular concern with issues of economic justice and inequality (Rogers, 2011). However, it is undeniable that the direction and goals of the movement are often amorphous and vague. I am not the first to suggest that economic democracy has the potential to be one of the unifying and orienting ideas of this broad new social movement (Arsdale et al., 2012). What do the Occupy protesters want? What are their economic goals and what is their underlying vision? These pages represent an attempt to provide at least a partial answer to these questions.

There is no standard usage of the term “economic democracy”. While the main themes that fall under it – ranging from cooperatives to public investment to regulating the market – have long been familiar points of discussion in political economy, the term itself has only become commonly used since the 1980s, and still today it is not particularly widespread. Probably the most common use of the term is simply as a synonym for workplace democracy or worker participation, indeed some of the most prominent books
on the subject have focused almost entirely on the question of workplaces (Archer, 1995; Dahl, 1985; Ellerman, 1992). That said, other authors have used the term “economic democracy” as a label for very diverse issues: from pension funds in Sweden to codetermination in Germany to Employee Stock Ownership Plans in the US. There is now a sizable literature on many different aspects of economic democracy, with some authors focusing particularly on workplaces, some on investment and finance, and some on the market itself. Unsurprisingly much of the work in one of these areas has important implications for other areas. For example, a common theme of workers’ cooperatives is that they struggle to acquire external finance. So the question of expanding workplace democracy is necessarily linked to a question of finance. For another example, it’s sometimes argued that the market would be more democratic if the population had more equal amounts of wealth (so that people had similar numbers of dollar-votes), yet trying to reduce inequality is very difficult so long as private investors can threaten capital strike. This means that democratizing the market is inherently tied up with democratizing investment. However, to date there has been an unfortunate lack of work which attempts to bring together these disparate strands into a coherent and cohesive whole. Such is a central purpose of this book. It’s an attempt to provide a synthesis of the main strands of economic democracy and to integrate the parts into a whole.

There are several reasons why a project like this is important. First, looking at economic democracy as a whole allows for a comprehensive perspective that is too often lost from a narrower focus. It allows us to appreciate the interconnections and interdependencies of the parts, and recognize how the pieces fit together, like the sides of an arch which are fused together by the weight of each on each. Second, a synthetic project like this allows us to bring together theory and practice, the ideas of how democratic institutions should function, with the empirical records of how they actually do function. This is useful since pure theory by itself can often lack the compelling force and messy texture of real world example, whereas pure reliance on current evidence can prevent us from seeing beyond the actual to the desirable. Moreover, bringing together theory and practice is particularly useful because it allows us to consider the question of transition. The most elegant theory in the world will convince no one if there is no understandable explanation about how to get there. This is why every empirical chapter of this work explicitly takes up the
question of how we might transition from the institutions that exist today towards democratized ones.

Of course, the question of transition has a sociological as well as a political-economic component. The former (which is beyond the scope of this work) asks important questions about the specific political alignments, social movements, party politics, and so on that make social change likely or unlikely in various contexts. The latter, which is our focus, asks how the broad institutions of the present might evolve into the institutions of the future. If the political will existed to make such reforms possible, then would the institutions work? Would they be sustainable? And would they deliver on their promises? From this kind of institutional perspective, one can think about transition at three different levels of abstraction. The first is the level of immediate reforms, i.e. things that are possible now. The second level is that of longer-term reforms – things that significantly change the balance of power or deeply shift the way institutions function. The third level is that of revolutionary changes – thinking about what a fundamentally different society might look like and how it might function. This work is situated mainly on the second level. The proposals advocated here are things that a variety of social movements could incorporate into their longer term visions as a way of orienting their struggles. In particular I’m interested in exploring the continuities that exist from the first to the second level, in other words, the immediate reforms that have the potential to lay the groundwork for deeper seismic changes. In other words, the task is to try to illustrate how a significantly different society (even a socialist society) might evolve, slowly and incrementally, out of the present society – without falling back on the theoretical crutch of revolution, which allows one to imagine that any change can simply happen “after the revolution”. Concretely, I want to show that economic democracy can be incrementally and institutionally realized by slowly democratizing workplaces, alongside increasingly democratized financial institutions, in the conducive framework of a cooperative market system – and demonstrate how these features interlock in a coherent fashion. Of course in the real world the processes of democratization would likely proceed by parts, unevenly, and with substantial experimentation, but the point is not to predict how changes would actually happen in specific countries, but to try to clarify the institutional requirements for reform to be robust and stable.
The third and final reason for studying economic democracy as a whole is that it offers a compelling vision of societal change. Many on the left today feel easily demoralized and pessimistic without being able to offer a serious model of a better alternative. In the 1960s Milton Friedman ([1962] 2002) famously declared that there are only two possible ways of organizing complex economies: free market capitalism (along the lines of the US) or state-socialism (along the lines of Russia). With the decline of state-socialism, Margaret Thatcher was happy to draw the conclusion that only one possibility remains, declaring triumphantly that “there is no alternative” (TINA). Of course, many progressives are rightly skeptical of the idea that history is over, or that American-style capitalism is the only option. But nevertheless it’s true that large sections of the left, from trade unionists to Occupy protestors to community organizers, are much better at articulating what they are against than what they are for.\footnote{Of course I do not mean to imply that the left has produced no visions of alternatives in recent years, see for example, the following visions of social democracy (Jonas Pontusson, 2011), democratic socialism (Roemer, 1994; Schweickart, 1996; Wright, 2010), Marxism (McNally, 2002), and anarchism (Albert, 2003).} The rhetorical trump card of conservatives asking “what is the alternative?” is still a devastating question, all too often met with unease, confusion and silence.

Part of the problem is that left theorists have long been skeptical about model building, following Marx’s (1873) warning against writing recipes for the cookbooks of the future. While there is wisdom in the warning that the complexity of society is so great that we can never accurately predict what will occur in a complete way, there are nevertheless several good reasons why model building is a useful endeavor. (i) There is a difference between a model as a blueprint for a future order, and a model as a compass providing orientation and direction. While it is probably impossible (not to mention hubristic) to try to draw complete blueprints of social phenomena as hugely complex as economies, there is value in having a model that serves as a compass: it provides a fixed point to which people can orient their struggles. Having a goal to aim towards is crucial for thinking strategically about what kind of reforms we should engage in now in order to move in the direction we want to go. (ii) As mentioned before, visions of an alternative help combat the cynicism and hopelessness that comes in the wake of a dominant cultural belief in TINA. At least for some people, having a model to strive towards is empowering and
invigorating. (iii) As Eric Wright (2010) points out, the loss of belief in fundamental change has also weakened the achievability of more moderate reformist measures. So even for people whose goals are more short-term, by helping to reconstruct comprehensive visions of feasible change we also augment possibilities of immediate reform.

5 Central Objections

A project of this type tends to face resistance from everywhere. Liberal readers may see it as utopian. Socialist readers may see it as compromised by compromise, or as dirty reformism. There is a sense in which both charges are accurate, yet there is a deeper sense in which the aim of this project is to extend the common ground of a variety of readers. That said, clearly no work can address itself to everyone. The bulk of this book is aimed at the progressive mainstream – liberals and social democrats – who feel the pull of the ideals of equality and freedom, so cannot help but feel some discomfort towards the reigning inequality of our societies. This work tries to exploit this discomfort by showing how the basic ethical commitments that many of us share (about freedom, social equality and democracy) should, when taken to their logical conclusion, lead to the support of very different institutions than those which presently exist.

There are three predominant objections to economic democracy that recur frequently enough that it is worth mentioning them up front. First, it’s important to ask why such a system is superior to social democracy (i.e., a system that makes extensive use of markets, but regulates them heavily and uses the state to partially redistribute market outcomes for reasons of social justice). The second objection is the worry that economic democracy invariably risks economic inefficiency and therefore undermines prosperity. The third is the worry that more democracy may in fact be antithetical to freedom (by suppressing minority rights, by encouraging capricious decision-making, or by silencing those who are less good or able at participating, etc.).
These objections are legitimate and serious, yet throughout this work I hope to convince the skeptical reader that they are not at all fatal. Here we can just point to the bare bones of the rebuttals that will be further elaborated later. First of all, we can expect that economic democracy would be significantly freer than social democracy. Workplace democracy allows, for the first time in history, ordinary workers to participate in the management of their firms with others who are peers and of equal status. Democratizing finance and investment allows for increased accountability and self-determination in the economic development of people’s communities. In addition, economic democracy allows for a much more egalitarian society than social democracy. Not only do co-ops compress incomes, but democratizing investment allows for higher levels of redistributive taxation than social democracy can achieve. We will see that this greater equality of income and status promises a host of additional benefits from better health to increased happiness.

Neither is it the case that democratizing the economy brings with it severe inefficiencies. On the contrary, the evidence is compelling that in many instances democratized institutions operate with just as much economic efficiency as capitalist institutions – even though they tend to produce superior social outcomes. In terms of workplaces, what democratic firms lose in terms of motivation from fear of the boss and the single-minded obsession with profits, they gain from the reduced demoralization, increased trust, and improved motivation of being one’s own boss. Similarly, at the economy wide level, societies which have more market regulation, higher taxes and more generous welfare systems (such as the Nordic countries) turn out to be no less efficient than the more capitalistic market systems (like the US). This is largely because what is lost in terms of incentives (from high taxes and generous welfare) is balanced out by increased opportunities and capabilities that are acquired from heavy public investment.

Lastly, it’s true that the relationship between democracy and freedom is a complex one. When it works well democracy is deeply conducive to freedom. Indeed, in its essence democracy is the basic institutional form of social freedom. When it works well and when conditions are right, democratic institutions can foster self-determination, which is a fundamentally important aspect of freedom that is all too often lacking in contemporary
societies. But of course, things often do not work well. We should have no illusions about the inevitability of democratic structures leading to greater freedoms. As we shall see, all too often democratic structures get undermined by a host of informal hierarchies and internal constraints. But recognizing such constraints is the first step in dealing with them. The bottom line is that democratizing the economy can indeed offer profound improvements in the amount of freedom that most individuals enjoy, but only by being vigilant about the defects and informal hierarchies that inevitably arise and being committed to an ongoing process of experimentation with fixing them. For democracy, the goal is the process and the process is the goal.

6 Radical Realism

The methodological approach used here is one that I call radical realism. It is inspired by works in political science that are concerned with feasible socialism, such as Robert Dahl and Charles Lindblom’s *Politics, Economics, and Welfare* ([1953] 1976) and Alec Nove’s *The Economics of Feasible Socialism* (1991). The essence of radical realism is the conviction that we should be radical with our goals, but realistic about our means. Radical realism is radical in the conviction that our political-economic institutions should foster freedom, equality, and solidarity as much as possible. Unfortunately, in the social sciences, radicalism is often denigrated as utopian. Roberto Unger puts it like this, “If I propose something distant, you may say: interesting but utopian. If I propose something close, you may answer: feasible but trivial. In contemporary efforts to think and talk programmatically, all proposals are made to seem either utopian or trivial” (2000, p. 29). While it is important to avoid utopianism in the sense of unrealistic, ahistorical analysis, we should not avoid utopianism in the good sense of the word: having conviction that the world can be a fundamentally better place that it is now. As Oscar Wilde (1891) reminds us, “a map of the world that does not include Utopia is not worth even glancing at, for it leaves out the one country at which Humanity is always landing. And when Humanity lands there, it looks out, and, seeing a better country, sets sail. Progress is the realisation of Utopias”.

Radical realism is realistic in three main senses. First, it starts from the premise that there are intractable tensions and conflicts in social life that cannot be wished away. These tensions come partly from the inevitable messiness of institutions and partly from the happy fact of human plurality – that different people have irreducibly different projects, priorities and values about what constitutes a good life. This means that all feasible politics is a politics of compromise. Those who seek purity by way of the abolition of tension and contradiction are doing something – theology perhaps – but whatever it is, it’s not politics. Second, radical realism assumes that while some institutions may be better than others, all institutions have costs, and so the focus is on weighing the costs versus the benefits of different political-economic possibilities. In general, political scientists tend to focus on the four most common kinds of political-economic mechanisms: markets, democracy, state/bureaucracy, and unions. These provide freedom in different ways (via exit and dollar “votes”, via voice, via regulation, and via a combination of regulation and voice), and they all come with different kinds of costs. A general goal of this book is pointing out the specific areas in which democracy is the preferable institution. Third, radical realism is essentially reformist. It assumes that in a democratic society, legitimate changes can only occur with the support of the majority of the population. This means that changes are likely to be incremental and piecemeal. But that does not mean that fundamental change is impossible. On the contrary, small changes can, over time, add up to major changes. Seen from up close a hundred incremental changes over the years like a hundred reforms, but take a step back and it looks like a revolution.
Chapter 2
Economic Democracy: Beginning Orientations

1 Introduction

One of the peculiarities of economic democracy is that it has very rarely been subject to direct attention by the main political traditions. No tradition directly focuses on it, yet every tradition implicitly argues for it or against it in some way. That is, although the main traditions are dominated by great debates about private ownership versus public, market versus plan, capitalism versus socialism, just under the surface, yet rarely articulated, is another debate about economic democracy. So the central purpose of this chapter is to set the scene by orienting the reader as to how economic democracy relates to these traditions.

Today practically everyone claims to support the values of freedom and equality. This is as true for social democrats as it is for neoliberals, Marxists, anarchists and participatory democrats. Yet “freedom” is an elastic and essentially contested concept (Gallie, 1955), meaning dramatically different things at different times. It’s therefore crucially important to ask what kind of freedoms one hopes to equalize. Classical liberals argued for an equal right to protection from arbitrary interference from government, particularly in terms of their private property and religious views. Modern liberals often argue for equal civil and political freedoms, as well as equal opportunities to compete in the marketplace. Whereas socialists have tended to push for much greater social equality, arguing that liberal freedoms are empty without the necessary material means for their enactment.

From the perspective of economic democracy, then, what kind of freedoms should we strive to equalize? The overarching normative argument of this book is that people ought to have equal formal decision-making power in their core economic associations:
workplaces, finance and investment institutions.\(^8\) Of course, the attempt to increase the equality of people’s decision-making power should also be sensitive to the risks of losing the benefits of specialization that comes from homogenization. The overarching practical argument is that the best way to institutionalize this kind of equal freedom is through economic democracy: democratization of firms, finance and investment structures, and the market system. While the bulk of the book is dedicated to developing these arguments, this chapter lays the preparatory groundwork by orienting economic democracy vis-à-vis the major political traditions.

Although economic democracy as I conceive it borrows much from these traditions, it also diverges in some significant respects. It differs fundamentally from classical liberalism (or today’s neoliberalism) in its emphasis on equality as well as the focus on people’s freedom in a social setting. It differs from left liberalism not so much in terms of values as in doubts about whether such values are better institutionalized through capitalism or economic democracy. Similarly, it differs from Marxism in seeing the appropriate means for institutionalizing ideals of social equality not in state ownership and planning but in economic democracy. Economic democracy shares the greatest affinity with certain streams of anarchism and participatory democracy. It differs from the former in wishing to provide more specifics about possible institutional arrangements, and from the latter in insisting that such institutions be compatible with contemporary complex industrial society.

Beyond simple orientation, I hope to describe a number of reasons for why readers attached to one or other of the dominant traditions ought to pay attention to the issues of economic democracy. These traditions contain certain latent sympathies for economic democracy that lie half-hidden and which can be unearthed to show why, if not neoliberals, than at least left-liberals, Marxists, anarchists and participatory democrats should be open to considering an expansion of democracy into the economy on the basis of their own theoretical or ethical commitments. Of course it’s not possible to develop a comprehensive historical survey of all of these traditions. But we can point to a few key

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\(^8\) Equal formal decision-making means that decision-making authority rests, ultimately, on a one-person one-vote basis.
areas where these traditions seem to resonate with ideas of economic democracy more strongly than their protagonists might explicitly say.

2 Classical Liberalism

As liberalism has evolved from the 17th century, it has tossed and turned over the kind of “freedom” it seeks to promote, and about what kind of institutions – the market, private property, state regulation, unions, etc. – are best suited for maintaining it. While its evolution has been complex and convoluted (Eccleshall, 1986), it is possible today to discern two main branches of liberalism: a neoliberal branch, which continues most directly from the classical tradition, and a social democratic branch, which we look at in turn.9

Classical liberalism includes such figures as John Locke ([1689] 1980), Adam Smith ([1776] 1986), Jeremy Bentham ([1802] 1894), James Mill (1821), Friedrich Hayek (1960), Milton Friedman ([1962] 2002), and Robert Nozick (1974). Friedman’s liberalism – which is usually called neoliberalism – is probably the most influential version of these ideas today. The main tenets are shared to a large degree by the heads of the IMF, OECD, Wall Street and the City, the bulk of Conservatives in Europe and Republicans in the US. Neoliberalism, with Freidman as one of its fountainheads, is perhaps the dominant ideology of the world today.

2.1 Friedman

Without question the core value of Friedman’s liberalism is individual freedom: “as liberals, we take freedom of the individual, or perhaps the family, as our ultimate goal in judging social arrangements” ([1962] 2002, p. 12). What exactly does Friedman mean by “freedom”? He recognizes three kinds of freedoms – political, civil, and economic.

9 Historically, the social democratic movement emerged out of the programs of the socialist parties in Western Europe at the end of the 19th century. Over the 20th century much of the Marxian language was dropped and social democracy became largely indistinguishable from left liberalism (Sassoon, 1996).
Political and civil freedoms include the usual rights of electing representatives, freedom of assembly, expression, etc. His book *Capitalism and Freedom* ([1962] 2002), however, focuses mainly on *economic freedom*, by which he means chiefly two things: freedom to use and dispose of one’s property as one sees fit, and the freedom to enter into voluntary business agreements with others. A central argument of Friedman’s is that economic freedoms are a necessary condition for political freedoms; in other words, capitalism leads to democracy. And although it’s empirically indisputable that capitalism and political democracy have been historically intertwined, it’s not clear that there is any simple causation. For instance Rueschemeyer et al. (1992) argue that capitalism produces formal political democracy not because capitalists themselves want it (they generally do not), but because capitalism produces a working class with a vested interest in democratization in the hope that such will bring more substantive equality.10

Although freedom is his paramount value, he also believes in formal equality of rights and opportunity, but not equality of outcome. Unequal outcomes are just according to Friedman as long as they are formally or procedurally fair (such as might occur when a group of friends visit a casino; the rules apply equally to all, but some win and some lose). Everyone has the right to participate in the market, and no one should be discriminated against, but whatever inequality results is just; it should not be forcibly redistributed in the name of equality of outcome, for to do so directly conflicts with individual freedom ([1962] 2002, p. 174). Equality, in other words, is a kind of subsidiary value for Friedman. If it threatens individual freedom, the latter takes priority.11

How does Friedman believe these values are best institutionalized? He sees economic freedom as requiring a pervasive market and a minimal state. Friedman’s writing is clear and powerful, in part because he finds such a tight fit between values and institutions. Indeed, competitive capitalism is defined as a free system of “voluntary exchange” (13). Who could possibly be opposed to that?

According to Friedman there are two great virtues of competitive capitalism. First, it provides economic freedom directly. One can detect a basic syllogism in his reasoning

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10 This debate is beyond the scope of the present chapter. For a good survey see Dryzek (1996).
11 In this respect Friedman perfectly echoes classical liberalism (cf. Bentham in Eccleshall, 1986, p. 139).
that markets = voluntary exchange; voluntary = free; therefore markets = freedom. Second, it promotes political freedom indirectly by reducing the size and scope of government. Just as markets are seen as inherently conducive to freedom, government is seen as inherently detrimental to it: “every act of government intervention limits the area of individual freedom directly and threatens the preservation of freedom indirectly” ([1962] 2002, p. 32). So less government is a central, probably the central aim of Friedman’s liberalism.

Friedman’s conceptual scheme is remarkably straightforward: markets = freedom, while the state = unfreedom. But this doesn’t mean there should be no government – “the consistent liberal is not an anarchist” Friedman tells us ([1962] 2002, p. 34). He supports the existence of a democratic state, just a minimal one – hemmed in by a constitution on one side, and the market on the other. Government is required to be rule-maker and legal umpire (maintaining law and order, enforcing contracts, etc.); it is also necessary to provide services that the market is unable to adequately provide because of monopoly or neighborhood effects (i.e. externalities); and it is necessary to provide the minimal degree of necessary paternalism (e.g. looking after “madmen” ([1962] 2002, p. 33)). So although government should not be totally done away with, many of its current functions should be drastically curtailed in order to enlarge the scope of individual freedom. There should be reductions of tariffs and price regulations, including the abolition of rent control and minimum wages, government (and what he sees as union) monopolies; there should be much less regulation of the market, including banking, radio and TV, and less enforced licensing, including for medical practitioners. Finally there should be far less social services: no public housing, and much reduced welfare and social security, along with substantial privatization – of national parks, mail delivery, highways etc. ([1962] 2002, pp. 35-36).

So how does this vision relate to economic democracy? In order to see the differences clearly it’s useful to have a picture in our minds of what Friedman’s ideal society might look like in practice – a kind of Reaganite revolution, taken even further, with minimal restrictions on the market and workplaces and much less public and social services. Notice that there is little scope for democracy in such a society. The market is the main
institution, and the state, the only place where democracy is seen as relevant, is kept as small as possible. Clearly such a society would lead to an explosive gap between rich and poor. The wealthy would pay little tax, have little interference with their businesses, and be free to donate as much as they choose to their friendly tax-cutting politician; the poor would have no security, forced to take any job for peanuts, as the lack of welfare leaves no alternative. The jobs themselves would become riskier and more dangerous – without union protection or state regulation – allowing employers to increasingly cut corners.

Such a society would likely resemble a Dickensian one where a poor person walks to work (there are no public busses and the street owners have raised their tolls), where she is paid $1/hr to clean a building with toxic chemicals, with no mask provided, unable to earn nearly enough to pay for her children to go to the private universities, she eventually falls sick, going to a doctor who, unlicensed and offering a spring time “sale”, prescribes the wrong drugs by accident leaving her sicker than before; with no pension or subsidized housing, the private security forces evict her onto the street. Such a description may be colourful, but it is clearly within the realms of what Friedman sees as legitimate. Yet it stretches regular language as well as credulity to call this a “free” society.

Friedman’s conception of “freedom” is problematic on two basic levels. (i) On the individual level, which is his focus, the poor have very little freedom. This is a critique that has been made amply elsewhere (G. A. Cohen, 1995; Van Parijs, 1995), so here we will simply mention the central ideas. The first problem is that individual economic freedom is empty without the material conditions for its enactment – i.e. a basic amount of money and a decent level of human capital. The “freedoms” of a poor or homeless person are surely very limited. This is particularly true in a society where everything from the roads to the parks has price tags on them. The second problem is that the massive inequality in this kind of society significantly undermines the freedom of the weaker party. The “voluntary” bargaining that Friedman sees as characteristic of a market economy may be unfree when it occurs between vastly unequal parties, such as when a young unskilled woman applies for a job at Wal Mart. In cases like this, talking of the “freedom” of the market participants can obscure the fact that, as Tawney famously said, “freedom for the pike is death for the minnow” (Tawney, 1931, p. 164). The lack of
equality makes Friedman’s commitment to freedom somewhat hollow, since how can one value “freedom” so highly while being content with only certain people having it in a meaningful sense? Why should we value the freedom of the rich to not be taxed over the freedom of the poor to eat? Moreover, it’s important to note that remedying either of these issues – providing actual freedom by ensuring material conditions for real choice, and protecting weaker parties from economic domination – both require the action of the state, particularly in terms of redistribution, welfare, and accessible education. So Friedman’s notion that the state is inherently antithetical to freedom is, in many cases, simply wrong (A. Sen, 1999). Of course the state can undermine freedom – as his favourite example of the USSR clearly shows – but it can also augment it. Scandinavian countries have much higher levels of state involvement than the US – and yet this results in better healthcare, more accessible education, longer life expectancy, less poverty, less jails, etc. (Jonas Pontusson, 2005), meaning that the great bulk of the citizens are in many respects substantially freer than their American counterparts in any meaningful sense of the word, such as in their ability to implement and act out their own plan of life.

(ii) More relevant for us, and less commonly recognized, is the social dimension of freedom, in other words, the relationships between individuals in associations with others. The major contention is that control over economic resources can give certain members of associations power over other members, while those at the bottom of economic hierarchies find themselves powerless, and potentially dominated. In other words, our major point of divergence from Friedman is the belief that in a capitalist economy, property can translate into power over others: structural inequality can lead to systematic unfreedom.\footnote{I am using the idea of “power over” in the basic sense that A has power over B to the extent that she can successfully get B to do something she would not otherwise do (Lukes, 2005, p. 16). See Lukes (2005) for a thorough discussion of other dimensions of power.}

Friedman, and neoliberals more generally, tend to be insensitive to the importance of social freedom. This is likely because they see the economy as a realm of private individual bargains. The economy is conceived in the idyllic terms of a textbook model, a Walrasian auction, where there is a multitude of buyers and sellers, all small, and unable to affect prices. In such a model each individual is free to bargain or, if she doesn’t like
one deal or the offer of employment at one firm, she is free to move on to the next. In such an idealized setting the ability to exit is all the freedom one needs. If I don’t want to sell my corn to person A, no problem, I can simply go on to person B.

In the chapters that follow I present a very different but much more realistic picture of the economy. We examine three main areas – workplaces, finance, and investment – where issues of social freedom are pressing.

For instance, it makes little sense to think of the economy as operating through individual market exchanges between small producers, where firms are simply “intermediaries” for voluntary exchanges between individuals ([1962] 2002, p. 13). Such a prosaic image is deeply misleading since large firms today are not like large rooms where individuals come to bargain and exchange, they are concentrated loci of power and authority, typically hierarchically organized, where top managers have substantial discretionary power over lower ranks of employees. The reality today is that a large majority of the working class now work for corporations, some of which are richer than nations, employing millions of people, and of massive consequence for society at large. Corporate capitalism still involves the market, but the chief actors are no longer individuals, but large firms and massive banks. The locus of capitalism is no longer the individual, but the large hierarchical firm. Here we see an example of values clashing with institutions. Friedman says that “a liberal is fundamentally fearful of concentrated power” ([1962] 2002, p. 39). I share this fear, but I also think that if this position is to be applied consistently, one must be critical of concentrated power wherever one finds it, such as in many contemporary workplaces. Consistency requires that one be concerned with the power of large corporations and the liberty of their workers, just as Friedman worries about the power of the state vis-à-vis the liberty of its citizens. Of course Friedman shies away from this kind of analysis because he refuses to see property, for him the embodiment of freedom, as a potential source of unfreedom.

Additionally, instead of seeing finance and investment as the simple interplay of individual bargains, it’s important to recognize, for instance, how the power of capital
flight and capital strike can place powerful limits on government policies, thus deeply restricting the social freedom of the populace to decide their own future.

Economic democrats are skeptical of the idea that the economy can be adequately conceived as a purely private realm of individual transactions. Instead what is offered is a vision of the economy comprised of individuals operating within overlapping associations where the decisions of certain individuals – particularly those who wield economic power because of their control of economic resources – produce waves of consequences rippling out and affecting society at large.

So although Friedman, like much of classical liberalism before him, formally embraces the value of economic freedom, it is a vision of freedom which is starkly individualistic, overly tied up with private property ownership, and largely indifferent to social inequality, particularly in terms of power relations. It is, generally speaking, hollow on an individual level, and non-existent on a social level. I differ from neoliberalism in the conviction that a genuinely free society would require broader means for institutionalizing freedom on a social level, i.e. in the associations in which economic power is most relevant, as well as finding a way to ensure that such freedom is distributed in an egalitarian fashion. Equality in terms of equal basic power is of central importance; this is perhaps the point more than anywhere else where the paths of economic democracy and neoliberalism diverge.

3 Left Liberalism

The general perspective of left liberalism is that of social democracy. The essence of this position is that people’s political and civil freedoms should be guaranteed in equal fashion by a democratic state, while economic freedoms (for individuals to acquire property and meet their basic needs) should be protected by a combination of the market and a welfare state that regulates the economy and protects the citizens from excessive deprivations. Prominent figures in this tradition are Keynes (1936), Beveridge ([1942] 1969), Dahl and Lindblom ([1953] 1976), and Rawls (1971). and Social democracy was
the dominant perspective from WWII until the 1970s, instituted by socialist parties throughout Europe and the New Deal in the US (Sassoon, 1996).

John Rawls is commonly seen as a major intellectual defender of social democracy and the welfare state (S. Freeman, 2007; Sandel, 1998).\textsuperscript{13} For instance, Paul Krugman defines his own social democratic position in Rawlsian terms: “I believe in a more or less Rawlsian vision of society – treat others as if you could have been them – which implies a strong social safety net. I also believe that a mostly market economy, with public ownership and provision of services only in some limited areas, works best” (Krugman, 2011). In what follows I describe Rawls’s basic position, then describe several ways in which economic democracy diverges from it.

Rawls’s theory of justice is guided by the question of “which principles are most appropriate for a democratic society that not only professes but wants to take seriously the idea that citizens are free and equal, and tries to realize that idea in its main institutions?” (2001, p. 39). His answer is that all citizens should be entitled to equal basic freedoms (his first principle of justice). These basic liberties include freedom of thought and liberty of conscience; political liberties (e.g. the right to vote) and freedom to associate, rights and liberties of integrity of the person; rights and liberties covered by rule of law. Citizens should also be guaranteed the “fair value” of political freedoms, meaning that all citizens must have “roughly an equal chance of influencing the government’s policy and of attaining positions of authority irrespective of their economic and social class” (2001, p. 46). Beyond this, all citizens should have equal opportunities (his second principle of justice). And economic and social inequalities should be arranged to the benefit of the least advantaged (the so-called “difference principle”). It’s important to recognize that the “least advantaged” are not simply those with the least money, but are those with the least “primary goods”,\textsuperscript{14} which are things that every individual will

\textsuperscript{13} Although this perception is still widespread, it was never unanimous. For instance, Krouse and McPherson (1988) disagreed with the consensus by arguing that Rawls should be read as a kind of anti-capitalist, deeply critical of the welfare state. Indeed, in later life Rawls came to be much more explicitly radical, which I discuss below.

\textsuperscript{14} The primary goods are: (i) the basic rights and liberties, (ii) freedom of movement and free choice of occupation, (iii) powers and prerogatives of offices and positions of authority and responsibility (iv) income and wealth, understood as all-purpose means to achieve a wide range of ends, (v) the social bases of self-respect (Rawls, 2001, pp. 58-59).
want regardless of her conception of the good life. Rawls orders these principles in order of priority so as to provide some guidance about what to do when freedoms clash (S. Freeman, 2007). Without a doubt, freedom and equality are core values for Rawls, and the kind of freedom that he cares about equalizing – the ability of individuals to pursue their own conception of the good life – is attractive and powerful.

How are these values to be institutionalized? Rawls’s writing is incredibly rich and detailed, but in a nutshell we can say that he requires that basic civil and political rights be protected, equally, in a constitution, while in social and economic life, equality of opportunity is provided for by widespread education and training as well as inheritance taxes to reduce class distinctions. In the economy, the difference principle is institutionalized through a market system that is regulated by a democratic legislature. Rawls sees the market as useful for efficient economic allocation, but thinks that it must be regulated by a democratic state which ensures that the outcomes are justly redistributed (through taxes, transfers, and subsidies), with an eye to ensuring that the primary goods are distributed to benefit the least advantaged. So it’s clear why this vision is often seen as a defence of the welfare state: Rawlsian justice calls for a state to protect equal political rights, a market economy that allows inequality, but is regulated in ways that are supposed to mitigate the worst deprivations.

How does economic democracy differ from this vision? For the most part, I have no quarrel with Rawlsian values. Left liberals share a deep commitment to both freedom and equality that is commendable. The major difference is that Rawls (at least as he is conventionally read) is optimistic that these values can be adequately institutionalized in capitalist structures. I am more skeptical. There are three main points of divergence.

3.1

Reading Rawls, one is often struck by a stark divide between politics and economics. While some have critiqued Rawls on the grounds that this division is largely arbitrary (Clark & Gintis, 1978; Young, 1979), I want to make the more modest point that this
division tends to underemphasize the importance of freedom in the economy, specifically at work. It is undeniable that Rawls is deeply concerned with people’s freedom. He argues that political and civil freedoms are in fact so important that they should be constitutionally protected: they may not be revoked for the sake of economic efficiency or even by majority decree. Yet it is jarring that in the economy, his concern shifts from freedom to welfare. Freedom is central to the first principle pertaining to politics, but not the second principle pertaining to economics. This is not to say that he has no concern for freedom in the economy – the principle of equal opportunity is clearly important in this regard – but it is to say that he is insufficiently attentive to the issue of freedom at work. Other critics have pointed out the problem that Rawls discusses the economy in terms of allocation and distribution, but he largely ignores production (Gould, 1988). In other words, he largely ignores the extent to which capitalist workplaces can undermine workers’ freedom – the degree to which employers have power over their employees and the ways in which this can lead to subordination and even domination. Given the importance and centrality of work to our societies this is a problematic gap for anyone who values freedom highly.

Nowhere in A Theory Of Justice does Rawls explicitly discuss the issue of workplace freedom. He seems to assume, with the mainstream of the liberal tradition, that the right to exit, combined with state regulation for things like health and safety, and the right to join unions to collectively bargain over wages and work conditions, are generally sufficient to protect freedom at work. (In the following chapter I argue that such things are not sufficient, and so workplace democracy is necessary for real freedom at work.) My point here is that although the idea of increasing workers’ freedom through increased democracy is largely outside of the liberal tradition, there is actually support for this idea from within Rawls’s principles themselves. In other words, there are good reasons for Rawlsian liberals to take workplace democracy seriously on the basis of their own ethical commitments (Hsieh, 2005; O’Neill, 2008).

To see this, consider the difference principle more closely: “Social and economic inequalities are to be arranged so that they are … to the greatest benefit of the least advantaged” (1971, p. 302). Recall as well that the “least advantaged” are defined in
terms of their access to primary goods. The third and fifth are particularly relevant here. The third primary good is “powers and prerogatives of offices and positions of authority and responsibility”, and the fifth is “the social bases of self-respect, understood as those aspects of basic institutions normally essential if citizens are to have a lively sense of their worth as persons and to be able to advance their ends with self-confidence” (2001, pp. 58-59).

It seems to me that there is a solid case for thinking that workplace democracy (or at least increased worker participation in management) is implied by the difference principle. This is because it seems implausible to argue that the current hierarchical system of workplace management is better for the “least-advantaged”, either in terms of providing them with increased powers of office and positions of authority and responsibility, or providing them with the “social bases of self-respect”, than would occur from increased workplace democracy. For instance, compare two schemes. One in which workers work for a large worker cooperative like Mondragon (to be discussed in detail in chapter 4), and one in which workers work for a similar capitalist firm. Even though Mondragon is in many respects far from an ideal worker co-op, its members are still considerably better off than comparable workers in the capitalist firm. Mondragon members elect their management, so enjoy democratic freedoms completely absent in the conventional firm; they have much greater opportunities for participating in decision-making; Mondragon members have much greater equality in wages, with the highest paid getting less but the lowest paid getting more (which Rawlsians can hardly see as undesirable); their jobs are much more secure; and the overall pleasantness of work substantially higher. Furthermore Mondragon is just as efficient (if not more so) than comparable capitalist firms, and has closer connections with the community (so the least advantaged outsiders benefit more from this scheme as well).15 It is clear, I think, that at least from the perspective of the “least advantaged”, workplace democracy would be superior to the current system of workplace hierarchy. It may be worse from the perspective of the top managers and owners – but they, Rawls tells us, should not be our ethical focus.

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15 See Chapter 6 for the supporting evidence for these claims.
According to the difference principle, therefore, Rawlsian liberals should, at the very least, be open to the possibility of expanding worker participation in management.

3.2

A central value for Rawls, which I share, is that people should have basically equal political freedom. They should have “roughly an equal chance” as he says, of influencing their political system. Rawls recognizes (as neoliberals usually do not) that this equality can be undermined by capitalism to the extent that massive differences in wealth corrupt the political process. To ensure equal political freedoms, therefore, Rawls sensibly advocates public funding of elections, restrictions on campaign contributions, and assurance of a more even access to public media (2001, p. 149). I agree that these reforms are useful, but, and this is where we diverge, equal political freedoms are undermined by deeper mechanisms than simple wealth corruption. Equal political freedoms tend to be undermined by the very structures of capitalism themselves, in particular by private control of finance and investment (C. Lindblom, 1977; Adam Przeworski, 1985; R. P. Wolff, 1977).

Under capitalism the basic health of the economy is to a large degree determined by finance and investment. If private financiers stop providing credit to firms, or if managers and owners stop investing, the economy falters and eventually starts to crack. Unemployment rises, GDP falls, and the government comes under mounting pressure for something to be done. This means that a basic priority of the government, any government, of the left or the right, is to ensure that financiers and investors are happy and confident enough to continue their activities – thereby ensuring relative stability. After all, basic economic stability is the necessary prerequisite for any kind of politics that the government may wish to pursue. But since finance and investment are largely controlled by an unaccountable minority of the population, their control over such basic levers of the economy means that there cannot be equal political liberties for all citizens. Business people are in a “privileged position” as Lindblom (1977) says. Government must pay attention to this minority above and beyond anyone else. In chapter 7 we explore the full extent to which this economic arrangement undermines democratic
sovereignty, but here we must suffice with reiterating the conclusion that we reach there: private control over finance and investment fundamentally undermines the values of equal political liberties for all.

This means that Rawls’s value of equal political liberties is unable to be sustained within capitalism. Instead, this value requires the democratization of investment and finance. Since political freedoms are currently systemically unequal due to the fact that a minority has unaccountable control over finance and investment, it follows that what is needed is a way to ensure that basic decisions about such things are more widely dispersed and systemically accountable. This doesn’t mean that everyone needs to have a say over every investment decision in the economy, but it does mean that the people who are making those decisions are accountable in a democratic egalitarian manner to the people affected by such decisions, for instance by having finance allocated by democratic community banks, and local investment decided through participatory budgeting (see chapters 7 and 8 for more detail on this).

Since the important liberal value of equal political freedom cannot be sustained in capitalism, liberals and social democrats should be open to considering economic democracy as a means to making their values concrete.

3.3

The final difference from Rawls is less an institutional issue as it is a conceptual one. Rawls sees the main purpose of democracy as protection: “the political liberties … are only essential institutional means to protect and preserve other basic liberties” (2001, p. 143). In this respect, Rawls is very much within the mainstream of the liberal tradition, stretching back to Locke ([1689] 1980) and including classical liberals such as James Mill (1821) and Jeremy Bentham (1817) who developed their defence of democratic principles primarily on the grounds of protection (Macpherson, 1977). The idea is that democracy can provide freedom from powerful people, or “tyrants” in the state. So democracy is valuable as a mechanism for protection from tyranny, or, alternatively, as
accountability. When one lacks this kind of democratic freedom, one is in a position of subservience.

I agree that this is an important dimension of democracy. But I want to emphasize a second dimension of democratic freedom that Rawls downplays: the freedom to self-determine.\textsuperscript{16} This is the notion of individuals collectively deciding their future together. It is the aspect of democracy associated with popular sovereignty. This is the aspect of freedom – sovereignty and self-rule – that indigenous and anti-colonial movements often articulate. For instance, it is the ethos underlying the independence movement in Quebec inscribing its demand to be “maîtres chez nous”, masters of our own house.

In Western thought, this idea is central to republicanism.\textsuperscript{17} Rousseau is probably the most well-known exponent of such an ideal, arguing that people are only free if they rule themselves, if they are their own masters, and the authors of their own laws (Rousseau, [1762] 1987). Though central to republicanism, this idea clearly has much broader appeal. The attractiveness of the concept of self-determination comes from the idea of collective autonomy, of being in control of our own lives. There is something very powerful in the idea of people coming together to build the society they want to live in; in the sense that our fate is not predetermined, but that we can be active actors in our lives, captains of our own ship, so to speak. Indeed the attractiveness of this concept is obvious by noticing the distaste which we typically feel towards its absence – dependence, impotence and helplessness.

While “freedom from” is about protection and defense, “freedom to” self-determine is a more active conception of freedom. It requires doing, acting, striving, which is why this kind of freedom is more potent at small scales that allow for direct participation. On a national scale, it may be possible to feel the first kind of freedom, that, for instance, the Prime Minister, for all her power is still accountable to me; it is more difficult, however,

\textsuperscript{16} In the literature this is sometimes referred to as “developmental” freedom (Macpherson, 1977). I prefer to talk of “self-determination” to avoid any suspicion of teleology, that freedom is about developing into something inherent or predetermined. In legal discourse “self-determination” refers to the ability of a state to exercise its sovereignty. Here the idea is applied more broadly to different kinds of associations, from small ones like workplaces to large ones like states.

\textsuperscript{17} See the fascinating work of Skinner (1998) and Pettit (1997) in reviving this tradition.
to feel the second kind of freedom, that she is acting out my will, or that I am in any meaningful sense directing the ship of state.

One of the central reasons for advancing economic democracy is that it furthers both dimensions of democratic freedom, yet Rawls focuses only on the first. Rawls downplays the importance of self-determination because he is nervous about a tradition in republicanism (that he calls “civic humanism”) which argues that participation is “the privileged locus of our (complete) good” (2001, p. 142). In other words, he is, rightly, nervous of the claim that people must participate, they must engage in politics, they must come together to self-determine in order to be free, regardless of their own conception of the good life. They must, as Rousseau ominously said, “be forced to be free” ([1762] 1987, Sec 1.7). If self-determination means self-mastery by a “higher” or “truer” portion of oneself, then, as Isaiah Berlin famously noted, this kind of freedom can be no better than a disguise for tyranny, allowing the state to “ignore the actual wishes of men or societies, to bully, oppress, torture them in the name, and on behalf, of their ‘real’ selves” (1969, p. 133).

We can wholeheartedly agree with Rawls that self-determination and participation should not be forced on anyone, yet we should still insist that having the opportunity to self-determine is incredibly important. It is not necessary to think like Pericles and Rousseau that humans should want nothing more than to address their fellow citizens from the agora, while still believing that most of us do want, in our meetings at our workplaces and elsewhere, to be listened to as equals, to be empowered to articulate, devise, and implement a plan of action, and not be constantly overruled, shushed and sidelined.

We can still be neutral with respect to the good life while going further than Rawls does in ensuring that those who want it, have the opportunity to self-determine through participation in collective decision-making in the their crucial economic associations. For instance, in the following chapters it will be argued that self-determination is an important freedom not only at work, but vis-à-vis finance and investment. Extending democracy to finance and investment is in large part about expanding what it means to be an equal citizen of a democratic state. The democratization of finance and investment
provides citizens with the actual tools necessary for them to have a say in collectively
determining the direction of the development of their own communities, which I think
Rawlsians should agree is a good thing.

The final point to make in this regard is that Rawls’s whole conception of justice is based
on the original position – which, when we think about it, is basically a mechanism for
thinking about how people would self-determine behind a veil of ignorance. So given the
important of self-determination in deciding on principles of a just society, Rawlsians can
hardly be opposed to the importance of self-determination in an actual society (Young,
1979).

In summary, I diverge from Rawls in three respects. First, in holding that the liberal
concern with freedom should extend to the workplace. Rawlsians should be more open to
thinking about ways to democratize workplaces because the difference principle provides
solid grounds for doing so. Second, in the belief that equal political freedoms are
unlikely within capitalist structures because they will be undermined by private control of
finance and investment. For this reason, Rawlsians should be more open to democratizing
finance and investment in order to substantiate their own goal of equal political freedoms.
Third, that self-determination is an important aspect of democracy, and though it should
not be forced on anyone, it is a vitally important kind of freedom for those who desire it.

In fact these differences may not be so large as they first appear. In later life, Rawls came
to accept much of this kind of criticism and moved substantially closer to embracing
economic democracy. In the preface to the revised version of *A Theory of Justice* (1999)
and in *Justice As Fairness* (2001), Rawls aligned himself much closer to left liberals like
Walzer (1983) and Dahl (1985) who already supported aspects of economic democracy.
In these works, and to the surprise of many, he explicitly rejects the system of welfare
capitalism of which he was (and often still is) seen as the most prominent defender. He
now argued that welfare capitalism could not in fact fulfill his principles of justice
because it allows for very large inequalities in the ownership of property “so that the
control of the economy and much of political life are in few hands” (138). This is a very similar to the argument I made above; it appears to open the door to democratizing investment and finance as an institutional means for preventing political and economic life from falling into a few hands. Indeed, how could any transition away from welfare capitalism to a society that would place, as Rawls requires, control of political and economic life in the hands of citizens more broadly, be possible without some sort of democratic check on the enormous power of financiers and investors – in other words, through some sort of economic democracy?

Moreover, even though he says “I shall not pursue these questions” of workplace democracy explicitly, it is clear that his later work was very sympathetic to it. Having disregarded welfare capitalism, he argues that there are two kinds of societies that fulfill his principles of justice: a liberal socialism and a property-owning democracy. He supports a liberal socialist system, wherein “a firm’s direction and management is elected by, if not directly in the hands of, its own workforce” (2001, p. 138). Likewise he supports a property-owning democracy which, as Freeman (2007, p. 220) remarks would likely have substantial amounts of workplace democracy too, evidence by his statement that “Mill’s idea of worker-managed cooperative firms is fully compatible with property-owning democracy” (Rawls, 2001, p. 176).

There are thus good reasons why Rawlsians, and left liberals more generally, should be open to economic democracy. A genuine commitment to freedom and equality which left-liberals have, naturally leads, as it did over Rawls’s career, to a greater support for the extension of democracy into economy.

4 Marxism

Classical Marxism (in the tradition of Marx, Engels, Kautsky, Lenin, etc.) had an

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18 In the preface to the restated version of A Theory of Justice (1999), Rawls says that his lack of clarity on this point was a major problem with the initial work.
19 A property owning democracy is a system with widely dispersed ownership of property and capital, while liberal socialism is a system of market socialism (Rawls, 2001, Part IV).
ambiguous and paradoxical relationship to ethical values such as freedom and equality. On the one hand, they tended to deride such values as mere bourgeois prattle, ideological, and designed to obfuscate actual social reality, while on the other hand, as Lukes says, “open practically any Marxist text, however aseptically scientific or academic, and you will find condemnation, exhortation, and the vision of a better world” (1985, p. 3). So even though these Marxists were sometimes critical of the idea of morality, they tended to be devoted, indeed passionately devoted to the enlightenment principles of the French revolution: freedom, social equality, solidarity, progress. In Engels’s words: modern socialism “originally appears as a more developed and allegedly more consistent extension of the principles laid down by the French philosophers of the Enlightenment in the eighteenth century” (qtd in Archer, 1995, p. 1).

In most respects Marxists have shared with others progressives the values of freedom and equality. Where they differed, primarily, was in regards to institutions. Marxists thought that there could be no real equality, freedom, or democracy so long as capitalism existed. They believed that for these values to be real required a material basis and institutional structure that was incompatible with capitalism. As long as a small class owned the means of production, democracy would basically be a smoke screen behind which the bourgeoisie would rule. Probably the most important contribution the Marxists made to economic democracy is their astute analysis about the ways in which capitalist structures could operate to undermine people’s social freedoms. While left liberals recognized that disparities in wealth could lead to the corruption of democracy, the Marxists saw the deeper structural impediments that capitalism imposed on democracy. They pointed out the structural constraints on equal political freedom, discussed above, that flow from private control of investment and finance (F. Block, 1977; Adam Przeworski, 1985). Additionally, they pointed out how capitalist workplaces can lead to alienation and hierarchy, thus undermining freedom and equality at work (at least for anyone below the highest echelons) (Braverman, 1974; Marx, [1844] 1978).

20 “We are not among those communists who are out to destroy personal liberty… we have no desire to exchange freedom for equality. We are convinced… that in no social order will personal freedom be so assured as in a society based upon communal ownership” (Marx and Engels, qtd in Eccleshall, 1986, p. 60). There is of course much debate about how exactly Marx understood freedom and emancipation – for penetrating analyses see Lukes (1985) and Elster (1986).
21 Of course, this is not only a Marxist insight, see for example Lindblom (1977).
On an abstract level one can share the values of equality and freedom professed by Marxists and liberals. But the crux of the issue and the source of major disagreements is in the institutionalization of these values. While the Marxists have often been insightful in pointing out the ways that capitalist structures can undermine equal freedoms, their own institutional proposals have often been just as problematic.

How have Marxists thought that their values should be institutionalized? This is a difficult question because of the breadth of Marxism as a tradition. Marx himself can be read in different ways. He definitely had an authoritarian undemocratic side. In the *Manifesto of the Communist Party* ([1848] 1968) and elsewhere he clearly calls for centralization and state control.\(^{22}\) He expelled Bakunin and other anarchists from the First International, silencing their democratic call for bottom-up federations of workers’ associations. However, it’s also possible to read Marx as a kind of radical democrat, concerned above all else with overcoming alienation.\(^{23}\)

Although there is not a single reading of Marx, nor a single tradition of Marxism, there is, historically, a dominant tradition, usually called classical or orthodox Marxism, which sees a line of continuity from Marx to Engels to Kautsky and Lenin. This tradition tended to be severely undemocratic in its institutional proposals – and so it is here that economic democracy diverges most sharply from Marxism.

By the beginning of the 20\(^{th}\) century orthodox Marxism was quite clear that the solution to the problems of capitalism did not involve economic democracy, but rather nationalization and state control of production in a planned manner. Kautsky, who at the turn of the century was read much more widely than Marx himself (Sassoon, 1996),

\(^{22}\)“Workers must not only strive for one and indivisible German republic, but also, within this republic, for the most decisive centralization of power in the hands of the state authority. They must not allow themselves to be misguided by the democratic talk of freedom for the communities, of self-government, etc” (Marx, [1850] 1978, p. 509).

\(^{23}\) This perspective depends on two basic texts – the *Economic and Philosophical Manuscripts* ([1844] 1978), which Marx chose never to publish, and the *Civil War in France* ([1871] 1968), where Marx embraces the democratic Paris Commune in a way that struck his contemporaries as a radical change of perspective “[the] general effect [of the Commune] was so striking that the Marxists themselves, who saw all their ideas upset by the uprising, found themselves compelled to take their hats off to it. They went even further, and proclaimed the its programme and purpose were their own…. This was a truly farcical change of costume” (Michael Bakunin, 1973, p. 261). For further debate about this question, see Avineri (1968) for a sympathetic view and Nove (1991) for a critical one.
described the coming socialist society as being “nothing more than a single gigantic industrial concern” (Kautsky, 1888, Chap IV.9). A giant factory, owned by the state, and operated (supposedly) for the benefit of the population at large. Instead of the “anarchy of production” that Marx decried, the state would rationally plan production and distribution. In their more honest moments these Marxists recognized that economic planning was in tension with workers’ freedom. “It is true” Kautsky recognized, “that socialist production is irreconcilable with the full freedom of labor, that is, with the freedom of the laborer to work when, where and how he wills” (1888, Chap IV.10). These are words that Trotsky would take to heart with his brutal implementation of the militarization of labour (Brinton, 1975) – organizing industry along military lines, strictly hierarchical and intensely disciplined24 – continued more viciously by Stalin.

Engels (1874 [1978]) famously ridiculed the idea of workplace democracy, thus starting a tradition of contempt for workplace democracy that orthodox Marxists would follow consistently, largely on the grounds that is risked undermining state control. Thus Lenin would deride the idea of “a producer’s congress! What precisely does that mean? It is difficult to find words to describe this folly. I keep asking myself can they be joking? Can one really take these people seriously? While production is always necessary, democracy is not. Democracy of production engenders a series of radically false ideas” (Lenin, qtd in Albert & Hahnel, 1991a, p. 22).25

That said, it is important to point out that there has always been an alternative, smaller tradition of anti-authoritarian Marxism, much more concerned with workers’ control and much closer aligned to economic democracy. This is the tradition associated with such figures as Bernstein ([1899] 1993) – who famously equated socialism with the extension of democracy – Pannekoek (1970), Castoriadis (1974), Brinton (2004) and Schweickart (1996).

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24 “Labour…. obligatory for the whole country, compulsory for every worker, is the basis of socialism” (Trotsky qtd in Brinton, 1975, p. 64).
25 Again, “Unquestioning submission to a single will is absolutely necessary for the success of labour processes that are based on large-scale machine industry… today the Revolution demands, in the interests of socialism, that the masses unquestioningly obey the single will of the leaders of the labour process” (Lenin qtd in Brinton, 1975, p. 41, emphasis in original).
Since 1989 and the fall of the Berlin Wall, many Marxists have engaged in substantial revision of the earlier orthodoxies. This revision has occurred around three main points, all of which have made Marxists more sympathetic to economic democracy. First, contemporary Marxists are now universally in favour of democracy, at least in the state. Second, there has been substantial criticism (from within Marxism and without) of the belief that a free and equal society requires state ownership and central planning. It has become widely recognized that state ownership, need not result in any important change in the character of the workplace itself. Work in public firms often remains top-down, hierarchical, and alienating – in other words, unequal and unfree. This was blatantly the case in the USSR, just as it was in the welfare states of the north, where nationalized firms often made no attempt to alter the previous bureaucratic structures of work. Changing the “boss” from a private businessperson to a state bureaucrat often had very little impact on the actual degree of power that workers had over their workplaces.\(^{26}\)

Third, many critics across the political spectrum, including Marxists, have expressed grave doubts that central planning is a good method for allocating labour, goods, and services, and have therefore become less implacably hostile to the market (Bardhan & Roemer, 1993). Some have pointed to the advantage that markets have in allowing a greater freedom of choice of occupation (Dahl & Lindblom, [1953] 1976; Nove, 1991). Additionally, there is significant consensus across the board that markets are more efficient than comprehensive planning (Roemer, 1994).\(^{27}\) Many leftists have therefore concluded that it may be desirable to alter the market’s overall distributions (e.g. through taxation and subsidy) for the sake of justice, while still endorsing use of the market for basic issues of allocation. I share this perspective. In chapter 5 I will argue that markets can in fact be a democratic mechanism of allocation, a kind of voting-machine (though this is true if and only if there is a profound reduction in the inequality of the number of dollar-votes each person has, as well as a reduction of distortions from things like externalities and monopolies).

Today, many Marxists no longer support the USSR-style of socialism. Instead their work

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\(^{26}\) On this basis, GDH Cole considered the “socialist” policies of the British Labour Party after WWII to be a failure partly because they had failed to alter the major power relations in society (Dahl & Lindblom, [1953] 1976, p. 475).

\(^{27}\) Though not everyone shares this perspective (Albert, 2003; McNally, 1993).
spans many fields, such as arguing for market socialism (Roemer, 1994) and a universal basic income (Van Parijs, 1995), refining principles of justice (G. A. Cohen, 1995), analyzing capitalist globalization (D. Harvey, 2006; I. Wallerstein, 1974), and indeed, pursuing questions of economic democracy (Miller, 1989; Schweickart, 1996). Erik Olin Wright’s recent book *Envisioning Real Utopias* (2010) is a masterful attempt by an anti-authoritarian Marxist to outline the prospects for socialism today, which reaches very similar conclusions to the ones expressed in this book. Indeed, Wright ends up identifying the core of socialism with economic democracy (2010, p. 189). For Marxists like this, the concerns of this work are very much their own.

For these kinds of Marxists, there are good reasons to be open to ideas of economic democracy. (i) In the short term, building economic democracy allows for the growth of what Marxists often call “dual power”, which is important because it means that the chances of reforming neoliberal capitalism are much more likely (Wright, 2010). For example, Crotty and Epstein (1996) argue that reforms to democratize finance, such as capital controls (discussed in chapters 7 and 8) are vital in order to change the balance of forces in society, enabling a working-class movement to push for a new kind of class compromise. (ii) In general, building economic democracy strengthens the so-called “working class” and weakens the “capitalist class”. This happens in several ways. Workplace democracy can reduce alienation – a consistent Marxist goal – much more substantially than state ownership. Indeed, workplace democracy challenges the very root of the power of capitalist owners. Financial democracy can increase the freedom of working people in their political communities by giving them more say over how finance should be directed than happens under state control. Here too, financial democracy challenges the root of capitalist financial power. Marxists have often had a strong analysis of the ways in which capitalism undermines equal freedoms, but more often than not their instinct was to replace capitalism with the state, which is deeply problematic since the state is generally a poor substitute for actual popular power. Thinking about ways to actually democratize work, finance, and investment in ways that go beyond the

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28 Dual power refers to the creation of alternative or counter institutions alongside the dominant ones. While the term was initially used by Lenin ([1917] 1964), the idea has mainly resonated with anarchists and socialist-libertarians as part of the attempt to build a new world in the shell of the old. Many anarchists now use the phrase interchangeably with that of “prefigurative politics”.
state, so as to concretely increase the power of regular working people, is closely in line with Marxists’ historical ethic. (iii) Economic democracy is at base a vision of society as irreducibly social. Like Marxism it holds that individual freedom is inextricably linked to social relations: “only in community [with others has each] individual the means of cultivating his gifts in all directions; only in the community, therefore, is personal freedom possible” (Marx & Engels, [1846] 1964, p. 91). (iv) Ultimately, economic democracy leads to a vision of market socialism that accomplishes many of the traditional goals of Marxism – abolition of a capitalist class that controls the economy, increased equality in material terms and in terms of economic power, reduced alienation, greater freedom for people to control their lives as individuals and as part of a community – while avoiding the failures and brutalities of the soviet model. Economic democracy offers the potential of a non-state socialism, which is feasible and viable for the 21st century. The conclusion of this book, chapter 9, illustrates a vision of this kind of socialism that I suspect many Marxists would find attractive.

5 Anarchism

Of all the major traditions of political thought, the anarchists have probably been the most consistent advocates of an expansion of democracy throughout society and into the economy, and therefore have the most affinity with economic democracy. Unfortunately much contemporary democratic theory largely ignores this tradition.29 Today anarchism is less a single cohesive political doctrine as it is a large family of those with similar convictions and aspirations: hostility towards unaccountable authority,30 distrust of

29 For instance, David Held’s Models of Democracy, which has become a standard text in the field entirely passes over the contributions of anarchism (Held, 2006, p. 6)
30 Anarchists are sometimes caricatured as being against all authority. This is partly their own fault, due to over general and passionate language. For instance, at one point Bakunin calls for “absolute rejection of every authority” (1980, p. 76). In calmer moments, however, anarchists are, in general, not opposed to authority per se, but only to unaccountable authority. Bakunin illustrates this spirit when he asks “does it follow that I reject all authority? Far from me such a thought. In the matter of boots, I refer to the authority of the bootmaker; concerning houses, canals, or railroads, I consult that of the architect or engineer. […] But I allow neither the bootmaker nor the architect nor the savant to impose his authority upon me” (qtd in Graham, 2005, p. 90). Anarchists have regularly made similar difficulties for themselves in their occasional
hierarchy and power, and optimistic belief in the capacity of ordinary people to control their own lives and organize social relationships on the basis of freedom, equality, and solidarity. In Chomsky’s words: “what attracts me about anarchism personally are the tendencies in it that try to come to grips with the problem of dealing with complex organized industrial societies within a framework of free institutions and structures” (qtd in Marshall, 2010, p. 579).

Within the anarchist family there have been two main traditions: an individual and a social. The smaller tradition of individual anarchism focuses on individual freedom conceived of in terms of personal autonomy; this tradition places less emphasis on equality and is less hostile towards capitalism than it is towards the state. Its main proponents are Proudhon, at some points (Graham, 1989; Proudhon, [1847] 1888), Warren and Tucker (Marshall, 2010). This tradition bears some affinity with that of the new right libertarians (Nozick, 1974; Rothbard, 1982). Its central message is that “society must be constructed as to preserve the sovereignty of the individual” (qtd in Marshall, 2010, p. 384). This tradition has little in common with economic democracy.

The dominant anarchist tradition is that of social anarchism, sometimes called anti-authoritarian or libertarian socialism. Its principal exponents include Proudhon, at other points (Vincent, 1984), Bakunin (1980), Kropotkin ([1912] 1974), Malatesta (Richards, 1965), Rocker ([1938] 1988), Bookchin (1971), and Chomsky (P. R. Mitchell & Schoeffel, 2002). Unlike the Marxists, anarchists generally had no hesitation about declaring their ethical commitments: their core values are freedom balanced by a belief in social equality. Social anarchists are passionate defenders of an ideal of freedom as self-determination or self-government in a community of equals. They have gone further than most in thinking through the kinds of structures that might institutionalize equal freedom, in the sense of providing everyone with the means to self-govern in political and economic life, as individuals and in associations with others. They have tended to describe their ideal in contrast to (classical) Marxism.

condemnation of all power, or all organization. So care must be taken to separate the hyperbole – form which anarchists suffer more than most – from the practical proposals.

31 In Malatesta’s words: “that aspiration towards unlimited freedom, if not tempered by love for mankind and by the desire that all should enjoy equal freedom, may well create rebels who, if they are strong enough, soon become exploiters and tyrants, but never anarchists” (qtd in Marshall, 2010, p. 38).
Marx is an authoritarian and centralizing communist. He wants what we want, the complete triumph of economic and social equality, but he wants it in the state and through the state power, through the dictatorship of a very strong and, so to say, despotic provisional government, that is, by the negation of liberty. His economic ideal is the state as sole owner of the land and all kinds of capital, cultivating the land under the management of state engineers, and controlling all industrial and commercial associations with state capital. We want the same triumph of economic and social equality through the abolition of the state and of all that passes by the name of law (which, in our view, is the permanent negation of human rights). We want the reconstruction of society and the unification of mankind to be achieved, not from above downwards by any sort of authority, nor by socialist officials, engineers, and other accredited men of learning – but from below upwards, by the free federation of all kinds of workers’ associations liberated from the yoke of the State (Bakunin qtd in C. Ward, 2005, pp. 247-248).

So what is the relationship between social anarchism and economic democracy? Reading the social anarchists one gets the impression of kind of schizophrenic attitude towards democracy. At times severely critical, and at times intensely supportive. Yet this confusion is, I think, mainly an issue of terminology. Rhetorically, the social anarchists often expressed virulent dislike of “democracy”. For instance, Proudhon, that “perpetual contradiction” at one point says that “democratic government is nothing but a monarchy returned”, yet practically in the same breath declares “we want the mines, canals, railroads given to workers’ associations, organized democratically”. Criticism of “democracy” is widespread throughout the history of anarchism, from Malatesta (Richards, 1965, p. 50) to Gelderloos today who says that “democracy is an authoritarian, elitist system of government designed to craft an effective ruling coalition while creating the illusion that the subjects are in fact equal members of society (Gelderloos, 2004, p. 18). This criticism of “democracy” is best interpreted as criticism of the social order of so-called democratic states. Classical anarchists tended to be critical of actually-existing democracies because of the widespread exclusions of workers, women, and racialized people (which was standard throughout the 19th century), the lack of meaningful participation in the centralized state structure, and, particularly, what they saw as the

32 This characterization of Proudhon comes from James Guillaume (qtd in Mikhail Bakunin, 1980, p. 26).
33 I have translated these quotations from the French, from (Guérin, 1999, p. 76 and 86).
meaninglessness of political democracy given the reality of massive social and economic inequality, the massive inequality in wealth as well as the de facto disenfranchisement of the majority of people from economic decision-making. This is why Bakunin says that even in the “democratic” states “self-government of the masses … remains a fiction” (143). In other words, the social anarchists were not opposed to democracy per se; they were opposed to a system that called itself a “democracy” while maintaining the capitalist systems and entrenched social hierarchies which they saw as undermining any possibility of real democracy or equality.

The fact is that although they often lambasted “democracy”, it is undeniable that whenever they started to discuss proposals for alternatives, their visions were deeply imbued with a democratic ethos. Their ideals were fundamentally visions of radical democracy, of people having equal decision-making power in their associations, even if they tended to shy away from using the word “democracy” in favour of words like “bottom-up,” “self-management,” “autogestion”, “workers’ control”, “self-government” etc. – words which display an unmistakably democratic impulse.

In broad outline the social anarchists envisioned a replacement of the state with a federation of communes – which they saw as deeply democratic bodies, with elected and easily revocable delegates, providing as much direct participation as feasible. More importantly for our purposes, they envisioned the economy being run according to similar principles of democracy and bottom-up control: empowering regular people with decision-making power. The main current of this tradition thought the economy could be run by federations of workers’ councils coordinating with federations of consumers’ councils (Mikhail Bakunin, [1866] 1980; Berkman, 1929; Bookchin, [1968] 2005). However, the degree to which different industries were to coordinate their activities with each other and with consumers via a market, a plan, or some kind of bargaining, is very unclear. Participatory Economics, or Parecon, is a recent attempt to spell out some of the institutional details of such a vision (Albert, 2003). The clearest example of these ideas in practice is the organization of industry in Spain, particularly in Barcelona, during the Spanish Civil War, when anarchists found themselves in charge of large parts of the country. The collectivization in Barcelona included construction, metal industry,
bakeries, slaughter houses, public utilities, transportation, health services, theaters and cinemas, even the regional textile industry employing 250,000 workers. Each newly collectivized factory was reorganized: wages were equalized, formal distinctions between workers were abolished, and the administration of the factory was reorganized on the basis of self-management, with all managers being elected and revocable to the rank and file. Each factory from the same industry was organized into a Local Federation. All the Local Federations then sent delegates to the Local Economic Council which coordinated economic exchange. In order to facilitate exchanges across regions, the Local Economic Councils federated into National Economic Federations (Dolgoff, 1990).

In terms of principles, the social anarchists have historically been the most consistent supporters of economic democracy, particularly in their committed advocacy of ideas of self-management and workers’ control. In practical terms, however, they were often overly vague about the specifics. Since anarchists were rarely in power their theorists felt little need to spell out the details of how their institutions would concretely work. How should economic coordination happen? Should a market and price system be used? If not, what is a better alternative? How should finance be allocated? Who, exactly, should have a say about the direction of societal investment? How should conflicts between different democratic bodies be resolved? What kind of equality is possible and desirable in complex large-scale systems? These practical questions were too often left unanswered, with too much confidence that they would simply work themselves out “after the revolution” (for an acute example of this naïveté see Berkman (1929)). One way to think about economic democracy, therefore, is an attempt to work through these institutional difficulties while trying to remain faithful, as much as possible, to the anarchist convictions of equality, freedom, and self-management in the economy.

6 The Participatory Democrats

Throughout the 20th century the dominant conception of democracy that emerged in the West was a largely cynical and pessimistic one. From Weber ([1922] 1968) to Michels
(1916) to Schumpeter ([1942] 1987) to (early) Dahl and Lindblom ([1953] 1976) the mainstream view was that modern industrial society due to its scale and complexity was inevitably hierarchical, requiring extensive bureaucracy, and allowing for only the bare minimum of participation. Schumpeter’s ([1942] 1987) view that democracy belonged only in the state, and meant nothing more than competition between elites, sanctioned by a vote every four or five years, became the standard perception. Nothing more was felt possible.34

This pessimism was rejected by the participatory democrats – close cousins of the anarchists. As a tradition of political thought participatory democracy stretches from Ancient Athens (James, 2005) to Rousseau ([1762] 1987), JS Mill ([1848] 1965), GDH Cole (1920), Pateman (1970), Mansbridge (1980), and Bookchin ([1968] 2005).35 Their ideas rose to prominence in the student movements of 1960s, for instance through the Students for a Democratic Society (SDS) in the US, and Extra-Parliamentary Opposition (APO) in Germany. The SDS in their famous Port Huron statement explicitly called for a new kind of “participatory democracy” to replace the status quo, involving widespread participation in politics and the economy (SDS, 1962). Likewise, the APO called for direct democracy and workers councils. In Paris in 1968, the students precipitated a massive rebellion leading to massive strikes of up to seven million workers, with “autogestion” (self-management) being a central demand (Sassoon, 1996).

Participatory democracy emphasizes the importance of participation in political life for two basic reasons: self-determination and educational development.

Firstly, participation is seen as important because it provides the conditions for the possibility of self-determination. Participation allows one to actively take a role in managing one’s own affairs. To be not just a passenger, but to exert some control over one’s associations. It gives people the freedom to apply their own knowledge to a problem, to deliberate, listen, learn, debate, and strive towards implementing a collective

34 Indeed, it’s remarkable that in Schumpeter’s vision of democracy the main actors are not the “demos” at all, but in a dramatic reversal of the very idea of democracy, the society’s elites and political parties
35 Of course, neither the Ancient Athenians nor Rousseau nor Mill were anarchists, but the other main figures in this tradition are at the very least anarchistic, as are the modern social movements associated with participatory democracy, in the broad sense of the word meaning anti-authoritarian socialism.
vision. Participation can be exhilarating even if it’s also exhausting and time-consuming, which is why the Students for a Democratic Society (SDS), used to say, with a kind of rueful gravitas, that “freedom is an endless meeting” (Polletta, 2002).

Secondly, participation can be useful for spurring educational development. Participation can build up the capacities of ordinary people. This was the basis for JS Mill’s argument that while a benevolent dictator may make good decisions, authoritarian rule would never allow for the development of the people who would inevitably remain “dwarfed” ([1861] 1998). Ableist language aside, the point is a good one: people clearly learn from doing, just as they increase their knowledge through exposure to countervailing ideas. Participation in democratic associations can expand people’s horizons since it forces people to take the public interest into account – asking not what’s good for “me” alone, but what’s good for “us” as well. It is in this vein that Mill argued that participation played a vital educative role by encouraging each person to “weigh interests not his own; to be guided in the case of conflicting claims, by another rule than his private partialities; to apply, at every turn, principles and maxims which have for their reason of existence the common good” ([1861] 1998, chapter III).

Economic democracy is largely sympathetic to both of these rationales for increased participation. However, the claims of the benefits of participation can be taken too far. For instance, the notion that participation in townhall meetings or workplaces will quickly transform participants into concerned, knowledgeable, empathetic, civic-minded people is clearly unrealistic (E. Greenberg, 1981; Mansbridge, 1980). But that said, the basic claim that one often feels freer through actual participation, and one often learns from actual deliberation, can hardly be denied.

The most obvious dilemma of this tradition is coming to grips with realities of contemporary society: particularly the issues of scale, complexity, and the need for expertise, things which by their very nature tend to undermine the possibilities of equal participation. Throughout this work I try to illustrate how increased participation is in fact possible within complex societies, and how increased equality is possible too, even if it
could never be, nor would we want it to be complete sameness in decision-making responsibility.

In fact, one respect in which cynics are right and the anarchists and participatory democrats are wrong (or at least ambiguous), is this question of equality. While anarchists have often argued that equality is a fundamental value, they tend to go further than this in implying that more equality is always better – and this, I think, is wrong. Total equality in decision-making can only be achieved with huge costs. There are costs in terms of size (since equal input in every decision means organizations must remain very small), inefficiency (since specialization is impossible), and homogeneity (since consensus decision-making over long periods of time is difficult to achieve without similar people). This argument will be spelled out in more detail in chapter 4, but here it’s useful just to make the point that one place where economic democracy diverges from the anarchist or participatory democratic traditions is in the belief that the goal is not total equality but equality in formal decision-making power, since this promises similar democratic benefits with much fewer costs.

Too often the discussion about participation polarizes into a perspective of cynical pessimism on the one side (e.g. Michels’ (1916) belief that the degeneration of democracy into oligarchy is an “iron law”36), and utopian optimism on the other (as seen in some in some of the advocates of participatory democracy (Roussopoulos & Benello, 2005)). In the following chapters I attempt to avoid either of these pitfalls by steering a middle path of radical realism: attempting to remain faithful to radical aspirations while being pragmatic and compromising with respect to their institutional possibility.

7 Conclusion

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36 “Thus the majority of human beings, in a condition of eternal tutelage, are predestined by tragic necessity to submit to the dominion of a small minority” (Michels, [1911] 1962, p. 354).
We have seen that economic democracy shares with the major traditions a basic commitment to equality and freedom, even if diverges at various points. It differs fundamentally from neoliberalism in its emphasis on equality, particularly in relation to equal formal power in associations. It shares with both left liberalism and Marxism a broad commitment to freedom and equality but differs from liberalism in doubting that such values are well institutionalized in capitalist structures, and differs from classical Marxism in doubting that they are well institutionalized through state ownership and central planning. Economic democracy has the closest affinity to the anarchist and participatory democratic traditions, particularly the parts of these traditions that emphasize the importance of freedom and equality in economic associations, though it differs from the former in wishing to provide more specifics about possible institutional arrangements, and from the latter in insisting that such institutions be compatible with contemporary industrial society, that the goal should not be total equality, but equal formal power.

I have also tried to point out why left liberals, Marxists, anarchists and participatory democrats should feel some affinity with a project of economic democracy, since it many respects such a project resonates with their own ethical commitments. This is not to say that such people will have no doubts with economic democracy. A number of issues are recurring, such as questions about the freedom of minorities and the tyranny of the eloquent. There are also pragmatic worries about efficiency and practicality, particularly on a large scale, combined with doubts that economic democracy is really better than social democratic alternatives. The resolution of these issues is a major goal of the following chapters.

So although economic democracy, as I envision it, crisscrosses various traditions, it is not reducible to any of them. One of the main contributions of economic democracy – and in this respect we have much to thank other authors on the subject (Archer, 1995; Carnoy & Shearer, 1980; Dahl, 1985; Ellerman, 1992; George, 1993; Melman, 2001; Schweickart, 1996) – is that it helps to change the focus of political-economic debates away from public versus private ownership, to debates about who should have power in various
types of economic decision-making. This is a new paradigm, which, as we’ll see, can illuminate old problems in a new light.
Part Two: Workplaces
Chapter 3

Should Workplaces be Democratized?

“The modern corporation may be regarded not simply as one form of social organization but potentially (if not yet actually) as the dominant institution of the modern world” (Berle & Means, [1932] 1962).

1 Introduction

In many ways these words of Berle and Means have now come true. Large corporations today are vastly influential and massively powerful. They are among the most powerful organizations in the contemporary world, central features of liberal-democratic societies, yet they themselves are fundamentally undemocratic, since the people at the top of the structures are unaccountable to the people at the bottom. This means that a dominant institution of modern “democratic society” is not democratic itself. Is this justifiable? Although we are appalled at states that don’t allow their citizens to elect their leaders, we take it for granted that workers should have no ability to elect their bosses. Why is this so? The present authoritarian structure of workplaces means that the majority of the population spends the majority of their lives in associations that are severely undemocratic and hierarchical, yet we unhesitatingly call our societies “democratic”. This is a puzzle and a paradox.

But the lack of democracy at work is not simply an academic puzzle. It is also a fact of life, and an often terrible one at that. Most workplaces in our society, particularly for working class jobs, are organized so hierarchically that they are deeply unpleasant if not outright oppressive. Almost everyone has experienced at some time or another the degradations of workplace hierarchy – yelling bosses, managers who act like petty tyrants, arbitrariness and inequality, favoritism and snobbery, privilege and superiority. Such things, and many more, represent the symptoms and epiphenomena of the structural reality of capitalism: that hierarchical work deeply undermines the freedom of most people to adequately be in control of their own lives.
Arguments for workplace democracy are not new, and tend to reappear every generation or so. The first theoretical defence of cooperatives as “working men’s associations” appeared in the writings of Phillipe Buchez in France in the 1830s and 1840s (Saul Estrin, 1989, p. 169). More recently, most countries in the West experienced a wave of substantial enthusiasm for workplace democracy starting in the 1960s, galvanized by the student movements. From that generation, some of the most well-known political theorists – Carole Pateman (1970), Michael Walzer (1983), and Robert Dahl (1985) – came to advance justifications for workplace democracy. Today we are perhaps witnessing another wave of interest (for example the international Occupy movement) galvanized in part by the global financial crisis as well as by the renewed experiments in workers’ control in South America, particularly in Venezuela.

The central argument of this chapter is that the current system of hierarchical work is deeply unjust because the vast majority of workers are compelled to join workplaces within which they are fundamentally unequal – essentially servants. It is very difficult for the average person to choose an alternative in the form of workplace democracy. The argument here is that no one should be compelled to be subservient at work and so everyone should have a meaningful choice of workplace democracy. For such a choice to be real, the state needs to foster and facilitate the expansion of worker cooperatives.

The argument proceeds by first examining the hierarchical nature of most workplaces and then showing how people are compelled to join them because of material and cultural pressure and lack of alternatives. The following section differentiates workplaces from purely private associations, such as clubs, to make the argument that the state should be involved in fostering the expansion of democratic workplaces. The next section examines what this concretely means in terms of spreading worker cooperatives. The final sections consider some common objections to workplace democracy.

2 Work Hierarchy and the Compulsion to Accept Subservience
The average person in our societies faces intense material and culture pressure to get a job. But due to the large inequality in ownership of productive assets most people apply for jobs in situations where they have significantly less bargaining power than the owners, and so are compelled to sign contracts handing over large discretionary power to the employers. I will argue that this means that the average working person in western societies is, in her functional role at work, essentially a servant.

Consider the most common jobs in contemporary industrialized economies – retail and service jobs – for example in department stores. The typical employee faces sustained material and cultural pressure to get a job, which in most cases requires signing a contract that establishes deeply hierarchical work relations. The average worker finds herself ordered around by the manager, given menial, repetitive tasks day in day out. Likely feeling no sense of ownership or pride over the work, since it is in no sense hers. Whatever creative talents she has are stifled as she has no say in the running of the store, ability to influence its direction, or voice in its organization. Her own initiatives tend to be ignored or undermined, and her human talents and potential tend to be depreciated in favour of her machine-like abilities to follow orders.

Consider another example, the tens of thousands of automobile workers across North America. These workers are among the most highly unionized workers in the economy, much more protected than other sectors, yet even so they are largely disenfranchised from having a say in the work decisions that directly affect them – from daily details, to issues of work pace and organization, to new lines of investment, to plant closures, etc. Instead they are subordinate to the shop-floor managers, as well as the faceless commands emanating down from the Board of Directors (or even further removed people in London or Tokyo who have power because they own shares).

The situation is similar for teachers, nurses, and other workers in the public sector. Although in this case the employer is a bureaucrat or public administrator and not a businessperson, the essential work hierarchy is much the same. This is, of course, not to say that these jobs are uniformly terrible, or that there is no difference between public and private sector work. For instance, in North America, public sector jobs are usually more
unionized and thus tend to offer slightly higher wages and more protections. However, the broad contours of the organization of work are similar. Public sector work, just like private, is generally organized hierarchically which means that the mass of workers are subject to the decisions made by those in power, without having any direct means to render that power accountable.

In general workplaces in capitalist societies are hierarchies in the sense that they institutionalize inequality. This structural inequality is a deep problem because it means that workers are unfree in the two senses described last chapter. Hierarchical workplaces make workers unfree from the (potentially) arbitrary power, coercion, and bullying of those in authority. This is the sense of unfreedom as subservience. It is the result of inequality in terms of formal decision-making power. This kind of unfreedom often manifests itself in hierarchical workplaces through arrogance and caprice on the one hand, fear and fawning on the other. Additionally, workplace inequality tends to make workers unfree in the republican sense of lacking self-determination or sovereignty. This is the sense of unfreedom as helplessness and dependence, marked by the inability of workers to collectively manage the direction of the firm themselves. This is unfreedom as impotence, the stultifying of creativity and the stifling of enthusiasm that results from disempowering work.

Of course, some economists have taken issue with this line of thought and insisted that workplaces do not involve any kind of internal servitude or compulsion at all. For instance, Alchian and Demsetz famously argued that there is no question of authoritarian control at work because work is simply a series of voluntary contracts that the worker can terminate at any point: “the employee ‘orders’ the owner… to pay him money in the same sense that the employer directs... [the worker] to perform certain tasks. The employee can terminate the contract as readily as can the employer” (Alchian & Demsetz, 1972, p. 783). The intuition behind Alchian and Demsetz’s argument is that because work involves a voluntary contract there can be no exercise of power of one over the other. The employer and worker are just exchanging something for something in a deal that both agree to. This is why they don’t see any difference between the standard employer-employee relationship and the standard customer-seller relationship.
The firm has no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting between any two people... telling an employee to type this letter rather than to file that document is like my telling a grocer to sell me this brand of tuna rather than that brand of bread (777)

The first problem with this is that the authors fail to see the ways in which the employment contract is in fact substantially different from standard market transactions. In a simple market transaction we can agree that there is usually no issue of hierarchy or power, for example, when one buys a can of tuna from a grocer, because the relationship between the actors is brief and transitory. But the employment contract is very different from this. Instead of a single agreed upon transaction, the contract provides the employer with broad levels of discretionary authority over the worker. Instead of exchanging one commodity for another, the employment contract involves an exchange of a wage for an agreement to fulfill certain tasks and accept the general authority of the managers. Fundamentally the exchange is one of money for obedience. Of course there are exceptions to this. Some kinds of work allow for the individual employees to retain significant levels of autonomy (such as sessional instructors in universities), and some kinds of workplaces involve group work that is structured on an egalitarian basis (like cooperatives). But most workplaces in capitalist society involve group work that is structured hierarchically. What the contract establishes in the general case – for the line cook in the restaurant or the sales person in the department store or the nurse in the hospital – is a general relationship of authority.

It is standard for contracts to give management not only the power to fire and discipline, but also to determine the rules and regulations by which employees are expected to abide. Workers who are unionized may have some general level protections, especially around wages, but most union contracts include a so-called “management clause” which reserves essential powers and decision-making ability to management alone. The broad

37 There is an exception with monopoly ownership, for example, where one owns the only water in the desert.
38 This management clause between the UAW and GM in 1990 is typical: “The right to hire; promote; discharge or discipline for cause; and to maintain discipline and efficiency of employees, is the sole responsibility of the Corporation except that Union members shall not be discriminated against as such. In addition, the products to be manufactured, the location of the plants, the schedules of the production, the methods, processes and means of understanding and solely and exclusively the responsibility of the Corporation” (Melman, 2001, p. 21).
discretionary powers given to managers allow them to compel workers to do things that they would not otherwise do – to do this task, in this way, at that pace, etc. It is in that sense that we can say that workplaces involve the governing of workers. The most important point about contracts is that since all the precise tasks and minutiæ that a worker must do can never be fully described in all the minute details, what contracts really establish is the general parameters of authority and obedience (we might say, parameters of government) that are expected to be followed. If workers simply followed the contract to the letter, doing nothing more and nothing less, the workplace would grind to a halt almost immediately – which is precisely the rationale behind work-to-rule strikes. In other words, structuring inequality by establishing power and authority over the worker is a fundamental purpose of the employment contract in order to extract a variety of particular work from an inevitably general contract (H. A. Simon, 1951).

In a simple, transitory market transaction the participants can make a deal as self-determining individuals, but the employment contract establishes the worker not as a self-determining individual agreeing to do a certain activity for a certain reward, but as a servant, agreeing to follow general orders. This is the sense in which we can say that contracts institutionalize hierarchy. Of course, this is not at all to say that all jobs in hierarchical workplaces are terrible or that all employees in such firms are oppressed or powerless. Not at all. The point is rather that as far as formal structures of power are concerned, most workers are fundamentally unequal in decision-making power with respect to their employers. Most workers are, in this sense, like servants. In the rich societies of the West most workers are in a functional sense like Alfred – the butler of Bruce Wayne (Batman’s alter-ego); they are not starving or living terrible lives. They are definitely not slaves. But neither are they equals. When Bruce Wayne calls, Alfred comes running.

So far I’ve been arguing that employment contracts often serve to institutionalize hierarchical relationships, but it may well be argued that people should be free to be

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39 R. H. Tawney puts it this way: “What I want to drive home is this, that the man who employs, governs, to the extent of the number of men employed. He has jurisdiction over them. He occupies what is really a public office. He has power, not of pit and gallows… but of overtime and short time, full bellies and empty bellies, health and sickness” (qtd in Walzer, 1983, p. 293, my emphasis).
subservient at work if they so desire. This is true but the crucial issue, of course, is whether the vast majority of people who are agreeing to subservience at work are genuinely consenting, as opposed to simply having no other viable options and so being basically compelled to join. Alchian and Demsetz’s claim that workers can fire their bosses just as easily as the reverse is a strange perspective as it implies that the employee is in general in a position of equality to the employer – a perspective that flies in the face of practically all the evidence of recorded capitalist history. In general, it’s fair to say that the degree to which we can be confident about the genuineness of the consent is the degree to which workers and employers are bargaining from positions of rough equality. In the real world, however, the normal case is that of substantial inequality, which means that Alchian and Demsetz mistake the formal truth that a worker can legally terminate a contract just as well as the other way around, with the substantive reality that a worker is usually far less able to do so.

The exact degree of inequality varies widely in different countries but every country in the West contains substantial material inequality. It therefore seems to me that there is strong evidence for saying that an average worker in many contexts is largely compelled to accept a hierarchical job. Consider the US context. The fact that the top 20 percent of the population controls 85 percent of the country’s wealth, means that the bottom 80 percent of the population face serious material pressure to find work (E. Wolff, 2010). This material pressure is particularly severe in the US due to the weak welfare supports. The average welfare provision is about $17,000/year for a family of four whereas a living wage is calculated to be close to $50,000. Moreover, without employment Americans also lose their vital health insurance. This means that leaving work means leaving money, and in a commodified society like the US, lack of money entails serious deprivation and insecurity.

In terms of cultural pressure, it’s well-known that the lack of work in the form of chronic unemployment often leads to severe psychological suffering. We cannot be flippant about the seriousness of this deprivation when we recall that there is a strong correlation

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between unemployment and suicide (Lewis & Sloggett, 1998). Additionally, work is often an important element of one’s social status, and is crucially important for many people’s sense of dignity and self-worth (Jahoda, 1987).

The final important factor is that there are usually no alternatives to hierarchical work. Workers are generally unable to choose to work in a democratic firm for the simple reason that there are basically no options to do so. In most Western countries (Italy is a partial exception), democratic workplaces in the form of worker cooperatives make up only about 1% of firms. In the US, 99.9% of private workplaces employing more than one person are hierarchical firms (Dow, 2003). So are there any ways to escape hierarchical work? One potential route is to become self-employed. This is, at present, the most institutionally plausible path for some people to achieve self-determination at work, but of course it is only available to those who can afford to start their own business. The only way that is currently institutionally practicable for workers to acquire democracy at their present workplace is to become co-owners, through buying enough shares from their employers that they acquire equal decision-making power as the other owners. But of course, for most people this is merely a formal possibility. Many firms are private and will not sell their property rights, and even if they would, most workers could never afford to buy sufficient shares to acquire equal decision-making power.\(^{41}\) This means that, in general, workplace democracy is highly inaccessible because workers in hierarchical firms have no rights to democratic voice, nor are there widespread alternatives in the form of democratic firms.

The standard situation in the western world is that inequality of resources compels the average worker to accept the authority relations stipulated by the employment contract. One might say that employers’ power over workers comes \textit{de jure} from the employment contract but \textit{de facto} from unequal bargaining positions resulting from unequal property ownership. This produces the paradox that the typical worker is compelled by force of circumstance to be subservient in a society that prides itself on its democratic equality.

\(^{41}\) As we’ll see next chapter, it is estimated that 80% of families have an average net worth of only 50% of the capital stock of their firm per employee. And of this, about half again is tied up in cars and homes (Dow, 2003, p. 189).
3 Free to Choose?

When Milton and Rose Friedman named their book *Free to Choose* (1980), they were attempting to advance their conservative arguments by appeal to a widely held sentiment that a core goal of liberal societies is that individuals should be free to choose the products, services, and kind of employment that they desire. In an important article, Ian Maitland (1989) argues in a similar vein that there is no need for the state to foster workplace democracy because workers can freely choose to have meaningful work if they so desire. In a competitive market system, he argues, workers are free to bargain for whatever kind of benefits they want; if they desire more meaningful work they can trade it off against lower wages so that firms have an incentive to offer it to them. But the fact that this happens so infrequently is taken as evidence that in fact workers don’t want more meaningful work. The upshot of his argument is that workers are presently free to choose and indeed have chosen *en masse* to stick with subservience.

Now while Maitlan’s argument focuses on “meaningful work” we can easily imagine a similar argument about “democratic voice”. The argument would go as follows: workers are free to choose the degree of democracy at work that they want by bargaining with employers for more/less democracy in exchange for lower/higher wages. There is no reason that workers can’t bargain for more democracy just like they commonly do for more vacation time or better benefits. A competitive labour market allows for workers to bargain for any particular package of benefits that they may want.

In fact, democracy at work is not something that workers can easily bargain for. There are two basic reasons why. The first is that it is not institutionally available. It is simply not common practice anywhere for firms to offer varying degrees of democratic rights to prospective workers. This doesn’t mean that it’s impossible for them to do so, but it does mean that there is currently no well functioning market for democratic rights. There is a market failure, in other words, in the sale of democratic rights, and this is precisely one of the reasons why the state should help to expand democratic workplaces – in order to
provide a choice for democratic work that the market is failing to provide. The broader point is that choice always happens against a set of background conditions. Think about a cafeteria in a university. If there are ten restaurants all of which are corporate fast food chains, and after a year 99% of the students have eaten at one of the chains at some point, we cannot sensibly conclude that this proves that students overwhelmingly prefer fast food to healthy or fair-trade alternatives. People’s choices are inherently constrained by the existing institutional options.

The second issue is that workers have not generally been strong enough to put the issue of firm governance on the bargaining table. The lack of widespread bargaining for democratic voice that we see today does not, I think, reflect a lack of interest in democratizing work (pace Maitland) but rather reflects a lack of bargaining power. The reason that the shark and the tuna do not harmoniously share the sea has little to do with the wishes of the tuna. The evidence for this is clear: at the height of workers’ bargaining power – in the 1970s in social democratic countries, governance issues and economic democracy were firmly on the bargaining table. Indeed, it was precisely at the height of union power in the 1970s that saw major moves towards economic democracy in the form of codetermination in countries like Sweden and Germany, the Auroux laws facilitating autogestion in France, Tony Benn’s call for industrial democracy in the UK, etc. (Sassoon, 1996).

In other words, I share the liberal sentiment that people should be free to choose. The choice of workplace governance structures, of whether to spend thousands of hours of our lives in associations in which we are formally equals or in which we are formally subservient, is a very important one with large impacts on our freedom, happiness and well-being. But I disagree that such a choice is currently open or institutionally accessible for the majority of people. In fact, as we’ll see below, there is strong evidence that many people do desire more democracy at work; the problem is that there are so few avenues for people to freely choose this option.

4 Are Workplaces Private Associations?
So far the argument has been that the average person finds herself compelled to join hierarchical workplaces from force of circumstance and lack of alternative options. Widespread inequality in the ownership of productive assets leads to unequal bargaining positions which in turn leads to inegalitarian contracts that establish hierarchical relationships where workers are essentially servants. This, I believe, is unjust and so requires that the state foster democratic alternatives to remedy the situation. Implicit in this argument is that workplaces are different kinds of associations than, say, clubs. They are not “private” in quite the same way.

It is a widely accepted liberal notion that private associations such as clubs do not need to be democratically organized. Liberals have long maintained, and rightly so, that people should be free to start or join any kind of association that they choose, and that there is nothing wrong with undemocratic kinds of clubs as long as one can always exit easily. As Mayer says: “clubs do not have to be democratic, even in a democratic society. Founders are free to craft the governance structure they deem best, and new members have no moral right to require political equality where it does not exist” (2001, p. 240). Rawls echoes this sentiment: “particular associations may be freely organized as their members wish, and they may have their own internal life and discipline subject to the restriction that their members have a real choice of whether to continue their affiliation” (qtd in Rosenblum, 1998, pp. 53-54). Liberals are quick to point out that if the state were to promote particular kinds of club structures (such as democratic ones) – this would be potentially paternalistic (Rosenblum, 1998). Encouraging democracy in clubs might undermine the freedom of individuals to associate with whatever structure of club they prefer. It would limit individuals’ choices and require the state abandoning neutrality to impose a particular vision of the good life on the civic lives of its citizens.

Several critics of workplace democracy have made the same kind of argument vis-à-vis workplaces. For example, Arneson (1993) implies, and others are more explicit (Mayer, 2001, p. 240), that workplaces should be seen as analogous to clubs. The implication being that since workplaces are private, workers and employers should simply be left alone to associate however they please, democratically or not; the state shouldn’t be involved.
This, I think, is wrong because workplaces are fundamentally different kinds of associations than clubs. Firstly, it is not nearly as easy for workers to exit their workplace as it is for people to exit their clubs. Most people are compelled to join workplaces for a variety of material and cultural reasons this is simply not the case with joining, say, a typical bowling or bird-watching club. That means that the power that is exercised in hierarchical workplaces cannot be easily avoided. This is not to say that people are completely bound to any particular workplace – I accept the general empirical claim that most people can exit their workplace easier than they can exit their state, for example. And so there may well be a deeper inalienable right to democracy in the state that doesn’t exist in the workplace (Arneson (1993) makes precisely this argument). Nevertheless, it’s also the case that, generally speaking, it is significantly harder to exit workplaces, people are significantly more compelled to join them, than is the case with clubs. While people can exit particular workplaces (one can leave a job at McDonalds for a job at Burger King) it is much more difficult to avoid hierarchical work altogether. In workplaces, exit is always allowed but in practice it is often difficult and costly. Exiting work is almost always costly since one must spend time searching for a new job, and workers in their jobs almost always develop firm-specific skills that are not transferable, which means they suffer a cost of having to take lower pay elsewhere (Hsieh, 2005). None of this is true for clubs.

Secondly, workplaces occupy a position of centrality to people’s lives that is largely different from private clubs. On the one hand, people typically spend much more time and energy at work than they do at clubs. The average employed American, for instance, spends about thirty-five hours per week working, compared to only two hours per week involved in religious or other association (Estlund, 2000, pp. 8-9). Moreover, work plays a crucially important role in determining one’s social status. One’s position in the workplace has broad implications for one’s overall social standing, sense of self-respect and dignity, in ways that are not all comparable to most clubs. For these reasons, the power that is exercised in workplaces and the significance of the internal governance

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42 Two excellent investigative journalistic reports on the difficulty and costliness of attaining work for the working poor are the following: from Britain, Toynbee (2003), and from the US Ehrenreich (2001).
43 Religious organizations might be a partial exception.
relationships is much more “socially consequential” than in clubs (Sameul Bowles &
Gintis, 1986). The state cannot be totally “hands off” vis-à-vis workplaces because
ignoring long-term inequality in such associations means abandoning people to second-
class status. For this reason it is not quite right to characterize workplaces as either
straightforward “public” or “private” associations. We might more accurately call them
“private socially-consequential” organizations.

The fact that workplaces have these differences from clubs means that we must be much
more concerned and proactive to ensure that, as Rawls puts it, people have “a real choice
of whether to continue their affiliation” to their workplace (my emphasis). Unfortunately,
the current state of affairs is one in which people generally do not have such a choice; the
typical working person is compelled to join a hierarchical workplace where she is
especially a servant. Because of the centrality of work to people’s lives this is a serious
problem. Long-term involuntary servitude at work can be detrimental to one’s self-
respect, damaging to the full development of one’s moral powers, and an affront to one’s
ability to exercise meaningful control over one’s own life. Since work is so socially
consequential the state does need to be involved in order to ensure the background
conditions are such that an individual’s choice to enter such associations is genuinely
voluntary: the choice of joining a hierarchical workplace must be “real”, as Rawls says.
There is nothing particularly radical about this. All liberals would agree that it is unjust to
compel people to join other kinds of hierarchical associations – such as churches or
mosques – since a compulsion to join such organizations curbs one’s personal pursuit of
the good life. Likewise, we need to ask: does it not restrict people’s own pursuit of the
good life when so many people are systematically denied the opportunity to be equals at
work?

To clarify the underlying argument, consider another important association: that of the
family in the 1940s or 1950s. The essential fact about marriage in this era is that it is
categorized by only a limited degree of exitability. While divorce was legal, there was
substantial pressure – both material and cultural – for women to get married. Moreover,
while marriages are intensely private affairs, family relationships are also socially
consequential – one’s family life is a central locus of one’s time and energy and an important determinant of one’s social standing, self-respect, and sense of moral worth.

So what does justice require for the internal governance relationships of the family (i.e. between the adult partners)? Questions like this are so thorny because the family has characteristics of both public and private associations. On the one hand, the personal is the political – it is wrong to abandon women to a lifetime of subservience or to turn a blind eye to harm or suffering; but at the same time we clearly do not want the state to engage in any overt surveillance or interference with people’s private lives by directing families how they need to organize their decision-making. We should neither abandon women to abuse, nor insist on democratic equality.

I would argue, and suspect that many liberals would agree, that justice in such cases requires that the state should foster the background conditions so that women are free (but not forced) to choose egalitarian relationships. Concretely, this requires a range of state policies – facilitating divorce, ensuring alimony, instituting laws against physical abuse or rape within marriage, facilitating material independence by outlawing discrimination at work, legalizing maternity leave, as well as fostering real alternatives in the form of legal rights for gay marriage. In passing it’s worth noting that as the background conditions have changed dramatically over the last fifty years through the enactment of policies like these, i.e., as women’s choices about marriage have become less constrained, we have concurrently witnessed a corresponding surge in egalitarian relationships. The more the choice of equality has become possible, the more such a choice has actually been taken.

Now I want to argue that the same precise argument holds in the case of workplaces. Workplaces today are likewise characterized by a limited degree of exitability. While exit is legal, the average worker is nevertheless largely compelled to join a hierarchical workplace due to force of circumstance and lack of alternative options. Additionally, workplaces, like families, are deeply socially consequential since they constitute a central locus of people’s time, energy, and social standing. And just as justice requires that women should not be compelled to be subservient in their marriages, justice requires that
workers should not be compelled to be subservient at work. This doesn’t mean that people should be forced to adopt workplace democracy; adults should be allowed to sign up for subservience if they so choose – just as consenting sexual partners can choose to engage in BDSM. The point is only that the choice needs to be genuine, and for that to happen there needs to be real alternatives. The bottom line is that justice requires that the state should foster the background conditions so that just as women are free (but not forced) to choose to choose egalitarian relationships, workers become likewise free (but not forced) to choose democratic workplaces. Concretely this requires that the state foster the expansion of workplace democracy so that this choice becomes accessible (in ways that are discussed below).

It is important to realize that while the argument advanced here is not standard among liberals, it is in no way illiberal. It is based on basic liberal convictions that long-term relations of subservience are dangerous (because they risk undermining human dignity), and the importance of free choice for safeguarding people’s freedom. Liberals are right to be wary of forcing a particular form of association (democratic or otherwise) on people because of a respect for individual free choice. But the intuition that says “people should be free to associate however they want – even subserviently” must be balanced by another intuition – just as rich in the liberal tradition – that says with Kant and John Stuart Mill “sapere aude!” Servitude conflicts with human dignity. Free men and women cannot be content and are unlikely to develop their capacities and moral powers to their full potential in long-lasting relationships of subservience. We cannot force people to be free. But we can and should arrange the background conditions so that those people who desire democracy at work are genuinely able to choose it. Granted, this is no strict state neutrality. A state that acts to foster opportunities for people to replace hierarchical relationships with democratic ones, is not strictly neutral but it is nevertheless entirely defensible on a relatively thin account of the good life that many people can endorse – based on common liberal-egalitarian values of the importance of equality and self-determination.

44 Kant defines “sapere aude” as the exhortation to “have the courage to use your own understanding” (Reiss, 1970). Mill expresses a similar hostility to servility in On Liberty (1998).
5 Fostering workplace democracy

What would it mean for a workplace to be organized democratically? While democratization can take multiple forms, the standard model for a democratic workplace is that of the workers’ cooperative where ultimate authority resides with the general assembly on a one-person one-vote basis. This means that although different jobs may pay different wages, the management of the firm is decided on a strictly egalitarian basis. In small firms, decisions might be made collectively through direct participation of all members. Many small cooperatives, such as co-op cafes, restaurants, bike stores, etc. work in this way. For instance, the Mondragon Bookstore in Winnipeg (named after the famous Mondragon co-op) has used its democratic structure to implement a system of balanced job complexes (BJCs) (Burrows, 2008). In normal capitalist firms, there tends to be a stark division between those who have more empowering jobs at the top of the hierarchy and those that get stuck with the less empowering “drudgery”. The basic idea behind BJC’s is that an attempt is made to share out the unpleasant work as well as the more empowering work so that neither falls entirely on one group of people, without meaning that everyone is expected to do everything (Albert, 2003). In this way the democratic structure has allowed the Bookstore to experiment with new ways of improving the quality of people’s working lives.

Larger co-ops with high levels of complexity and specialization can clearly not make all their decisions through general participation – they require delegation of authority by electing representatives in the familiar ways of parliamentarian democracy. For example, the 40,000 or so worker-members of the Mondragon co-ops meet as a whole in a Cooperative Congress, which acts like a mini-parliament, composed of elected representatives from every co-op (in proportion to their size).

45 Of course different people will have different evaluations about what kind of work they enjoy or dislike, so balancing can’t be done with mathematical precision, but nevertheless there are often jobs that most people agree are unpleasant – washing the dishes, scrubbing the floors, taking out the trash, etc. An important advantage of democratic workplaces over conventional firms is that they allow for increased deliberation to identify the agreements that do exist in this regard, and then if the majority wishes to, to implement some mechanism to share the benefits and burdens more equitably.
Co-ops often hire new workers on a temporary basis who do not have equal democratic rights. Of course, this may not be a problem for those workers who want to be only temporary, but clearly it’s important that a significant majority of the workers in a co-op be full members so as to prevent the emergence of an exploited sub-group of disenfranchised workers. I would argue that for co-ops to be genuine they must fulfill two standards: the significant majority of the workers are full members (perhaps 75% or more), and, even more importantly, the non-members are able to become members should they wish to do so (after a reasonable probationary period and a not-prohibitively-high investment stake). Workplaces with less than 50% members are usually not genuine co-ops; they are more often “capitalist partnerships”.46

Large co-ops that meet these specifications will still require specialization and so still have order-givers and order-takers. But those who give orders are now fundamentally accountable to those who take them. This is what makes a co-op a democracy and not a hierarchy. The democratic structure of the firm creates an important basis of formal equality in terms of decision-making power and basic freedoms. The basic parliamentary structures protect workers’ freedom in the negative sense, while the avenues that exist for direct participation enable workers’ self-determination in the positive sense. Participation is easy in small co-ops but it must be cultivated in large ones (we examine how this can be done in the next chapter). Ideally, a co-op structure means that all people in positions of power and authority are elected, revocable, and accountable to the rank and file. Authority no longer derives from shareholding and property rights, but, ultimately, from the consent of the workers themselves. Whereas capitalist firms are characterized by the fact that capital hires labour and uses it for its benefit, cooperative firms are characterized by what Mondragon workers call the “sovereignty of labour”.

Notice that workplaces have the potential to be substantially more democratic than contemporary states. The level of democracy that can exist in workplaces need not be

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46 Co-ops with 50-75% members are in a grey area. It seems to me that these can be considered genuine co-ops only if the non-members can become members after a reasonable period. Of course, this numerical breakdown is only a rule-of-thumb. It’s possible to imagine a co-op where 60% of the workers are non-members, but who nevertheless share in all the day-to-day decision-making in a one-person one-vote manner, and are only excluded from long-term strategic investment decision-making – this could still be a highly democratic workplace.
limited by the mediocrity of political democracy in contemporary states. In particular, workplaces have the potential to be much more deeply democratic than states because they are much smaller so they have much more scope for direct participation and therefore more possibility for meaningful self-determination. In 2005 the American economy had a total of 5.98 millions firms (involving more than one person). Of these, 5.36 million have less than 20 employees. In other words, 90 percent of all American businesses (discounting single person businesses) involve the cooperation of less than 20 people (SBA, 2008, p. 278). The economy with its millions of small firms thus provides fertile ground for democratic participation, and therefore meaningful self-governance at a scale and scope that is simply unimaginable in the political arena. Additionally, the fact that there are huge numbers of workplaces means that there is vastly greater opportunity for democratic experimentation – workplaces can experiment with different kinds of governing structures, different organizations of work (such as using BJCs), different patterns of remuneration (such as according to effort instead of productivity), etc. In this respect workplaces offer much more fertile ground for the flourishing of democracy than the state which has been its historical pasture.

Of course, in the real world it cannot be simply assumed that having a cooperative structure translates into having a truly empowering workplace. The degree to which cooperatives really do translate into genuine workplace democracy depends on a number of factors. On the one hand, there is the question of the formal structures of democratic governance within the co-op – is there legal joint ownership, a guarantee of equal decision-making power, access to information, an active opposition, etc.? And in addition are there substantive avenues for participation – do everyone, particularly the lower skilled and women, actually participate (C. P. Harnecker, 2007)? Is there a culture of egalitarian participation and mechanisms for fostering it? Are their opportunities for workers to learn the skills necessary to manage? As we’ll see in the next chapter, establishing genuine workplace democracy requires getting both of these things right.

Concretely, what is required to foster the expansion of democratic workplaces? While we will discuss a number of important reforms in the next chapter, in general the most important thing is for the state to facilitate the formation of worker cooperatives. As we
will see, the biggest constraint to the spread of co-ops is that of acquiring finance to start up. Once they are established co-ops are just as robust and efficient as capitalist firms; the problem is that they get started much less frequently. One important mechanism to overcome this problem would be to set up an arm’s length cooperative bank that could provide financing. In addition, tax breaks can provide an important incentive to encourage the set up of new co-ops. While these reforms are important and would generate a slow increase in the number of worker co-ops, they would not fundamentally effect the position of the mass of people already employed in hierarchical workplaces. So the most important long-term objective on this front would be for states to pass legislation whereby workers acquire the right to transform their workplace into a cooperative. In the majority of cases this would require a legal right for workers to buy out their workplace from their employers (with appropriate financial help). Theoretically, workplace democracy can be accomplished without direct ownership, for instance by workers collectively renting the facilities and capital stock of the firm from the old owners (Ellerman, 1992). This might be possible for small NGOs or service-oriented businesses with little physical infrastructure. However, in practical terms it is an empirically robust fact that generally cooperative businesses require collective ownership to succeed.47 So in order for workplace democracy to be a meaningful option, workers require a right to buy out the employers or shareholders.

6 A Caveat

At this point we need to introduce an important caveat into the argument. Although I’ve been arguing that workers should have the option of transforming their workplace into worker co-ops, there are several sectors of the economy where this is not appropriate

47 In practice workplace democracy has rarely been successful without collective ownership due to the difficulties of establishing regular, secure financing in a capitalistic environment, as well as the difficulties in maintaining sufficient incentives without a material stake in the firm’s ownership (Dow, 2003). For example, in first thirty years of Mondragon’s existence only three co-ops failed (out of more than a hundred). At least one of the failures was attributed to the fact that workers didn’t put up a large enough material stake in firm, so it became an established requirement for workers to put up roughly 20 percent of the starting capital (Campbell, Keen, Norman, & Oakeshott, 1977; Morrison, 1997).
(Nove, 1991). Single-person businesses are not exactly co-ops, but they importantly allow for the same kind of self-determination that co-ops are meant to provide. The two main areas where worker cooperatives are not an appropriate model are the public sector\(^{48}\) and areas of very high capital intensity.

Workplaces that are public tend to be so because they are thought to directly fulfill a general public interest either in social terms (e.g. hospitals, schools, post offices, etc.) or in economic terms (e.g. water companies, electricity companies, transportation systems, etc). Such workplaces are particular in that they significantly affect two different constituencies – the larger association of the community itself, and the smaller association of internal workers. How a school operates is obviously of concern to the internal teachers as well as to the broader public. Public workplaces are already partially democratic in that they are supposed to be accountable to the citizenry at large via their elected representatives who control them, but they are not democratic with respect to the internal workers. The denial of democracy to the internal workers seems to me unjust for all the reasons of freedom and equality articulated above. But in cases like this, it doesn’t make sense for such workplaces to be entirely controlled by the workers. We wouldn’t want all the electricity in a country to be controlled by the handful of workers who worked the plants, nor the school curriculum decided unilaterally by the school staff, since this would be undemocratic from the perspective of the larger community who genuinely do have a public interest in such things. So in these cases, some broad type of co-management seems appropriate. This might mean having a board of directors for public firms which splits authority between state and worker representatives,\(^{49}\) or having certain public sector workplaces (such as schools or hospitals) reorganized as cooperatives, but with their funding remaining contingent on meeting state-specified objectives (Hirst, 1994). Indeed, in northern Italy, many social services are provided by this kind of social co-op (J. Restakis, 2007).\(^{50}\)

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\(^{48}\) This is an important category as it makes up about 17% of the American workforce, 20% of the Canadian and 40% of the Swedish (Gornick & Jacobs, 1998).

\(^{49}\) This was proposed by Tony Benn, Secretary of State for Industry, in Britain in the 1970s (Benn & Mullin, 1979).

\(^{50}\) In chapter 5 we further discuss the issue of the degree to which consumers should have a say in economic decision-making.
The final sector that is inappropriate for co-ops consists of firms with large capital intensity (i.e., few workers but very expensive equipment). These kinds of industries (oil, steel, auto, pharmaceutical, etc.) are not suitable for cooperatives because it is basically impossible for a group of average-income workers to acquire ownership of firms like this. Nor would we want the state to help fund a small group of workers to take over multi-million dollar capital goods, since far from increasing societal equality, this would simply create a handful of new elites. So in this sector too, a better solution is that of co-management: firms like this could be bought by the state, but instead of being run in the usual way, management should be divided between representatives of the internal workers, and representatives of the community. This kind of nationalization-with-democratization need not be costly for the state (indeed it can be very profitable) provided such firms are run well.\textsuperscript{51} This gives workers some control over their workplaces, without requiring enriching a handful of workers to render such control possible.

7 The Social Democratic Objection

At this point it’s important to consider the social democratic objection: in a context of Sweden or other social democratic countries where workers have heightened bargaining power due to a combination of a strong welfare system, powerful unions, and state regulation of business – in such a context is there still a need for workplace democracy?

While social democratic institutions are an important advance over neoliberal ones in the increased protections they offer to workers, they still do not address the fundamental issue which is that workers do not have a genuine choice to work in democratic workplaces; the option of equality at work remains largely unavailable. It’s true that there is less compulsion to join work in, say, the Swedish context because the safety net makes

\textsuperscript{51} Although there is a common prejudice against the idea that publicly-owned firms can be as efficient as private ones, there is much evidence to the contrary, from Renault in France to Singapore Airlines. Indeed, today’s fastest growing economy, China, state-owned enterprises account for 40\% of national output (Chang, 2007; P. Cohen, 2010).
it easier to leave, but the average Swedish person who does not want to be on welfare her whole life is still effectively compelled to join a hierarchical firm and become a *de facto* servant at work because there are so few democratic alternatives. The worker cooperative sector accounts for a miniscule amount of the economy (about 0.2%), and given that only about 0.12% of the adult population stay on welfare for long periods of time, the vast majority of the population clearly has little alternative to hierarchical work. 52

Social democratic institutions do indeed increase workers’ freedom in the negative sense of protection. This is a good thing, but it is still inadequate for two basic reasons. Firstly, workplaces within social democracies retain deep-seated structural inequality. All the regulations in the world don’t change the basic fact that business owners have unaccountable power over workers not because they were elected, not through rational deliberation or the consent of the governed, but because they own property. Perhaps they acquired their property through inheritance; perhaps they were frugal all their lives and saved it; perhaps they won the lottery. Whatever the case, it is fundamentally unfair for some to have substantial decision-making power over others simply on the basis of their wealth. Walzer is right to insist that “[w]hat democracy requires is that property should have no political currency, that it shouldn’t convert into anything like sovereignty, authoritative command, sustained control over men and women” (1983, p. 298). The idea that legitimate decision-making power can stem from property ownership is a feudal anachronism that we need to outgrow. Getting rid of the last remnants of feudalism, which we have not yet fully done even in the progressive social democracies, means recognizing that legitimate authority can only rest on agreement between equal human beings. No matter how strong unions are in social democracies, the workers are never the equals of managers and owners. In a co-op, however, workers and managers are fundamentally equal. Though elected managers have more decision-making power, both managers and workers are subject to the same rules and enjoy the same fundamental rights. In other words, social democratic workplaces retain structural inequality in the

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52 The first figure is derived from the number of worker co-ops existing in Sweden in the early 1990s (about 100) compared with the total number of private enterprises (about 55,000) (Johansson, 1997; Stryjan, 1990). For the second figure, 1.95%, of the 6.4% of the general adult population on assistance in 1987, received social assistance for ten consecutive years (Andren & Gustafsson, 2004).
form of hierarchy. As long as they do so there is a constant and ubiquitous danger of workers getting abused, mistreated, and oppressed. Unions and regulations may soften the dangers, but they cannot alleviate their source. They are like taking aspirin for cancer: painkillers but not a cure.

Secondly, unions and state regulations are fundamentally inappropriate institutions for enhancing the freedom of self-determination. Unions (ideally) are defensive organizations.³ Likewise, regulations are blunt but often useful tools for the defence of workers’ freedoms. But just like unions, their strength lies in their ability to defend and protect; they are largely inadequate in terms of fostering self-determination.

Unions (ideally) are defensive organizations. They exist to soften the work hierarchy and make inequality bearable. Though they are responsible for most of the freedoms that citizens in the western world now enjoy (from public pensions to universal healthcare to the existence of the weekend), they are not designed to transform the management of the workplace or to challenge who is in ultimate control. Fundamentally, GDH Cole is right to say that unions have in their hands only a brake and never a steering wheel (1920, p. 20). They maintain workers in the passenger seat of history – unable to steer for themselves, and able only to pull the handbrake in times of emergency. In contrast, co-ops (ideally) are organizations for workers’ self-management and self-determination. They are not designed to soften work hierarchy, but to abolish it (in the sense of removing formally unaccountable power). They are not simply defensive organizations but active ones, enabling workers increased power to navigate their own path. This is not of course to say that co-ops are always successful at doing so. Too often they prove inadequate in their defensive role (as the strike in 1974 at Mondragon famously demonstrated), and equally inadequate in their active role of providing meaningful avenues for widespread participation (as is witnessed by some of the co-ops that we’ll analyze in the next chapter). Nevertheless, co-ops offer a real potential to foster the freedom of self-determination that is lacking in social democracy.

Notwithstanding the welfare system, the unions, and the state regulations, workplaces in the social democracies do not allow for self-determination. This is a major problem. Having the power to influence the direction of your workplace, being able to participate as an equal in the evolution of a project, these are things which are currently a privilege...
in our society, available only to a lucky few. Cooperative workplaces are hardly
paradises. But, when they work well, they provide definite improvements by fostering
much broader avenues for participation than conventional firms, as well as significantly
reducing the alienation and powerlessness from which the bulk of workers suffer in a
manner of quiet frustration which for too long has simply been accepted as the norm.

8 Further Objections

The skeptical reader will likely have a number of further objections to the idea of
workplace democracy. Three in particular deserve our attention. First, there is the
objection that people don’t really want democracy at work. Second, one might worry that
workplace democracy undermines the freedom of the entrepreneur to direct her business
as she sees fit. Third is the Platonic or technocratic objection that employers and/or
managers should have superior say because of their expertise in running the business.

8.1 The desire for workplace democracy

It is sometimes suggested that talk of workplace democracy is moot since most working
people do not actually want it. Indeed, it’s true that there are valid reasons why one may
well feel hesitant towards the prospect of increased democracy at work. Most simply,
people may not want to risk the money required to buy out their firm or start a new one.\footnote{For workers to buy out their firms, even with state support, would require a financial commitment. It
would likely require a significant degree of savings over a number of years, and since a worker’s savings
would have to be plowed back into the firm to gradually acquire ownership shares, she is potentially at risk
by putting all her eggs (her job and her savings) in one basket. The lack of diversification means increased
risk. So the normal risk-adverse worker may well prefer to continue working in an undemocratic firm. This
is, of course, a choice she should be free to make.}
But beyond the normal material restraints, there may be other reasons why people are
resistant to democracy itself. They may not want the time commitment that democracy
requires – echoing Oscar Wilde’s quip that the chief defect of socialism is that it would
take too many evenings; they may not want the responsibility and stress that comes with
being “in charge”; all in all, people may feel that self-determination is simply too hard work for it to count as “freedom”.

Those who value increased democracy at work do so because they subscribe to the ethic that self-governing through participation in decision-making is an important aspect of freedom (though not the only kind of freedom, since being left alone to engage in one’s own pursuits is clearly an important kind of freedom too). Yet if there is a one critique that I find most difficult to answer, it is the rejection of the notion that self-determination counts as a type of freedom. For some, this simply cannot be freedom. Freedom cannot be an endless meeting, but must be the opposite, such as collapsing in front of the TV. Life is hard as it is, so freedom must be light and relaxing. Easy, like a tremendous exhale. This is the intuition that many have which runs precisely counter to the ideal of self-determination. Though I agree that life is hard, I think that freedom is hard too. Which is not to say that it is terrible – in fact it can be one of the best things in life – even if it is hard. I don’t know how to counter the common intuition that freedom must be easy except by juxtaposing it with another equally powerful intuition: that abandoning self-determination requires relinquishing something very deep about the desire of human beings to not be controlled. A character in Ursula Le Guin’s novel *Dispossessed* puts it this way: “it’s always easier not to think for oneself. Find a nice safe hierarchy and settle in. Don’t make changes, don’t risk disapproval, don’t upset [others].... It’s always easiest to let yourself be governed” (1974, p. 149). It goes without saying that easier is not always better.

What is the empirical evidence concerning workers’ desire for increased democracy at work? The answer depends a lot on how you phrase the question. On the one hand, it is clear that most countries in the West have very limited amounts of workplace democracy right now (Dow, 2003). We’ve seen that some on the right argue that this shows that workers don’t actually want it, for if they did they would be willing to take lower wages for increased democratic voice (Maitland, 1989). However, the empirical fact about the rarity of workplace democracy may simply reflect businesses’ intransigence and hostility
towards the idea of forfeiting control over the firm, combined with the fact that even if workers really do value workplace democracy they may perfectly reasonably not wish to sacrifice substantial amounts of income for it. That doesn’t mean that workers don’t value increased say at work, only that it may not be their primary concern.

On the other hand, when workers are directly asked whether they would like more say at work, they tend to answer yes. In a comprehensive study of social attitudes, Zipp et al. report that although most Americans report job satisfaction, there is also “widespread favorable feelings toward increased democracy in the workplace” – with 79% of respondents stating they would rather work for an employee-owned firm than investor or government-owned (1984, pp. 406-407). A Federal Commission sponsored by the US Department of Labor found that 84% of workers would like to participate more in workplace decisions ("Employee Participation and Labor-Management Cooperation in American Workplaces," 1995, p. 39). Even this degree of enthusiasm for increased workplace participation is somewhat surprising given the dominant cultural norms that take for granted the need for experts and superiors, the naturalness of hierarchy, the idea of work as a drag, and freedom as independence and relaxing in front of the TV.

The bulk of the evidence indicates that while a minority may indeed choose subservience at work the majority has subservience thrust upon them.

Related evidence for people’s desire to control their own lives is the widespread desire to be self-employed. Not only is self-employment a dream of many people, but whenever people are asked why they want it, their answers invariably refer to the absence of a boss, the capacity to make decisions oneself, to be in control of one’s own working schedule, in short, the ability to self-determine.

One of the most interesting aspects of the evidence on participation is that once workers begin to participate, they tend to want it more and more – participation breeds participation in other words (Mason, 1982; Sobel, 1993). This trend has been noted in co-ops all over the world, from Italy to Venezuela (C. P. Harnecker, 2007). Such a trend

55 Consider for example the massive campaign waged by the Swedish business class against the proposed plan for increasing economic democracy through wage-earner funds (J Pontusson & Kuruvilla, 1992).
implies that, in general, the more people are exposed to workplace democracy, the more they will desire it (other things being equal). I suspect this is generally the case, since freedom is like a muscle of the human spirit; it tends to atrophy and diminish with neglect, but grows and becomes stronger from regular use. It’s instructive to recall that throughout the 1950s millions of middle-class women started to work outside the home, even though the work conditions were often unpleasant and the material requirement to do so was often quite limited. Fifty years later, the desire to work outside the home, and the recognition of the kind of freedoms that can come with this, have grown immensely and become normalized. Indeed, today, the denial of the freedom to work outside of the home would strike us as atrocious. The radicalism of the second-wave feminists in demanding opportunities to participate in the workforce has become our common sense. Similarly, I suspect that were the real material possibilities for workplace democracy to increase, we could expect a drastic increase in the number of cooperatives as well as in the number of people who desire increased workplace participation and feel distinctly unfree without it.

8.2 Property rights versus democratic rights

Consider the case of an entrepreneur, call her Rana. Most would agree that there is nothing wrong with her renting capital and/or machines in order to start a business. Such a process is often an important source of innovation, and should she produce something that others wish to buy (and assuming they can afford it), her self-interested behaviour can serve the public good. Should the business prosper, Rana will likely wish to hire employees in order to expand. But this is where the difficulties occur. It is not a problem for Rana to rent the capital or machines and use them however she wishes, but it is a categorically different issue to rent human labour and use it however she wishes. Some have argued that it is never acceptable to rent human beings (Ellerman, 1992) – but I want to sidestep this issue here. The important point is that when a business is a one-person business, then the entrepreneur legitimately has total control over it. However,

56 Although the language of “renting humans” sounds strange to our ears, this is precisely what is involved in the employment contract. Even Paul Samuelson, the neoclassical economist par excellence, recognizes this: “Wages are the rentals paid for the use of a man’s personal services for a day or a week or a year” (qtd in Ellerman, 1992, p. 95).
when Rana starts hiring others, the business becomes less and less a simple extension of her particular vision and more and more an association of work. Time is the crucial factor here. On the day that Rana hires Hanan, it seems clear that we’d still want to call the business Rana’s. Yet if Hanan were to work there for several years, then so much of the business would be the product of joint labour, joint effort, joint intelligence, joint creativity, etc. that it seems increasingly false to see the business as solely Rana’s, and increasingly unfair for Rana to retain supreme control over it, to be able to direct Hanan as she sees fit, order her around, and so on. After a certain time a group of people working together start to constitute a work association, and Hanan acquires a right to choose whether she wishes to become an equal in the association.

Consider the injustice we would feel at the following (common) situation: Rana decides to give the company to her daughter Ranette. All of a sudden Ranette is in charge. She may have never set foot in the business before and know nothing about it, but she comes in on Monday morning, twenty years younger than all the workers, with the power to hire/fire to give raises, slash pensions and much more. She orders Hanan and the others to change the business direction, ordering them to scrap one project that they had been working on for years to take up an entirely different one. She insists on a more formal workplace than her mother did – requiring the workers to dress differently and refer to her as “Madam”. We feel the injustice of such a situation because it is clear that what is being inherited here is not simply wealth but power.

After a certain time the employer shouldn’t lose her right to her property, but she should lose the right to use her control over property as a means for controlling other people. So we see that conventional private enterprises are really a bundle of two distinct things: (i) a set of property and capital, and (ii) an association of work involving power relations between people. Usually, (i) implies (ii), that is, unequal ownership of property compels those without property – Hanan in our example – to accept the work relations within the association dictated by the owner. Usually, unequal ownership of property is translated through the employment contract into power over people.
It’s important to remember that firms are always both of these things (a set of property and an association of workers) because ownership of things should not translate into power over people. This should be a basic principle of a democratic post-feudal society. Since work is a particularly important type of association – one that is deeply socially consequential – Hanan and the other workers should have the legal right to choose to democratize the workplace. But this is difficult as long as Ranette is the sole owner of the property of the firm (because if one person owns the property there can’t be equal decision-making about how to use it). So in most cases what is required is a right to hold a referendum to decide if they would like to buy out Ranette (so that the workers come to collectively own the firm, and therefore are in a practical position to collectively govern it). The right to do this is conditioned in part by time. Having worked for one week does not seem to be enough time to give an employee a right to equal say, whereas ten years is more than enough. Deciding the time limit at which point a worker is considered no longer temporary but part of the association is, of course, slightly arbitrary, but the underlying principle should be clear: after sufficient time the right of property owners to direct labour is eclipsed by the right of the associated labourers to choose whether they would like to self-determine. One year seems to me about right.

Connected to this issue is the worry that giving a voice to employees might seem to require unfair redistribution of property. For instance, if Rana initially invests $10,000 into her business then works hard on it by herself for ten years, it seems unfair for Hanan, a new employee, to immediately acquire say over the business property now worth $100,000. Indeed, for Hanan to have equal say over this capital is tantamount to expropriation. This kind of expropriation is unjust.\textsuperscript{57} Hanan should not instantly acquire a right to voice, but only after a certain time. And even then, her right is to buy out Rana (or become co-owners with her) so there is no issue of expropriation of property, only redistribution of voice.

\section{8.3 Paternalism}

\textsuperscript{57} Whether expropriation is always unjust is a question that is beyond the scope of this chapter. At present it seems clear that large-scale expropriation would be unacceptable to the vast majority of the population – thus making it undemocratic. A slow, incrementalist approach to socialism seems to me to have much more potential for actually improving the conditions of working people.
The case for workplace democracy can be accused of paternalism on two grounds: that by forcing owners to sell their productive property to workers the state paternalistically promotes the freedom of the latter over the former, and that by funding the expansion of workplace democracy through general taxation (to pay for co-op banks, financing co-op transformations, etc.) requires compelling people who personally don’t value workplace democracy to subsidize it for those who do.

In terms of the first issue, it’s important to remember that every act of the state, every policy and legislation, will “paternally” promote some freedoms and deny others, since the expansion of any kind of freedom whatsoever logically requires the simultaneous restriction of those forces that would undermine it. Freedom for the criminal is unfreedom for the citizen and vice versa. The real issue is deciding which kind of freedoms we want to promote. In this case, since there’s no expropriation of property, the only way that the objection can be sensibly made is to argue that the freedom of an employer to make unilateral decisions over workers is more important than the freedom of workers to make joint decisions as equals. I doubt that such a case can be made with a straight face.

In terms of the second issue, it’s true that fostering workplace democracy requires those who don’t value it to pay for it. Perhaps this is paternalism, but of course the same can be said of virtually any and every government program. Healthy people are forced to pay tax for healthcare that they don’t personally need; elderly people are forced to pay for primary education that won’t benefit them, and so on. Society as a whole contributes money towards these things because they are thought to provide widespread benefits (even if they don’t directly benefit each individual). The same is true in this case. Spreading workplace democracy would arguably do more than any other reform (with the possible exception of introducing a substantial basic income) to increase economic freedom and equality. And, as we’ll see next chapter, many of the positive benefits that come from workplace democracy (such as increased equality and long-term employment) spill over from the workplace to provide positive external benefits for all people regardless of whether they personally desire workplace democracy or not. Moreover, for the reasons we discussed earlier, it’s generally not possible in existing circumstances for
individuals to privately negotiate the amount of workplace democracy that they want on the market. There is a “market failure” in terms of the provision of workplace democracy. This means that acquiring it requires state action and therefore taxation.

8.4 Democracy and Experts

While the legal basis of authority of management rests on contracts and ownership, the ideological basis for their authority usually involves some claim of expertise. CEOs typically justify their exorbitant salaries with the claim that such is the market value of their managerial expertise. Does expertise justify a lack of democracy in the workplace? The first thing to say about this is to point out that in fact managers (and this is even more true for shareholders) may have very limited knowledge of all the complex inner workings of a firm – and often substantially less than the workers who engage in such operations on a daily basis. The mass of workers are likely to have thousands of ideas for improving the firm’s operations, however they usually have no incentive (or power) to implement them, since whatever benefits result, will flow to the employers alone. In Colin Ward’s words, “the fantastic inefficiency of any hierarchical organization is the outcome of … [the fact that] the knowledge and wisdom of the people at the bottom of the pyramid finds no place in the decision-making leadership hierarchy of the institution” (1982, p. 41). One of the fundamental arguments in favour of democratization is that it unleashes the creativity and contributions of all those who had been disempowered but now feel a sense of ownership. This said, it’s clear that complex organizations do require specialization and expertise – so the question remains as to whether experts should have authority over rank-and-file workers on the basis of their expertise. The answer, I think, is no. This becomes particularly clear when we consider the state. It is commonly agreed that the state should not be controlled by an elite on the basis that they know the most politics – the political science professors or philosopher-kings. Democrats throughout history have rejected this Platonic justification for elite rule and rightly insisted on the capacities of ordinary citizens to decide for themselves what is best for themselves.

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58 However, there is good reason to be skeptical of this. For example, Noble prize winner Daniel Kahneman researched the performance of 25 well-paid wealth advisers across eight years, and found that the consistency of their performance was non-existent: “the results resembled what you would expect from a dice-rolling contest, not a game of skill” (Daniel Kahneman, 2011).
Experts are necessary, but they should serve, not lead – “experts should be kept on tap, not on top” (Dahl, 2000, p. 71). Similarly, we should reject the argument that business should be run by economist-kings. In both cases democrats should insist on the capacities of ordinary people to self-govern and be suspicious of others acting in the people’s best interests, no matter how intelligent or benevolent the rulers may appear. A wise co-operative would obviously select experts from within its ranks to oversee various areas of operation (or hire them on a contractual basis), but, and this is the crucial point, at no point should such experts acquire permanent power or privilege – efforts must be made to keep them accountable and responsible to the body of workers.

9 Conclusion

The central argument of this chapter is that the current system of hierarchical work is deeply unjust because the vast majority of workers are compelled to join workplaces within which they are fundamentally unequal – essentially servants. In both neoliberal and social democratic contexts it is very difficult for the average person to choose an alternative in the form of workplace democracy. I have argued that no one should be compelled to be subservient at work which means that everyone should be free to choose workplace democracy should they so desire it. For such a choice to be real, the state cannot be hands off, but must foster and facilitate the expansion of worker cooperatives.

Although my focus has been on issues of equality and freedom, these are not the only reasons for caring about workplace democracy. Republicans have often stressed the importance of workplace democracy for fostering a culture of political involvement (Barber, 1984). Certain Marxists have emphasized how workplace democracy abolishes a central paradox of capitalism – that owners get to own the property that their workers have created (Ellerman, 1992). Other people from anarchists to deliberative democrats have highlighted the salutary effects of increased participation – the education that happens through interchange with other perspectives, the heightened quality of the
decisions that reflect broader involvement, the psychological benefits of feeling engaged, etc. (E. S. Greenberg, Grunberg, & Daniel, 1996; Pateman, 1970).

Additionally, there are good reasons to think that a cooperative based economy would have substantially less inequality, as well as more sensitivity towards the environment. Co-ops are less likely to abandon their town or city to engage in a race-to-the-bottom and they’re less likely to sacrifice employment for profit maximization. And yet they seem to operate with a degree of economic efficiency that is largely comparable to standard firms. It is to these kinds of arguments about the real world performance of co-ops that we now turn.
Chapter 4
Worker Cooperatives in Practice

“The decision-making process [of cooperatives] as a whole can be seen as the assertion of economic rationality with a human face” (Morrison, 1997, p. 188).

1 Introduction

One of the most striking facts about life in the Western world today is that the average person is more than twice as rich as fifty years ago, and yet for all the tremendous increases in wealth, people’s overall happiness has not improved at all (Layard, 2005). Why is this so? One study of 900 women in Texas reported that of normal day-to-day activities, working was their least enjoyable activity (other than commuting); and while the women were happiest interacting with different people, the only thing worse than being alone, was interacting with the boss (Kahneman, et al., 2004). No one knows for sure why this contemporary unhappiness is so pervasive, but one thing is clear: work has not become the place of creativity and freedom it was often hoped it might be. Across the economy in the richest countries in the world, many workers continue to suffer from hierarchy at work, feeling powerless and demoralized. Such is the reality of work at the present time. But is there no alternative?

Many people can see the strength of the theoretical case for workplace democracy. That workplaces are like mini-states, and so shouldn’t be run as mini-fiefdoms, but should be reorganized in a way that makes power formally accountable so as to better ensure workers’ freedoms. However, for many, the fatal problem with economic democracy is not the theory, but the practice – the fact that there do not seem to be obvious real-world examples, particularly since the major attempts to democratize the economy – the USSR in the east and social democracy in the west – have largely failed in terms of actually extending democratic participation in workplaces.

This chapter (as well as the other two empirical chapters) has two major goals: first to look at the empirical evidence concerning the kinds of democratic economic institutions that already exist, and second, to inquire about how transition to a fuller more robust
form of economic democracy might actually be possible. In other words, the goal is to question how the democratic examples that we have here and now might be deepened and expanded.

Here we are concerned with the practical experience and empirical evidence that we have of democratic workplaces in the form of worker cooperatives. We assess this evidence by contrasting co-ops with conventional hierarchical firms on the one hand, and egalitarian collectives on the other. The central finding of this chapter is that the evidence shows that cooperatives operate with levels of economic efficiency that are comparable to normal capitalist firms. They are very much viable economic organizations. Moreover, they appear to be socially superior in certain ways. There are, however, a number of key obstacles that keep co-ops rare, which will need to be overcome to enact any transition to an economy with widespread democratic workplaces.

Before turning to the real-world examples it’s worth pointing out that there is now a sizable theoretical economic literature attempting to predict and describe co-operative behavior. Unfortunately, the literature is extremely contradictory (see J. P. Bonin & Puttermann, 1987).

Among the critics, the two most well-known critiques of cooperatives comes from Ward (1958) and Furubotn and Pejovich (1970). Ward argued that co-ops strive to maximize net income per worker. Since co-ops share their profit equally the more members they have means the more slices of the pie there are. So the attempt to maximize personal income will mean that co-ops react perversely to changes in the market – hiring in bad times, and firing in good times (Domar, 1966; B. Ward, 1958).59 Furubotn and Pejovich argued that co-ops are doomed to underinvest and so will never be able to compete with capitalist firms. Their critique centered on the idea of the “horizon problem”, which is essentially the idea that in co-ops that are collectively owned, the individual worker will not see any benefit from making an investment until that investment pays off down the

59 The intuitive idea here is that the more people employed means the more that the profits are shared out – so co-op members will have incentives to shrink their membership to get a bigger slice of the pie. Vanek and Robinson were quick to point out that even theoretically this argument makes little sense, as it would require co-operatives, which are organizations based on solidarity, to self-mutilate in order to make more money (J. P. Bonin & Puttermann, 1987).
road (unlike an individually-owed co-op or a capitalist firm where investment increases the value of sellable shares today by representing the value of future profitability). And since some of the workers will retire before the investment pays off, their limited time horizon creates a disincentive to invest, thus leading, at least in theory, to substantial underinvestment in comparison to capitalist firms (Furubotn & Pejovich, 1970).

Other critics have argued that worker co-ops will be less innovative (Roemer, 1994), less disciplined (Alchian & Demsetz, 1972; Jensen & Meckling, 1979), or suffer from collective decision-making problems (Hansmann, 1996). Still others have argued that co-ops will inevitably degenerate over time due to market pressure (Luxemburg, [1900] 1986; Mandel, 1975; Marx, [1867] 1933; Webb & Webb, 1907) or due to problems of internal structure (Ellerman, 1984).

On the other hand, some economists have predicted quite the opposite, that co-ops will react normally to market changes (Vanek, 1970), be sustainable over the long term (Ellerman, 1990; Vanek, 1970), and that they will in fact be more efficient than capitalist firms because co-op workers will be more motivated, more productive, more self-disciplined, more trustful, and less conflictual (S. Bowles & Gintis, 1993; Bradley & Gelb, 1981; E. Greenberg, 1981; Horvat, 1986; Joseph Stiglitz, 1993). These authors also tend to stress the social advantages that are predicted to flow from the co-op form: humanized work, higher wages, lower unemployment, greater equality of wages, better workplace conditions, and increased self-management.

Which of these perspectives is better reflected by the evidence? The rest of this chapter reviews much of the empirical evidence to attempt to answer this question. We will see that the popular stereotype of cooperative inefficiency is better known in theory than it is supported in fact.

We begin by looking briefly at cases some of the most important and widely studied co-ops in the western world: Mondragon in northern Spain, and La Lega network in northern
Italy. These examples have much to teach us about how co-ops should (and should not) be structured, as well as how they might be replicated elsewhere.

2 Mondragon

Mondragon is seen by many as the world’s outstanding example of a cooperative economic system within the context of a global capitalist economy (Gibson-Graham, 2003; Morrison, 1997; Whyte & Whyte, 1988). The Mondragon cooperatives (often referred to simply as Mondragon) started when five young workers graduated from a technical training school run by a catholic priest Jose Arizendarrieta in the small town of Mondragon, in the Basque country of Northern Spain. In 1956, with basically zero resources, they managed to scrape together enough money from friends and acquaintances to buy a bankrupt factory in order to start producing stoves as a small worker co-op.

After a few years, demand for the products was sufficient for the co-ops to expand, though they soon found themselves with limited access to finance as local banks were skeptical about the long term viability of co-ops and were hostile to worker ownership (Morrison, 1997). A decisive breakthrough came in 1959 when a small handful of co-ops affiliated together to create a co-operative bank – the Caja Laboral Popular (CLP) to attract local savings in order to finance the co-ops. The CLP functions as a second-degree co-operative, meaning that it is structured as a co-op of co-ops, managed by a mix of its own workers as well as representatives from the co-ops that are its principal clients. The CLP performs two basic functions: it provides finance at below market rates, as well as having an Empresarial division which provides business and managerial advice and

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60 There are also burgeoning cooperatives movements in South America – particularly in Venezuela (C. P. Harnecker, 2005; Malleson, 2010) and Argentina (Vieta, 2010). Unfortunately, the empirical research into these cases is still preliminary.

61 The most critical account of Mondragón is Kasmir (Kasmir, 1996), who makes a classical Marxist argument to the effect that Mondragón fosters middle-class values and undermines the larger working-class union movement without fundamentally challenging the worker-manager class divide.

62 For example, in 1985 the CLP was offering loans to its member co-ops at a maximum rate of 13%, 8% for special sectors, and free of interest for very special cases, compared to the prevailing market rate of 18% (Ammirato, 1996, p. 48).
helps to set up new cooperatives. The CLP is organized like a credit union, so is able to attract the savings of the local population, as well as holding the revenues from the associated co-ops. In this way the CLP acts to recycle the community’s capital through the democratic workplaces. Its significance can hardly be overstated: as Morrison (1997) points out, it has effectively freed Mondragon from dependence on capitalist financiers. With the help of the CLP, Mondragon grew enormously – today it employs over 85,000 workers with assets of $33 billion.

The co-ops operate according to ten guiding principles (Morrison, 1997). (I) Open Admission – no one can be denied entry based on gender, ethnicity, etc. (II) Democratic Organization – one-worker one-vote.\(^{63}\) (III) Sovereignty of Labour – meaning that workers control the co-op and distribute its surplus. (IV) Instrumental Character of Capital – so that the co-ops pay a just but limited return on invested capital, and ensure that owning capital does not give any rights of governance. (V) Self-Management – to ensure participation in management and the ongoing development of skills necessary to manage. (VI) Pay Solidarity – to limit the differential between highest and lowest paid. (VII) Group Cooperation. (VIII) Social Transformation. (IX) Universal Nature – emphasizing solidarity with all workers. (X) Education – which is on-going in terms of both cooperative values and technical skills.\(^{64}\)

Each co-op hires new workers on the basis of skills in addition to commitment to the values of cooperativism. New workers pay a membership fee (that goes into their personal internal capital account), of roughly $10,000.\(^{65}\) This fee acts to screen out workers who do not intend to stay, as well as providing an important source of internal financing. In contrast with other co-ops, such as the Plywood co-ops in the North-

\(^{63}\) Originally, ten percent of workers were allowed to be non-members in order to ensure flexibility for things such as seasonal work, though this changed radically in later years.

\(^{64}\) Education is a foundational value. Indeed the co-ops grew out of schools set up by Arizmendiarieta, who even went so far as to characterize cooperativism as “an educational movement that uses economic action” (qtd in Morrison, 1997, p. 15). This emphasis has continued. For instance, Fagor (the largest co-op group) in 1987 had 30% of its 6602 person workforce involved in technical or professional training courses. In addition to the $730,000 spent on more general social-education for members.

\(^{65}\) For instance, in an Eroski supermarket co-op, a new member must make a capital contribution of 6000 euros (which amounts to roughly 30% of a year’s remuneration) (Arando, Gago y Gonzalo Rubio Garcia, Jones, & Kato, 2011, p. 7). However, efforts are made to ensure that the membership fee is never an insurmountable barrier to entry. For instance, new members can often make a 25% down payment, and pay the rest through wage deferrals over a period of 3-7 years. Alternatively one can take a loan from the CLP.
Western US, Mondragon is collectively owned, so membership is not for sale. Should a co-op dissolve, its assets cannot be sold off but must stay in the community. Each year a portion of the firm’s profits goes into the individual internal accounts, which receive interest. Workers are permitted to withdraw the interest but not the principal, until they retire. This assures a large and vital source of internal finance. New members simply open new internal accounts. So since membership is separated from ownership, the co-ops managed to avoid the structural problems that had led many co-ops in the US to degenerate.

Of the co-ops’ surplus, 10% is mandated towards social charities in the local community, 20% (or more) goes to the co-op’s reserve fund, and 70% (or less) goes into the internal capital accounts. In other words, this structure effectively means that 90% of profits are saved within the CLP to help refinance the whole system.

The ultimate authority in each co-op is the General Assembly, which meets at least once per year. It is responsible for reviewing managers’ conduct, distributing earnings/losses, approving management’s plans, and electing the Governing Council. The elected Governing Council is the highest body of the co-op, in charge of hiring and overseeing management. Management runs the day-to-day affairs of the co-op and is composed of the Manager, who must be a member of the co-op, and an informal Management Council. There is also a Social Council, elected by workers in various departments to help with personnel issues (e.g. health benefits, safety). Although it officially has only advisory power, its purpose, while somewhat vague, is generally seen as a kind of internal union, allowing rank-and-file members more direct engagement. Whyte and Whyte argue that

66 The Plywood co-ops of North-Western USA were structured on the basis of individual-owned shares (Bellas, 1972; Berman, 1967). This meant that each member owned a share which gave him or her membership rights (to vote and share in the profits) as well as property rights (as owners of the firm’s assets). The problem is that when these co-ops were successful, the value of the shares rose hugely. And since they were structured so that the shares gave both membership and property rights, expensive shares meant that membership itself became very exclusive. In this case, shares of the plywood co-ops went as high as $95,000 (often requiring $20,000 down-payment) (Ellerman, 1990). This meant that retiring workers could not find new members who could afford to purchase the shares, thus shares were sold to outsider speculators (in which case the firm degenerated quickly), or were not sold at all, and new employees were hired as non-members (in which case the firm degenerated slowly). This is why Vanek calls firms of this structure “mules” – they are hybrids of capitalistic individual-style ownership with cooperative practices, which due to their structure find themselves unable to reproduce another generation (qtd in Ellerman, 1984, p. 258).
whereas the Governing Council represents the workers as owners, the Social Council represents them as workers – playing the essential role of guiding education, discussion and decision-making (1988, p. 148). Finally, an Account Control Board audits the books.

The system as a whole is represented in a Cooperative Congress, which acts like a mini-parliament, composed of elected representatives from every co-op (in proportion to their size) which meets at least every two years to consider issues of broad concern to the whole system. It is important to note that while each co-op is independent (i.e. under the direct democratic control of its workers), it is also embedded in a larger network of supporting structures that provide financial, business, technical, educational, and social support.

Mondragon underwent massive, some would say fundamental, changes in the 1980s and 1990s, due to substantial pressures from globalization. Management widely believed that they would have to adapt to the global competition if they were to survive. To get a sense of the global pressures they faced consider the dilemma of Irizar – one of the most successful Mondragon co-ops. In the 1990s Irizar was able to manufacture a bus at home at a cost of €180,000, whereas the same vehicle could be produced by competitors in China for only €12,000 (MacLeod & Reed, 2009, p. 137). So in the early 1990s Mondragon significantly restructured to be better able to compete internationally. The system changed its name from the “Mondragon Cooperative Group” to the “Mondragon Cooperative Corporation” (MCC), and workers stopped being “members” and became “associates” (Dow, 2003, p. 63). The co-ops which had previously been organized into geographical groups were reorganized into four business groups: a financial group, a distribution group (dominated by the Eroski supermarket chain), an industrial group (itself divided into seven divisions), and a research/training group – thus allowing for greater inter-firm cooperation as well as economies of scale (MacLeod & Reed, 2009, p. 120). Additionally, co-ops became more flexible in their hiring of contract employees as well as creating a new class of temporary associates.

Probably the most significant change was in terms of its membership composition. MCC witnessed a massive expansion of non-member workers in other parts of Spain
(particularly the south), primarily due to the expansion of the large Eroski supermarket chain (Arando et al., 2011). Furthermore, MCC has become a multinational, and like others multinationals, is increasingly acquiring foreign subsidiaries in places with low-cost labour such as China, Brazil, Mexico, Poland and the Czech Republic. It’s important to note that these firms outside of the Basque region, in Spain and overseas, are run as conventional capitalist firms; the employees are not members of MCC. While Smith (2001) points out that there is no evidence that MCC has refused any requests for foreign subsidiaries to be transformed into co-ops, it is nevertheless clear that the priority is in maintaining the survival of co-ops “at home” as opposed to expanding the movement throughout Spain or overseas. The official rationale for not attempting to democratize the foreign subsidiaries is the legal barriers that exist in certain countries to setting up worker co-ops; the fact that most of the subsidiaries are joint ventures with capitalist enterprises; and the lack of a co-operative culture amongst many of the foreign workers (Azevedo & Gitahy, 2010).

This expansion has fundamentally altered the character of Mondragon (Errasti, Heras, Bakaikoa, & Elgoibar, 2003). While the base of Mondragon in the Basque country has remained staunchly co-operative, MCC as a whole is most accurately seen as a “degenerated” co-op. The fundamental fact is that, according to José María Ormaechea (a past president of the General Council), by 2006 only 38% of workers in MCC were co-op members compared to 80% in 1990. In addition, four joint-stock companies are being established for every one co-op (cited in MacLeod & Reed, 2009, p. 134). By 2008, MCC operated in 129 non-cooperative subsidiaries, of which 75 were abroad (Azevedo & Gitahy, 2010). This means that today the actual co-op members represent only a minority of owners in the business as a whole. The members have, in effect, become privileged quasi-capitalist employers of a larger body of non-member workers. Members in the Basque region are essentially shareholders profiting off the cheaper labour of

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67 The bulk of MCC’s non-members (about 30,000 of them) are in Spain working for the Eroski retail chain. There are also about 12,000 non-members working in foreign affiliates, largely in the global south (Arando, et al., 2010; Monasterio, et al., 2007).

68 I use this term in a technical sense referring to the loss of widespread democratic control by the workers. MCC is in no way “degenerate” in the sense of rotten. Indeed, it remains an inspirational attempt to democratize work in very difficult circumstances.
disenfranchised workers in the rest of Spain and the Global South. As I argued last chapter, firms of this type should not be seen as genuine co-ops, but more accurately as a kind of capitalist partnership.

In order to evaluate the empirical performance of the Mondragon co-ops it’s best to divide the analysis into two periods, corresponding to the original Mondragon Group (from the 1950s-80s) and the global Mondragon Corporation (from 1990s to the present).

Starting with the first period, it is clear that, from an economic perspective, Mondragon has been a stunning success. Starting from five workers with basically no assets, by the late 1980s it composed 166 co-ops, employing 21,000, with $1.6 billion in sales (Morrison, 1997). In one of the most thorough economic analyses of Mondragon, Thomas and Logan (1982) found that co-op efficiency actually exceeded that of the largest conventional firms in Spain by 7.5% and medium and small enterprises by 40%. Levin (1983) confirms that Mondragon has higher labour productivity than the largest Spanish firms. Bradley and Gelb report that more than half the workers consider themselves to be working “significantly harder” than they would for conventional firms (1981, p. 224). Indeed, according to Whyte and Whyte, “all economists who have studied Mondragon’s financial history report than the cooperatives have far outpaced private Spanish firms” (1988, p. 131).

Since the publication of Ward’s (1958) famous theoretical paper, economists have often worried that co-ops will react perversely to changes in the market – firing when demand increases and expanding during downturns. There is however, no evidence for this here (Bradley & Gelb, 1985). In fact, although changes in market demand are reacted to in the normal manner (rising demand leads to growth, slow times lead to declines), the kind of changes are often more humane than in capitalist firms. For instance, during the recession of 1975-83, the Basque region lost 20% of its jobs. Capitalist businesses tended to react by disinvesting, often permanently closing their doors or moving to new sites where unions were weaker or taxes lower. The co-ops, however, reacted quite differently. The co-ops tend to treat labour as a constant cost, achieving flexibility in other ways. So recession is dealt with in the short term by transfers between co-ops, cutting prices, and
producing for inventory, while in the long term, wages and hours are cut, and large-scale reinvestment occurs. Lay-offs practically never happen, and only as a last resort.

Morrison thus characterizes the “decision-making process as a whole” as “the assertion of economic rationality with a human face” (1997, p. 188).

In terms of the social characteristics of Mondragon, the most striking social achievement is the virtual elimination of job loss and the minimization of business failure. During Mondragon’s first thirty years of operation over 160 co-ops were formed yet only three closed (Morrison, 1997). Such stable employment in a capitalist context is practically unheard of.

Like other co-ops, the wage scale in Mondragon is greatly compressed in the direction of equality. In the early years wage differences were restricted to a maximum of 3:1, in the 1980s this was relaxed to 6:1, which is the level it has basically remained ever since. The general picture being that the lowest earners tend to earn more than in comparable capitalist firms, the middle earners the same, and managers and the highly skilled earning half or less. Managers stay because of the moral incentives – their ethical commitment to the co-ops (Dow, 2003, p. 60); indeed the fact that the co-ops can attract such loyalty (so that managers decline leaving even though it would often double their income) strongly suggests that the co-ops are socially different kinds of firms, and deeply rewarding in their own way, since why else would managers stay?

Furthermore, the level of democracy and participation in the firm governance in this period was much greater than in comparable conventional firms. The General Assemblies can fire the top management, and in some cases have actually done so (S. Smith, 2001, p. 32). One study found that 13% of co-op workers felt that they directly “participated in important decisions”, and 20% indirectly through representatives, compared to only 4% and 3% respectively in comparable capitalist firms. Inversely, 30% of co-op workers felt that they did not participate in firm governance, compared to 80% in capitalist firms (Bradley & Gelb, 1981, p. 222). This points to considerably more participation in co-ops,

69 This has not substantially changed over the two periods. Currently the top salary for MCC managers is 6:1, although a few CEOs do earn up to 9:1. In the industrial group, which is the largest group in MCC, 67 percent of workers earn between the lowest rate and double that rate, while 30 percent earn up to 3.5 times the lowest rate, and only 3 percent earn between 3.5 and 6 times that rate (Flecha & Cruz, 2011).
but clearly not any kind of universal engagement. In 1974, Mondragon witnessed its one-and-only strike at the Ulgor co-op which then employed 3,500 workers. The strike shook Mondragon to the core, and led to an attempt to regenerate democratic participation in two main ways: by increasing the importance of the social councils, and, importantly, by introducing a convention to limit the size of co-ops to 500 (in order to facilitate face-to-face participation and minimize bureaucracy).  

A further social strength of Mondragon during its initial period was the connection with the community. One of its ten principles of course is “social transformation”. This principle is given some tangibility by the practice of directing 10% of profits towards charities and community projects. Beyond this, the community clearly benefits from the long-term stable employment, and the fact that the revenues of the firms stay in the community through the CLP, causing positive external benefits throughout the community. In this light, the traditional Marxist objection that co-ops are simply group-capitalists seems inaccurate. Moreover, even though in certain respects shop floor conditions are not noticeably different than in capitalist firms (Dow, 2003), it is nevertheless apparent that workers far prefer working in a co-op than the alternative. Mondragon workers are much less likely to be willing to transfer jobs to a capitalist firm (even for monetary increases of up to 50%), than the other way around – 27% compared to 54% (Bradley & Gelb, 1981, p. 220).

Overall these facts provide strong evidence for the viability of the cooperative model. Mondragon shows us the possibility of a democratic business model that is just as effective economically and substantially superior socially. Of course, we need to remember that such results were achieved in an era without direct competition from multinationals producing in quasi-sweat shops in the Global South. But given that the bulk of trade competition from countries in the North doesn’t actually come from the South (imports to the OECD from the Global South account for only about 20% of imports), and given that there are large parts of the economy (such as the service sector

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70 To avoid diseconomies of scale, large co-ops hive off divisions which then become their own independent co-ops, while remaining economically associated in a co-op Group.

71 See Chapter 8 for a more thorough discussion of the ramifications of globalization for economic democracy.
and many localized industries) that are not threatened by such competition,\textsuperscript{72} we can be confident that there is a large if not predominant part of the economy where cooperative practices of the type exemplified by original Mondragon would likely be entirely appropriate and effective.

Turning now to the second period of global MCC, we can see that, economically speaking, the internationalization process was very successful. Throughout the 1990s and 2000s MCC managed to substantially increased its growth and market share (Errasti et al., 2003). Moreover, MCC grew faster than many other firms: from 1996-2008, sales grew by 213% compared to 140% for similar firms in the same Basque region (Arando, et al., 2010). According to the Economist Intelligence Unit, Irizar is “probably now the most efficient coach builder in the world” (Forcadell, 2005, p. 256). By 2010 MCC as a whole had grown to encompass 250 co-ops, employing about 85,000, with assets of a tremendous $33 billion (MCC, 2010). While this growth is impressive, and shows that MCC has been successful at sustaining its jobs at home through expansion abroad, the fact that this has been achieved by a workforce of whom the majority are conventional, disenfranchised, non-co-op members, means that the success is not fundamentally different from that of other multinationals.

What have been the social results of global MCC? In certain ways it appears that the company has become more corporate. For instance Cheney claims that the democratic participation in the co-ops has become somewhat undermined by the routinization of participatory practices in the General Assemblies, centralization of corporate strategic policymaking, and the decline of the social councils – often accused of simply rubber-stamping management decisions; moreover he argues that education in cooperativism is increasingly taking a back seat to financial and technical training (1999, p. 135). He also reports workers saying things like “this place feels a lot more like a corporation and a lot less like a cooperative than it used to” (1999, p. 75). In terms of employment stability, MCC has been able to maintain its record of virtual guaranteed employment, although this is less impressive when it’s recalled that global Mondragon is able to assure work for

\textsuperscript{72} It has been estimated that locally oriented economic activity makes up about 60\% of total economic activity (in the US) – and this is likely to increase as the importance of manufacturing in Northern economies shrinks and the importance of services increases (Alperovitz, 2005, p. 126).
its members by simply firing its non-members when necessary. For example, in the midst of the recession of 2008-2009, the number of members rose by 6.1% whereas the overall numbers of employment fell by 8.3%, meaning that the security of the members was achieved through the disposability of the non-members (Flecha & Cruz, 2011, p. 160).

However, even if Mondragon is no longer a true co-op, it is still by most measures a better place to work than most comparable multinationals. The job security, profit-sharing and democratic opportunities clearly make MCC a great place to work for members. Indeed, MCC was ranked in 2003 by the Fortune magazine as one of the ten best firms to work for in Europe (Forcadell, 2005). Additionally, MCC employment may be somewhat better even for non-members than the alternatives. For example, Irizar pays the workers in its foreign subsidiaries 20% higher than the local competition (MacLeod & Reed, 2009); while this is commendable, it’s unclear how general this practice is, as the authors recognize that Irizar represents “best practice” with respect to internationalization (2009, p. 133).

Taking a step back now, what does Mondragon’s degeneration imply for our broader interest in co-op efficiency? Do we need to revaluate our positive assessment of original Mondragon in light of global Mondragon? Does the recent degeneration imply that co-ops are an obsolete form of business, best rejected to the trash bin of history? I don’t think so.

Firstly, Mondragon itself may well re-democratize in the coming years and emerge as a competitive multinational cooperative. It is clear that the existence of so many non-members in MCC has been a source of much soul-searching and debate; it was not the result of any kind of “selling out” but rather a response to unavoidable economic conditions. In particular, the bulk of MCC’s non-members emerged from the expansion of the supermarket chain Eroski outside the Basque region across Spain and France during the 1990s, where the new stores were not cooperatives. To combat this, by the late 1990s a partial employee-ownership structure had been established, and starting in 2011, Eroski has approved a multi-year initiative to cooperativize its operations to be completed by 2014-2016; this is expected to bring the total ratio of members to workers back up to
70-75% for MCC as a whole (Arando et al., 2010, pp. 20-211). If this is successful it will represent an important redemocratization of Mondragon. Beyond this it’s not inconceivable that the foreign subsidiaries will be slowly democratized, perhaps by being transformed into full member co-ops where local conditions allow, or at least acquiring increased rights to participation and profit sharing. Moreover, it’s important to remember that a fundamental reason that a re-democratization of Mondragon is possible is that, as many commentators have pointed out, its democratic culture is its primary competitive advantage (Cheney, 1999; Forcadell, 2005; MacLeod & Reed, 2009). Its economic edge comes from the motivation, loyalty, commitment, and constant training that flows from a democratically empowered workforce. This implies that even in a neoliberal global market environment, Mondragon may well be able to emerge as a model of democratic business. Time will tell.

Secondly, it is possible that that in the coming years the global marketplace will suffer little regulation or moderation and so will become increasingly harsh – characterized by a fierce race to the bottom. In such a case it is likely that any firm that cares about anything other than the bottom line (from co-ops to unionized firms to firms with environmental policies) will be forced under. Decent firms may well be unable to survive in such a brutal marketplace. But it must be remembered that this is not evidence of the invalidity of the cooperative form, any more than it is of the invalidity of unions or environmental protection. Indeed, most of us recognize that the fact that pregnant women aren’t as competitive as men does not justify their being paid less – it means that the market should be regulated (e.g. by mandating pay equity); the fact that green electric companies can’t compete against coal-burning ones does not mean that we should abandon green firms – it means that the market should be structured differently (e.g. by putting a price on carbon emissions). If socially decent types of business, like original Mondragon, cannot survive in a harsh global market environment, this is a condemnation of such an environment, not of the firms themselves. The answer is not to abandon co-ops (or other progressive kinds of firms) but to work towards reforming the market environment which is biased against
them – for example by working to implement regulations and tax incentives to motivate firms to work towards a broader bottomline.73

To sum, it is, I think, fair to say that Mondragon, particularly in its original thirty years, has been a hugely successful enterprise. It many ways it serves as conclusive evidence for the viability of the cooperative form, and should give pause to anyone who intuitively doubts the feasibility of workplace democracy. We can learn much by noting several of the key innovations that have been instrumental to Mondragon’s success. First and foremost, the CLP has been vital for loosening the constraints of finance, as well as providing an empresarial division for innovating and starting up new co-ops. Next, Mondragon has discovered a lasting *structural form*. It mandates high levels of internal investment (at least 20% but up to 90% of profits). The innovation of having internal capital accounts allows for divorcing membership rights from property rights (thus avoiding degeneration *à la* Plywood co-ops). The presence of a Social Council importantly complements the Governing Council, providing a mechanism for workers to deliberate as workers as well as owners. Next, Mondragon has shown the importance of ongoing *educational training* both in terms of the values of cooperativism (participation, solidarity, etc.) as well as technical training in bookkeeping, information sharing, participating in meetings, learning how to manage, etc. This is vital because it is only through teaching people themselves how to manage that “self-management” becomes less rhetoric and more reality. Finally, the *clustering* of co-ops together into networks for social and economic support (for instance forming co-op Groups) has been greatly useful.

3 La Lega

Whereas Mondragon grew out of the Christian vision of one man, La Lega cooperatives emerged out of a vast socialistic social and political movement. The early cooperative movement in Italy formed itself into various networks, one of which was The Federation of Italian Co-operatives, formed in 1886 with 248 co-ops representing 74,000 members (about 38% of these were worker co-ops, 44% were consumer co-ops (Ammirato, 1996, 73 Chapters 5 and 8 develops this argument in more depth.
p. 69)). In 1893 the Federation changed its name to the National League of Cooperatives (commonly called “La Lega”).

In 1947, co-ops received formal recognition in the Italian constitution as organs to be promoted by the state. The Basevi Law determined the structure that co-ops were to adopt, reflecting the principles of the International Cooperative Alliance.\(^74\) It stated that co-ops are to be managed by one-person one-vote (with the General Assembly electing the Governing Council, which in turn is to appoint and oversee the management). Admission must be open to all. Membership shares are not sellable. There are limits on the amount of money that workers can invest in their own firms, as well as limits on the amount of white-collar workers allowed in. Interest on capital is restricted to 5% (though this was later relaxed). The co-ops are to distribute their surplus by keeping 20% in a reserve fund (with reduced rates of taxation), allowing up to 20% for supplementing wages, while the remaining had to be used for social activity or reinvestment – thus guaranteeing substantial levels of reinvestment. In the event of dissolution, the co-ops are not permitted to distribute assets to members, which must instead be devoted to a public fund – the purpose of which is to ensure that co-ops won’t degenerate by being sold off to private enterprises for speculative purposes. So although this law constrained the co-ops in certain ways, it also supported them through tax breaks, and privileged access to public contracts (Ammirato, 1996, p. 82).

The structure of La Lega as a whole is formed by each individual co-op electing representatives to a National Congress held every four years, which then elects the overarching governing bodies. The main functions of La Lega are to provide general guidance, support, and cohesiveness to the member co-ops. For instance, La Lega lobbies the state for support, it provides legal, business, and accounting services, it provides research and development information, it helps coordinate business evolution, and helps finance the development of new cooperatives. Overall, the structure is broader than that of Mondragon, but less centralized. The main strategic economic direction does not come from above, but from decentralized Consortia – which are groups of co-ops that have formed together for economic reasons, to pool resources and obtain economies of scale.

\(^74\) The International Cooperative Alliance, founded in 1895, represents co-ops worldwide.
The 1950s was a period of economic stagnation for La Lega, which Ammirato attributes largely to the difficulty of acquiring finance as well as managerial skills (both of which were often caricatured and disparaged as part of an alien capitalist culture). By the 1970s however, these problems started to be overcome. The Consortia were developing and become capable of providing managerial skills and business strategy (Menzani & Zamagni, 2010). In addition, La Lega developed its own financial system, around the financial consortium Fincooper. Fincooper provides three main functions. First and foremost it provides finance to the co-ops at below market rates; it also provides financial services, and thirdly, acts as a major shareholder in strategic companies useful to La Lega as a whole. Fincooper finances itself by charging each co-op a fee as well as attracting deposits from co-ops. Attracting deposits is facilitated by the state, which allows depositors to pay only 12.5% tax on the interest received, compared to the 25% they would have to pay in regular banks.

These factors combined to help make the last several decades a time of great growth for cooperatives. Even with increased pressure from globalization, as well as attacks from Berlusconi’s right-wing government, the co-ops have grown impressively. In 1950 there were about 10,000 Italian co-ops (including but not only worker co-ops) representing about 2% of all workers. By 2001, there were 53,00 co-ops representing 5.8% of workers (Zamagni & Zamagni, 2010, p. 56). During the 1990s, the number of people employed by co-ops rose by 60%, compared to an average of 9% for capitalist firms (John Restakis, 2010, p. 70). Worker co-operatives, particularly large ones, are now major players across the Italian economy: accounting for roughly 18% of all workers in large firms in the food processing sector, 23% in construction, 16% in trade, 19% in hotels and restaurants, 17% in financial intermediation and 17% in facility management services. By 2006, La Lega represented 15,200 firms, with 7,500,000 members and 414,000 direct employees (Zamagni & Zamagni, 2010).

Economically, La Lega co-ops have been remarkably successful. They constitute a vibrant sector of the economy, and are now leaders in their fields of construction, agriculture, retailing, housing, food catering, transport, health, ceramics, machineries, rubber products, furniture, hi-tech equip. Especially in the region of Emilia Romagna, the
success of La Lega allows one to catch a glimpse of a future economy largely dominated by cooperatives of all sorts.

Bartlett et al. (1992) summarize the economic evidence from La Lega: they find that the co-ops have compressed wages compared to capitalist firms, fewer managers as a fraction of the workforce, more hours worked per person, significantly lower assets per person, significantly higher productivity\(^7\) (i.e., value added per worker per hour worked per unit of fixed capital), fewer strikes, absentee days, and quit rates (although interestingly not higher wages). Ammirato concurs that the co-ops tend to outcompete capitalist firms. The co-ops increased their value-added by 42% from 1976-80, whereas the national average was only 18%. Likewise, the co-ops maintained higher levels of employment for firms of similar size, increasing employment by 16% compared to 6% for conventional firms (1996, p. 93).

So it is clear that notwithstanding certain neoclassical expectations, La Lega co-ops have not underinvested or underemployed (Ammirato, 1996, pp. 236-238; Bartlett et al., 1992). On the contrary, they have proven to be eminently sustainable. Many of the co-ops employ hundreds of people and have survived for decades (1996, p. 2).

Can this success be attributed to state subsidy? Definitely the Italian state has been significantly involved in the economy, more so than in many parts of the Western world. The Italian state explicitly determined how co-ops were to be structured and how they were supposed to function – sometimes supporting, sometimes hampering. Italian co-ops have historically been much more explicitly political than elsewhere, leading them to prosper under sympathetic governments and be attacked or sidelined under others (Ammirato, 1996). On the one hand, co-ops have in some ways been supported over and above conventional firms, primarily through being allowed to bid for public contracts without competition, and receiving tax benefits (Forte & Mantovani, 2009). However, it’s also true that in certain ways the co-ops have been restricted vis-à-vis conventional firms: they were long restrained in the amount of interest on capital they could pay (to 5%) which acted as a deterrent to investing in co-ops. Likewise, the number of white-collar

\(^7\) Estrin (1991) disputes this claim of higher productivity.
workers was long restricted. As well, the co-ops often have received much less financial support from the state than capitalist firms, even relative to their size. Furthermore, in many ways the state is not particularly focused on co-ops at all, but is simply interventionist in general, supporting all kinds of firms. The issue of state support is thus complicated. It is probably fair to say that the Italian market environment has generally been supportive of co-ops, but undoubtedly it is inaccurate to dismiss La Lega’s success as simply due to subsidy.

Whereas capitalist firms find themselves enmeshed in a political-legal system that has been set up with them in mind, co-ops are like freshwater fish in a capitalist sea. What is remarkable about La Lega, and a core ingredient of its success, is its ability to develop its own system of supporting structures through a large and highly developed cooperative network. This network provides the best glimpse we have of what a cooperative market system might look like – where the market is structured and regulated so as to provide credit and training, help problem-solving, and encourage expansion in ways that are specifically relevant for cooperative firms.

What about the social features of La Lega co-ops? Ammirato (1996) argues that the co-ops operate efficiently but with a different kind of business ethic. They have a broader bottom-line than simply profit maximization, extending to social concerns of the workers as well as the community (e.g. through donations of a portion of profits and other solidarity initiatives). In many ways, the co-ops strive to balance social and economic considerations.

La Lega co-ops have significantly more internal equality than comparable firms, with wage differentials usually not exceeding 3:1 (Ammirato, 1996, p. 91). Additionally, most co-ops try to institute a culture of equality, through common cafeterias that everyone uses, and replacing the formal language that is the business norm with the egalitarian “tu” between managers and workers (Holmstrom, 1989).

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76 For example, between 1945-47, co-ops only got 0.83% of the total state funds provided to finance business (Ammirato, 1996, p. 83).
In terms of democracy, the co-op shop floors have much more democracy than in conventional firms: the General Assembly has final authority, with day-to-day authority delegated to management who serve at the pleasure of the assembly. Some co-ops proudly proclaim signs on their walls of slogans such as “40 years of self-management!” (S. Smith, 2001, p. 32). Holmstrom (1989) provides an importantly balanced view, documenting the wide variability of democracy in different co-ops. He shows that, as Smith notes, the co-ops do have quite strong democratic structures, yet it’s also true that there is rarely widespread rank-and-file participation in management. Most technical aspects of production are decided by management, and simply assented to by the Governing Council. There is often little experimentation with direct democracy, or alternative work practices, and even General Assemblies are in some cases little more than symbolic events.

All in all, La Lega co-ops have shown themselves to operate with levels of economic efficiency at least comparable to capitalist firms, while being socially superior in many ways. What have been the main reasons for La Lega’s success? First, the co-ops have adopted a sustainable internal structure – mandating high levels of reinvestment, and preventing sell-offs. Next, the league itself has been vital in allowing co-ops to cluster into a shared network which promotes shared values, lobbies the state, provides services, and promotes new co-ops. Next, the consortia have been important in terms of improving market competitiveness by pooling resources, achieving economies of scale, and promoting intersectoral co-op trade, thus providing the basis for national and perhaps even international competitiveness. Next, the financial support and services provided by Finacoop and other financial/banking bodies devoted to cooperative success have been immensely useful. Next, the self-identification of the co-ops as part of a political movement has allowed them valuable alliances with trade unions and political parties, which in turn has been valuable in galvanizing state support – which has been consistently helpful in providing tax incentives, financial provision, and access to public spending.

4 Egalitarian Collectives
While co-ops are characterized by their democratic organization, they do not generally involve complete equality. Co-ops tend to utilize a division of labour with different people performing different tasks, with managers and specialists overseeing various aspects of the business with the authority to direct others. However, at the extreme of the cooperative movement there are organizations that endeavor to organize on completely egalitarian grounds. These can be called “egalitarian collectives” and provide a useful contrast with normal co-ops as they illustrate the tradeoffs that different kinds of social structures allow.

Egalitarian collectives are workplaces that aim for more-or-less complete equality between all the workers-members; their goal is not democracy per se, but isonomia. Rothschild and Whitt (1986), in their excellent work on the subject, describe a number of firms of this sort. For example, a small newspaper The Community News, which employed between 14-18 people. There were no managers or formal hierarchy of any sort. Decisions were made collectively and by consensus in meetings where everyone was encouraged to participate, usually taking up to four hours per week. Jobs were rotated – the photographer this month might be the writer or the layout designer next month – so that no one acquired expertise over anyone else.

In general, egalitarian collectives are defined by the following characteristics. The locus of authority rests with whole group on an egalitarian basis and is not delegated. Decisions are made through a collective participatory process, usually by consensus. There tends to be no distinction in status between any members. Jobs are shared or rotated and wages are usually equal for all. Such firms are always small, with low levels of capital intensity and basic technologies, and tend to be quite homogenous in their personnel. For instance Rothschild and Whitt (1986) describe how practically all of the American collectives that arose in 1970s were formed by middle-class participants of the student movement, well-educated, and ideologically committed.

Studying firms of this sort is extremely useful because it forces us to see the inevitable tradeoffs that exist in social life. Total equality in the workplace, while an admirable goal

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77 Isonomia, meaning “society of equals” was the way that Cleisthenes described his city of ancient Athens.
in certain respects, brings with it at least two requirements: collective decision-making (or else some become managers) and shared tasks or job rotation (or else some become specialists). What flows from these requirements? Collective decision-making is much easier with similar kinds of people – similar cultural background, ideological perspective, and levels of education, which is why these organizations tend to be quite culturally homogenous. Furthermore, collective decision-making necessarily requires smallness as groups much bigger than 10 or 20 simply cannot make decisions in this manner in any reasonable amount of time. And with smallness comes lack of broader impact. Small may be beautiful, but tiny and culturally homogenous firms can only be marginal firms, and are therefore unlikely to impact conditions of work for the majority of people. Likewise, sharing tasks or rotating jobs means that the firm’s operations must remain quite simple with little advanced technology or production processes. Without a division of labour people cannot specialize in activities in which they are particularly skilled but find themselves performing activities they cannot do particularly well, creating massive inefficiency and low level productivity (Mansbridge, 1980, pp. 246-247). Division of labour and efficiency are inextricably linked (A. Smith, [1776] 1986). With substantial inefficiency comes a lack of competitiveness, which is why firms of this sort as so few and far between.

Another tradeoff that exists is between equal wages and motivation. Equal wages means that motivation must rely solely on moral incentives. Egalitarian collectives show that these kind of incentives often are sufficient for stimulating substantial motivation, at least among particularly ideological people (Mansbridge, 1980; Rothschild & Whitt, 1986). However, the dark side of pure reliance on moral incentives is that it encourages free riding since you know you’ll get paid the same no matter how much you do or how much you shirk. Moral incentives also brings with it a culture of moral expectation and conformism – “why aren’t you sacrificing as much for the collective as I am?” – which can be oppressive in its own way. Of course, this is not to say that equality of wages should be totally abandoned as a goal, but that there is probably a sensible balance to aim for between motivating via money on the one hand and via coworkers’ moral expectations on the other. Whereas conventional firms tend to be extremely unbalanced
in the direction of inequality, egalitarian collectives tend to be unbalanced in the opposite
direction of abolishing financial incentives altogether.

In the real world it is, unfortunately, not possible to combine any kind of characteristics
one might want. One must choose between equality or large-scale transformative
potential, between homogenization or experts, between equal wages or material
incentives. This means that in practice you can have democratic workplaces that are
egalitarian, participatory, with no division of labour, that are small and homogenous, or,
you can have democratic workplaces like most co-ops that allow some inequality, are
representative, with specialization, and are potentially large and diverse. The restraints of
reality mean that this tradeoff is inevitable: we cannot have our cake and eat it too.

In my opinion the weaknesses of egalitarian collectives usually outweigh their strengths.
This is because complete equality in all kinds of decision-making requires serious
leveling, smallness, homogeneity and inefficiency, and therefore lacks large-scale
transformative potential. It seems to me advisable to relax our insistence on ideological
purity in terms of insisting on absolute equality for the sake of building organizations that
can grow, include diverse kinds of people, and operate efficiently so as to have the real
potential for actually improving the lives of broad swathes of the population. Egalitarian
collectives do not have this kind of potential. However, as we will now see, workers’
cooperatives do.

5 Compiling the Economic Evidence

Historically, co-ops in the West have been financed almost entirely by personal savings.
They therefore have tended to be small, and confined to areas of low capital intensity,
particularly in industries that lack significant scale economies, require few specialized
physical assets, and have limited barriers to entry, such as construction and certain
branches of manufacturing, printing and publishing, clothing, food production, textiles,
glass, ceramics, wood and furniture (Dow, 2003). Traditionally, co-ops have had
basically no presence in industries that are highly capital intensive, such as chemical or
pharmaceutical industries, iron, steel, transport or auto. That said, Mondragon and La
Lega demonstrate that co-ops with significant capital intensity can be viable provided that financing difficulties can be overcome.

The central empirical question regarding cooperatives is “are they efficient”? This broad question can best be analyzed by breaking it down into the following criteria: productivity, ability to grow and create jobs, appropriate reactions to changes in the market, and sustainability over a sufficiently long term.

In terms of productivity, there is wide-ranging evidence that cooperatives have just as high if not higher productivity than capitalist firms. This is seen in the US (Bellas, 1972; Berman, 1967; P. Bernstein, 1976), in Britain (Derek Jones, 1982), in Denmark (Mygind, 1987), in Spain (H. Thomas & Logan, 1982), in Sweden (Thordarson, 1987), in France (Defourny, 1992), in Italy (Ammirato, 1996; Bartlett et al., 1992; Zevi, 1982), in Poland compared to state-owned firms (Derek Jones, 1985), and more generally that increasing participation aids productivity (S Estrin, Jones, & Svejnar, 1987). Of particular interest is Doucouliagos’s meta-analysis compiling the results of 43 studies comparing the productivity of co-ops to capitalist firms. He concludes that there is a strong association between co-op profit sharing and productivity and a small but statistically significant association between worker participation in decision-making and productivity thus “rejecting the traditional view that democratic management of the firm is associated with reduced efficiency” (1995, pp. 67-69).

The evidence is thus robust that being your own boss does seem to improve productivity. In the same vein, there does not appear to be widespread problems of shirking in co-ops (Dow, 2003, p. 183), nor is there evidence of the lack of discipline that authors like Alchian and Demsetz have suspected (Bartlett et al., 1992; Cornforth, Thomas, Lewis, & Spear, 1988). Indeed, it’s likely that an important source of efficiency advantage of co-ops is that the increased worker trust enables them to substantially reduce monitoring costs, which for capitalist firms typically account for as much as one-fifth of total labour costs (S. Bowles & Gintis, 1998). The productivity advantages of worker participation have been obvious enough that recent years have witnessed a flurry of attempts by capitalist managers to experiment with ways to increase it without sacrificing managerial
control – such as through Quality of Working Life programs. We should not find co-op productivity surprising, since even in capitalist firms the coordination that happens is only partially order-giving and order-taking. An enormous amount is achieved by workers solving problems amongst themselves on the basis of mutual aid (“can you show me how to do X?”, “send me an email about Y”, “remind me to do Z”). Coordination does not generally happen through buying and selling; no one says “I’ll send you that email for $3.75” – or by micro-commands among finely grained hierarchy. Indeed it’s impossible to imagine any sophisticated coordination whatsoever happening without extensive amount of co-operation even within hierarchical structures. The only reason that the gears of a hierarchical system can turn at all is that they are constantly lubricated by millions of micro-acts of cooperation. The coercion, not the cooperation, is the anomaly.

Next, the evidence demonstrates that co-ops have no trouble in generating jobs and growing. Smith reports that co-ops tend to employ more workers than would maximize income per person (2001, p. 37), and Zevi (1982) shows that Italian co-ops tend to grow faster than capitalist firms. The worry that co-ops will not grow or employ is based on the underlying concern that co-ops will underinvest – perhaps because workers might prefer to siphon off the surplus into their personal wages instead of reinvesting, or perhaps because of short time horizons. Whatever the case, in practice there is no evidence that cooperatives underinvest (Dow, 2003, pp. 162-163). Bonin, Jones, and Putterman are conclusive about this: “no strong empirical support for the underinvestment hypothesis is found either in France or the UK”; they conclude that “the empirical literature contains no econometric support for this hypothesis” (1993, pp. 1311, 1316). Indeed, in practice many co-ops overcome horizon problems by simply mandating a portion of surplus towards reinvestment (e.g. Burdin & Dean, 2009).

In terms of their ability to react to market changes, it is clear that co-ops do respond efficiently to broad changes in market demand: expanding in times of increasing demand and slowing in times of recession. However, the precise way that they respond is usually different (Burdin & Dean, 2009). Co-ops tend to adjust to demand changes by keeping employment constant (treating it as a semi-fixed cost), and achieving flexibility by
adjusting hours and earnings, whereas conventional firms are more likely to adjust the quantities of all their inputs, including laying off workers (Dow, 2003, p. 162). So there is no empirical evidence to suggest that with the appropriate support structures for financing and facilitating new co-op formation, a market largely dominated with co-ops would not work well or would fail to provide similar levels of allocational efficiency. Indeed, Jossa and Cuomo argue that a co-op dominated economy would likely be economically superior in that it would have downturns that are less severe than capitalist ones. This is because when capitalist firms have downturns, they face wages that are quite rigid, which means that since workers’ wages can’t be reduced they have to be fired altogether leading to some productive capacity remaining idle. Thus the familiar capitalist paradox of recession: unemployment side-by-side empty factories, which is caused because wage rigidity leads to underutilization of capacity. But in a co-op economy, downturns mean that workers can choose to take pay cuts, (an option that doesn’t exist in typical capitalist firms), resulting in less unemployment and underutilization, and therefore a less severe recession (B Jossa & Cuomo, 1997, pp. 283-285).

Next we might ask if cooperatives are efficient in the sense of being sustainable over the long term. One possible form of degeneration discussed in the literature is conversion into capitalistic firms. However, the evidence is that this happens only with “extreme rarity” (S. Smith, 2001, p. 28), and when it does occur it is mainly due to having a poor organizational structure, like that of the Plywood firms. In terms of outright failure, the evidence suggests that co-ops fail no more often than comparable firms, and in many instances are surprisingly robust (Bellas, 1972; J. P. Bonin et al., 1993; S Estrin & Pérotin, 1987; DC Jones, 1975). This is corroborated by Smith (2001) who argues that death rates for co-ops have been extremely low compared to conventional firms. Of the 200 factories taken over by the workers following the 2001 economic crisis in Argentina, only two have shut down (John Restakis, 2010, p. 215). Gregory Dow’s excellent work is the most up-to-date compilation of the existing literature. He ends his study with the following: “The general conclusion … is that [co-ops] are not rare because they fail disproportionately often. Once created, they appear robust. Rather, they are rare because in absolute numbers they are created much less often than [capitalist firms]” (2003, p. 227).
Finally, it is clear that the efficiency of cooperatives cannot be written off as simply due to state subsidy. While co-ops (like capitalist firms) clearly perform better when supported, most states possess market environments that contain a complicated mix of supportive and hampering measures. For instance, co-ops often receive tax breaks, but almost never receive institutional financial help in any way comparable to the gigantic banks and stock markets set up to aid capitalist firms. So while it may well be desirable to support co-ops more in the future, studies to date indicate that co-ops are robust and efficient despite the political-economic environment, not because of it.

The bottomline is that co-ops operate with levels of economic efficiency that are comparable to conventional firms; they are eminently viable kinds of businesses. Their rarity and smallness seems to be caused not by any inherent inefficiency, or internal tendency to degenerate, but by contingent factors (such as structure and financing) which can in certain cases be decisively overcome – as Mondragon and La Lega powerfully demonstrate. (We examine the reasons for the rarity of co-ops below).

Of course, even if we can be relatively confident about cooperative efficiency on a small scale, this does not prove that an entire cooperative economy will be similarly efficient. We cannot know for sure until we try. But what can we expect? A skeptic might argue that small co-ops can be efficient by attracting highly motivated people who are ideologically committed to the co-op model, but that economy-wide, co-ops would not work so well. I think this pessimism is unfounded. We have seen that worker co-ops possess a number of productivity advantages over conventional firms that come from mutual monitoring, being one’s own boss, being more involved in decision-making, having incentives to work hard from having one’s remuneration directly tied to the firm’s performance, having a more pleasant culture leading to less turnover and absenteeism, etc. Nothing about these factors relies on cooperatives being small and peripheral; logic suggests that they should be just as effective on a large scale as they are today.\footnote{Indeed, there is strong indirect evidence for this in the case of shared capitalism, i.e. firms that are not co-ops but directly tie workers’ pay or wealth to the firm’s performance (through profit sharing or stock purchases, etc.) Almost half of American private sector employees participate in some form of shared capitalism so it is much less marginal than co-ops. And even though these firms have weaker worker ownership and worker decision-making than co-ops, the largest empirical study to date (surveying over}
6 Compiling the Social Evidence

It’s interesting to note that the two main criticisms commonly leveled against co-ops are largely contradictory. The mainstream neoclassical view is that co-ops behave *too differently* from conventional firms, whereas the Marxist critique, on the other hand, is that they operate *too similarly* (i.e. degenerate to become indistinguishable). In fact, while competitive market pressure does provide a broad base of similarities between the two types of firm – in terms of concern about productivity and profitability, standardization of work, and establishment of pyramidal management – in various ways co-ops *do* consistently behave differently from conventional firms.

Co-ops do not generally aim for simple profit-maximization. Indeed, it is unclear that they aim to maximize any one thing at all (Dow, 2003, p. 142). Most co-ops are interested in maximizing employment or job security in addition to profits, but this is not always the case (Burdin & Dean, 2012). Indeed, since co-op management is controlled by the workers collectively, it is unsurprising that there are a broader range of goals and priorities than a capitalist firm controlled by shareholders who are likely to have a more homogenous commitment to profit maximization (since that’s why they’ve bought shares in the first place). Most co-ops seem to have a broader notion of the bottomline, including profit, but also including various social concerns ranging from employment stability to community improvement. So the fact that co-ops are not single-mindedly profit maximizing may make them less profitable than conventional firms in a narrow economic sense, but this “disadvantage” (if it is a disadvantage at all) may well be balanced out by the productivity advantages that tend to accrue to co-ops from their the lack of such antagonistic management.

Co-ops also seem to act differently in terms of employment, as we have already mentioned. Co-ops are much more reluctant to lay off workers than conventional firms

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40,000 workers in shared capitalist firms) still finds empirical support for all of these productivity advantages (R. B. Freeman, Blasi, & Kruse, 2010).
(Burdin & Dean, 2009). Indeed, Dow states that “one of the most robust empirical generalizations about LMFs [co-ops] is that they respond to negative demand shocks by maintaining employment, while restricting hours, wage rates, or both” (2003, p. 198). In other words, flexibility is achieved in a democratic firm in ways that tend to be more egalitarian and consensual. So in this respect, co-ops behave more progressively than conventional firms – economic rationality with a human face, as Morrison would say.\(^79\)

Likewise, there is wide consensus on the fact that co-ops allocate wages with much more equality than in capitalist firms. So it follows that a society largely composed of co-ops, other things being equal, would be significantly more equal too. Of course, by suppressing wage differentials, co-ops face difficulties with acquiring scarce managerial talent; however, this problem is often overcome through a combination of modest wage incentives alongside the moral incentives of working in a community of equals. While egalitarian collectives tend to operate with strict equality, many co-ops allow some wage differentials (only rarely exceeding 3:1). But this differential much more egalitarian than the comparative practices in social democratic countries (where the differential is roughly 15:1 (Randoy & Nielsen, 2002)), and is tiny compared to the American world, where the average US CEO makes 300 times the average wage (The Economist, 2006); indeed in 2000 the gap was an extraordinary 531:1 (Bogle, 2008).\(^80\)

Another important area of difference is in terms of relationship to the community. Although it’s hard to precisely measure the degree to which co-ops differ in their relationship with the larger community, several points deserve mention. First, the practice of collective ownership serves to tie the co-op’s assets to the community, as it cannot be sold off for speculative purposes.\(^81\) More broadly, many co-ops (including Mondragon and La Lega) mandate a portion of their profits directly to the community for charities or

\(^79\) Recent work on the economics of happiness suggests that since people’s happiness is so contingent on social comparison with one’s peers, the only time one can take a pay cut without feelings of serious loss is when everyone else does so too (Layard, 2005, p. 44). This implies that the spread of co-ops could improve overall levels of happiness at work since inequality is mitigated.

\(^80\) In such a context as this, a CEO will make in a mere month’s work the same amount as a worker will earn in 30 years – an entire career.

\(^81\) Bartlett, et al., report that “cooperatives appear to have stronger links with the local economy: they are less export oriented, have higher shares of sales to local buyers, and are more likely to recruit unemployed labour than private firms” (Bartlett et al., 1992, p. 116).
social projects. Additionally, the fact that co-ops tend to maintain long-term, steady employment is clearly beneficial to the health of the community. Finally, since co-ops are controlled by workers who generally live in the community in which they work, there is less danger to the community from capital flight in the sense of the business leaving. This is an important point.

Normal firms, controlled by capital, will generally move wherever they can in order to maximize profit – sometimes responding to increased demand, sometimes simply to areas with less unions, less environmental protections, lower wages, lower taxes, etc. This results in huge wealth for some, abandoned communities, ghost towns, rust belts, and lower standards of living for others. Co-op practices are different. Since they are controlled by labour co-ops will seek profits, but only in ways that benefit themselves as workers as well as community members. Instead of moving, co-ops tend to use capital instrumentally in order to achieve competitiveness within the community, through reinvesting in existing jobs, retooling, furthering education, etc. Co-op business success thus provides all kinds of positive externalities that are otherwise lacking (e.g. stability, community reinvestment, etc.) In other words, the link that exists for co-ops between firm success and community benefit means that it’s much truer for co-ops than capitalist firms to say that a rising tide lifts all boats. Of course, it’s possible that this lack of mobility may reduce efficiency somewhat, but efficiency gains from capitalist mobility tend to concentrate unequally among the owners. As long as new co-ops are able to form in new areas where demand is growing, this shouldn’t be a massive problem. And whatever efficiency losses occur are likely to be far outweighed by the social benefits of treating capital (as opposed to actual labouring human beings) as a production variable.

Furthermore, although there is little hard data on the question, Booth (1995) has argued that cooperatives operate in ways that are more environmentally sensitive than capitalist firms. Although more investigation needs to be done on this question it does stand to reason that workers, presumably, are less likely to pollute the community they have to live in than a comparable capitalist firm controlled by distant shareholders.
However, co-ops have provided only weak and inconclusive evidence for the “spillover thesis” that participating at work will improve the civic virtue of people in their communities – making them better citizens, more eager to participate in politics, and less individualistic. In his extensive studies of American co-ops, Greenberg finds that the co-op workers were no more likely to vote in federal elections, though they were more likely to engage in local politics. Nor were they less classically liberal: they appeared to be just as “individualistic” as comparable workers (E. Greenberg, 1981). On the other hand, Putnam (1993) shows that Northern Italy, which has a much higher concentration of co-ops than the South, also has a much stronger civic culture and engagement. And although it’s very difficult to say that one factor directly causes the other, it’s entirely likely that the two reinforce each other.

What about the quality of work in a co-op – are co-ops more pleasant places to work? There is no easy answer to this question. Much work is inherently tedious or dull, and so no amount of organizational transformation is likely to alter this fact. Clearly democratizing workplaces cannot magically transform work into play. On the one hand, many co-ops have shop floor conditions that are not noticeably different than capitalist firms (Grunberg, Moore, & Greenberg, 1996). This is partly due to the fact that competition and dominant technologies exert some pressure on the way that work needs to be organized, but even so, it is disappointing that a larger number of co-ops have not experimented more with different modes of work organization. Also, co-op workers often complain of substantial work stress, which accompanies the increased expectations and responsibilities that workers have in democratized firms (Lasagabaster, et al., 2011; Rothschild & Whitt, 1986). On the other hand, since co-op workers who experience shopfloor conditions firsthand are also the ones in control of management, the possibility of experimenting with work organization remains much greater. Indeed, many co-ops do consciously strive to improve the quality of work, such as the Mondragon Café in Winnipeg via balanced job complexes (Burrows, 2008). In some respects work clearly is more pleasant in co-ops. Blumberg states that “there is hardly a study in the entire literature which fails to demonstrate that satisfaction in work is enhanced… from a genuine increase in workers’ decision-making power” (1968, p. 123). Co-ops consistently have lower levels of quit rates and absenteeism (Bartlett et al., 1992), as well as less
worker-manager antagonism (E. Greenberg, 1986). Even in large co-ops it is a consistent theme that members claim to prefer their workplace to the conventional alternative (though of course selection bias is possible). Co-op managers consistently earn far less than they would elsewhere, yet nevertheless choose to remain, which suggests that they do indeed find co-op work more pleasant. Workers too consistently articulate their preferences for working in a co-op, usually pointing to some combination of the more egalitarian environment and the reduced antagonism and hierarchy so prevalent in conventional firms. Participation at work – and the freedom of self-determination more generally – is not an easy breezy kind of freedom. It is both hard work and deeply rewarding.

One of the clearest indicators of the inferiority of work in conventional firms is visible in terms of health. For instance Marmot et al., (1984) found that men with low job control had three times the ten-year risk of suffering coronary heart disease. Their follow-up study, examining over 10,000 people, confirmed these results and led them to conclude that “this suggests that policies giving people a stronger say in decisions about their work or providing them with more variety in work tasks may contribute to better cardiovascular health” (Bosma et al., 1997, p. 564). This connection between low-job control and ill health has also been corroborated by a number of other investigators (De Jonge, 1995; Sauter, Hurrell, & Cooper, 1989).

6.1 Are Cooperative Workers Freer?

A central claim of this book is that democratizing the workplace makes workers freer. So we must ask if the evidence backs this up. Do workers in co-ops actually feel freer? The answer seems to be “yes”, but with important caveats. Obviously how people subjectively feel about their work will vary immensely across workplaces and cultures. The experience in working in a six-person anarchist bike co-op in Toronto is very different from a 2000-person industrial co-op in Italy. That said, the evidence points to several general points. In general, it’s clear that while co-ops are often successful at removing
formal hierarchy at work, informal hierarchies often emerge, based primarily on bureaucracy and expertise which tend to dull the democratic freedoms.\footnote{Another kind of informal hierarchy that often forms in democratic organizations is that of the tyranny of the eloquent. This will be discussed further in later chapters.}

There are three important components to this issue, which one might call the “structures of parliamentarian democracy”, the “structures of participatory democracy”, and the “culture of participation”.

Most co-ops are quite good at maintaining the overarching parliamentarian structures of democracy (general assemblies, one-person one-vote, transparency, availability of information, etc.), and this provides a certain sense of (negative) freedom. Workers often do feel that the managers are accountable to them, and that the gap between management and workers feels smaller and less intimidating than in conventional or unionized firms (Ammirato, 1996; Bradley & Gelb, 1983; E. Greenberg, 1986). The co-ops that are the most successful in this regard are the ones that develop mechanisms for maintaining vibrant democratic competition in order to prevent the same clique from winning election after election. As in political democracy, workplace democracy works best with active internal opposition so that dissatisfied people can form different groups and organize different platforms to ensure new ideas are heard and new leaders enter into management. Having social councils or work councils are useful in this regard.

However, the structures of participation, as well as the culture of participation are the most vital things for maintaining a sense of (positive) freedom as self-determination – and these are much more variable. Some co-ops clearly have these things, particularly ones that are smaller and more explicitly political, such as the Mondragon Café. However, many co-ops, perhaps most, do not.

Structures of participation tend to get undermined by two restraints of reality, originally pointed out by Weber ([1922] 1968) and Michels ([1911] 1962). The first is size. As the workplace grows in size it becomes increasingly difficult to directly participate; participation inevitably passes into representation and bureaucracy starts to form. It is practically impossible to feel that you are self-determining in a large co-op if you never
get to directly participate (which is why Mondragon sensibly restricts co-op size to 500). Self-determination, in other words, requires participation at some level (though not every level). The second major constraint is that of complexity. Complexity tends to lead to informal hierarchies because dealing with complex issues requires specialization and the creation of managers and experts who acquire a monopoly on information and relevant knowledge. This makes them difficult for the rank-and-file to control, and can undermine democracy as shopfloor workers feel obliged to simply go along with the advice of the experts. In particular the specialists who have access to information regarding changes in the market (e.g. new products, new manufacturing technologies, new competition) often manage to get their way much of the time (Holmstrom, 1989). So both size and complexity lead inexorably to a pyramid structure of governance in order to coordinate the whole. Such a pyramid may be harsh and capitalistic – with the top being unaccountable – or it may be parliamentarian and accountable to the bottom as in most co-ops, but regardless, all large firms will develop pyramid structures with bureaucrats and experts at the top, that if not circumvented in various ways will tend to create informal hierarchies, undermine participation, and thereby undermine feelings of freedom and self-determination. It is important to recognize that these constraints are real, they flow from the realities of the institutions themselves, and cannot be simply abolished or dismissed as the mere bagatelles of capitalism. Feasible radicalism needs to squarely recognize how these restraints undermine participation, otherwise it risks falling into nonsensical utopianism of thinking that somehow the “associated producers” will one day be able to participate in everything.83

Likewise, many co-op workers lose the sense of self-determination if the culture of participation at the firm petrifies. For instance, both Cheney (1999) and Holmstrom (1989) depict instances of co-ops where democracy has become routinized, symbolic and hollow – resulting in little more than a vote per year, with workers complaining that their General Assemblies feel as “predictable as Catholic Masses”. Participation can be

weakened from apathy, as well as cultural changes of the “Americanization” of freedom – seeing it less as participating at work and more as exiting work to shop and play.

However, none of this is inevitable. While Michels ([1911] 1962) thought that the corruption of democracy into oligarchy was an “iron law”, in fact it’s only a tendency that can be countered. The co-ops that are the most successful at maintaining feelings of self-determination do so by checking the informal hierarchies that develop alongside size and complexity. They recognize that getting democracy right isn’t simply a matter of finding the right design, but it’s a continual process of experimenting with different ways of furthering opportunities for meaningful participation within parliamentary structures. Such co-ops develop ways of ensuring widespread avenues of participation, which in large firms means finding possibilities for decentralization, such as having working groups with basic autonomy over their work design, as well as consciously striving to foster a vibrant culture of democratic participation, for instance by having active social councils and regular educational opportunities about the theory and practice of cooperativism so that shopfloor workers become knowledgeable enough to challenge the managers and experts. In other words, the co-ops where workers seem to feel the freest, are those that operate with overarching structures of parliamentary democracy, but within this, they attempt to decentralize where possible in order to provide avenues for direct participation, while simultaneously promoting a culture of the importance of participating, because it is only at the face-to-face level that self-determination feels meaningful and workers feel free.

So it’s an important, if not particularly surprising, conclusion that in practice, democracy in the workplace (particularly in large co-ops) has many of the same strengths and weaknesses as it does in the state. Although of course, workplaces are much more numerous, so there is more room for experimentation. Co-op workers rarely describe themselves as being totally free or in charge. Holmstrom (1989) poignantly describes how many co-op workers feel that managers make the crucial decisions, and that opportunities to actually participate are often few and far between. Such criticisms will strike a familiar chord to most citizens in the West vis-à-vis their political democracy. But although few citizens today are overly ebullient about the quality of their democratic
participation, even less would be willing to give it up for some kind of authoritarian or technocratic rule. Similarly with workplace democracy. Although few feel it’s utopia, those who have it consistently do not want to give it up, but often find on the contrary that participating breeds the desire to participate more (E. Greenberg, 1986). Cornforth et al. concur: “we found that people did not want to give back control over their working lives once they had experienced it” (1988, p. 111). People value the freedoms they have, even if they’re not everything they’d hoped for. This may be progress of an incremental sort, but it is progress nevertheless.

The bottom line is that worker co-ops are clearly not perfect institutions. Yet nonetheless, they do seem to be socially superior to most capitalist firms in terms of their humane and healthy treatment of labour, increased equality, community connection, and (admittedly variable) work pleasantness and democratic freedom.

7 Summarizing the Evidence

While we can think about types of firms in many different ways, from a democratic perspective it’s useful to recognize that we can classify firms based on the degree of equality in management decision-making. From this perspective there are three broad families of firms: egalitarian collectives, worker co-ops, and capitalist firms. Clearly there is much variety within these categories, but if we were to make a general assessment, what could we say? The evidence points to several basic conclusions. First, egalitarian collectives have little large-scale transformative potential. This is because their insistence on total equality in theory requires a high degree of leveling and homogeneity in practice, which keeps such organizations small and inefficient. Second, co-ops are in fact a kind of hybrid of egalitarian collectives and capitalist firms. They retain the formal equality and democratic aspirations of egalitarian co-ops, but structure themselves in a way that allows for a division of labour with large-scale potential, characteristic of capitalist firms. The fact that co-ops are hybrids may make them unattractive to purists, but for those of us interested in feasible socialism, we can see that their hybrid structure is actually a strength, allowing cooperatives to operate with robust
economic efficiency within a fundamentally democratic framework. Third, when compared to conventional capitalist firms, co-ops have a lot to recommend them. Importantly, they operate with comparable levels of economic efficiency to conventional firms. The standard perception of co-ops as inevitably small and bumbling organizations is a myth that should be disregarded; as examples like Mondragon and La Lega show, they can be large, complex, and immensely successful organizations. Fourth and finally, co-ops are not simply economically efficient, they are in many ways socially superior to conventional firms.

What moral should we draw from these conclusions? The overall lesson is that co-ops are sufficiently superior to conventional firms that they deserve our support. They are important enough and successful enough to warrant ideological support from activists and material support from the state in order to expand this form of business. Co-ops are not idyllic organizations. Their democratic structures can work poorly and be subverted by informal hierarchies, and they can be stressful and time-consuming even when they work well. Yet for all that, they are significantly better types of businesses. They offer a kind of workplace that is more equal (in terms of fundamental rights as well as wages), freer (in terms of accountability and self-determination), solidaristic (in terms of the lack of formal hierarchy, and increased connection to the community), and healthier (in personal as well as environmental terms). Instituting workplace democracy well, so that the benefits of equality and participation are actually widely felt, is possible, but it’s an ongoing and evolving process. Freedom, unfortunately, does not fall from heaven, but must be built with human sweat.

8 Obstacles to Co-op Formation

At this point we’ve reached a puzzle. If co-ops are roughly as economically efficient as capitalist firms (and arguably superior in certain social respects), then why are they so rare, usually making up less than 1% of most Western economies? Though there is no consensus on this question, several themes are stressed by almost all commentators.
First, the primary obstacle to the formation of co-ops is quite simply lack of money. As Drèze says, “funding difficulties are the main reason why labor-managed firms are not spreading within capitalist economies” (1993, p. 261). Workers are generally too poor to transform their firms into co-ops themselves. Bowles and Gintis have calculated that the bottom 80% of families have an average net worth of only 50% of the capital stock of their firm per employee. And of this, about half again is tied up in cars and homes (cited in Dow, 2003, p. 189). This means that workers wishing to set up co-ops can only do so by taking on huge risks. Since they have limited funds to begin with, they must place a high percentage of their total wealth into the firm, which is also their job, thus putting all their eggs in one basket (if the firm should go under, they’ll lose both their savings and their job). This riskiness hugely disadvantages co-ops. Capitalists can invest a little capital in many companies, thus spreading out their risk, but workers cannot invest a little work in many companies, so are unable to spread their risk. This means that a normal risk-adverse worker will find starting a co-op basically impossible, without large financial support.

This brings us to the second main obstacle that co-ops face – lack of financial support. With insufficient personal wealth, workers are reliant on raising finance externally, but this is usually extremely difficult. External financing is hard to acquire for several reasons. States do not generally provide sufficient support. Co-ops cannot sell shares in the normal sense84 (indeed, the joint-stock company was invented precisely to serve this function of raising capital). And co-ops often find it hard to convince conventional banks to lend to them, partly out of discrimination against worker-ownership, partly out of ignorance about how co-ops function, and partly out of cautiousness of first requiring workers to put down a lot of personal money as collateral, which brings up the poverty obstacle in another guise.85

Thus workers find themselves caught between Scylla and Charybdis. They are too poor to finance the co-op themselves internally, and yet generally are unable to acquire external

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84 In many jurisdictions, co-ops are legally allowed to sell shares, but they generally choose not to since bringing in “alien” capital undermines the democratic nature of the co-op by giving outside non-worker shareholders a say in the firm’s decision-making.

85 Bowles and Gintis (1994) point out that co-ops will inevitably have higher financing costs because bankers have to deal with not just a single owner, but with many – which raises risk premiums.
financing either. These two issues, poverty (and its corollary of risk aversion) and lack of financial support are likely the central obstacles which stand in the way of the spread of co-ops today. Several other points deserve to be mentioned briefly.

A third obstacle stems from collective choice problems. Without unions or networks of some kind, it’s often hard to unify workers in their plans to start a co-op (Dow, 2003; Hansmann, 1996).87

Fourthly, some co-ops adopt unsustainable structures that tend to degenerate. One problem that we’ve seen is with “mule” firms. Another common structural problem is not having procedures to guarantee sufficient reinvestment from revenues. An additional problem is the over-hiring of non-members, not to mention the ossification of democratic practices.

A fifth obstacle is a lack of cooperativist education, both among the general public, and especially among potential co-op workers. Cooperativist education is crucial, both in terms of the spreading the values of workplace democracy, as well as the requisite technical training.

A sixth obstacle is the difficulty in finding good compatible management. Some co-ops are ideologically hostile towards expert managers, and most offer smaller wages than they’re likely to find elsewhere.

Lastly, co-ops can suffer from the so-called “entrepreneurial problem”, which is that they have limited appeal to many entrepreneurs, who, if they start a successful co-op, will have to share with others the rewards and the control of the firm (Cornforth et al., 1988).

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86 The inability to get external financing has made self-financing the historical norm – thus keeping co-ops small and exposing them to difficult horizon problems.
87 It’s usually easier to convince a handful of capitalists to start a firm (or buy-out a co-op), than to convince workers to start a co-op (or buy-out a capitalist firm), because there are a smaller number of capitalists, with relatively homogenous preferences (making money); co-ops, on the other hand, require collective decision-making from a larger number of people with much greater diversity of goals (diverse attitudes towards effort, scheduling, job security, safety, social atmosphere, etc).
88 See footnote 65.
Taken together these obstacles explain why co-ops have lower birth rates than conventional firms, regardless of the fact that once they are set up they exhibit comparable longevity and economic efficiency.

Before moving on there is one final obstacle that needs to be mentioned, the issue of capital intensity. Industries with high levels of capital intensity (oil, steel, auto, pharmaceutical, etc.) are particularly difficult for co-ops to enter, since the always prohibitive financing obstacles are here even more daunting. In Chapter 3, I argued that these industries are unsuitable for traditional co-ops, and are better suited for state ownership and co-management. Hence we must address the question of whether co-management is economically viable.

Exploring this issue in depth is beyond our present scope, but a basic summary can be made. Co-management is currently being experimented with in a number of important firms in Venezuela (Wilpert, 2007), and in Europe it has existed in some form for many years under the name of co-determination in Sweden, Denmark, Norway, Austria, and Luxemburg. But it is Germany that has gone the furthest. The German Co-determination Act of 1976 updates the legislation from several decades before, and provides worker representation on the supervisory board of all large firms: one-third of the representatives on the board for firms of 501-1000 workers, and just under one-half for firms greater than 2000 workers, with shareholders getting the other half (and the tie-breaker vote) (Dow, 2003, p. 86). The supervisory board elects the management board, which controls the firm’s day-to-day operations. This system is now well established and enjoys widespread support and legitimacy in Germany, thus providing compelling evidence of the viability of co-management.

Although co-determination is clearly feasible – large German firms are among the most efficient in the world – it is not clear that it has resulted in the productivity gains that supporters hoped would stem from worker participation in management (George, 1993; Svenjar, 1982). A similar, and likely related disappointment is that the degree to which co-determination has allowed for meaningful worker participation and empowerment seems ambiguous at best (Dow, 2003). So while the stability of co-determination in
Germany provides compelling evidence of the viability of this form, there is clearly room for experimentation to improve its limitations.

9 Overcoming the Obstacles

Given these obstacles, what reforms should be pursued in order to overcome them and thereby help effect a transition to an economy characterized by significant workplace democracy?

Workers’ poverty cannot be easily overcome. But it’s important to remember that since poverty is an obstacle to formation of co-ops, the goal of reducing poverty goes hand-in-hand with democratization. In a very real sense equality and democracy are linked aspirations. Pragmatically, the most useful reforms would be those that help with providing finance. Fundamentally, a co-op bank or credit union is vital in this regard– partly to provide access to finance, and partly to provide financial expertise (à la Mondragon’s Empresarial division of the CLP) to help set up new co-ops. Clearly the state would need to help fund such an initiative. Such subsidy is defensible because of the social superiority of co-ops as well as the fact that as Cornford et al. argue, co-ops are always disadvantaged on the open market in raising finance (since they privilege labour rights over capital rights). So state funding is not an unfair subsidy, but a way of redressing the bias against them in the present system (1988, p. 218). Furthermore, state funds could potentially lead to higher productivity and thereby (at least partially) pay for themselves. Beyond helping to set up co-op banks, the state could usefully help develop, and legalize financial instruments suitable for co-ops to raise money on capital markets without having to cede control rights. Various suggestions for kinds of cooperative bonds of this sort have been put forward (McCain, 1977; Waldmann & Smith, 1999).

Just as important, tax support is an immensely powerful tool for encouraging the spread of co-ops. For instance, in Venezuela in 1998 there were fewer than 800 co-ops. By 2006
there were reportedly over 100,000, with over 1.5 million members (Hahnel, 2007).\textsuperscript{89} This exponential growth is due almost entirely to legislative changes under Chavez that allowed co-ops to pay less tax.

In addition, co-ops need to adopt sustainable structures that are not likely to degenerate. This requires collective ownership (to prevent “mules”), provisions to mandate adequate investment levels, careful selection of members, a policy of limiting the number of non-members, and policies to maintain the democratic structures (e.g. social councils for democratic competition, limits on co-ops size to 500 or so, decentralized avenues for direct participation in certain areas of work), as well as a commitment to maintain a culture of participation through continual education in self-management.

Additionally, a league or network is vital to foster the spread of co-ops, providing a source of mutual aid in a capitalist sea. As Smith points out, “cooperatives are unlikely to be successful in a highly competitive environment without the roles played by higher level co-ops and networks” (2001, p. 3). Leagues provide economic and political benefits. Economic benefits of clustering together include helping to provide leadership and coordination to overcome collective action problems (unions are vital in this regard as well); sharing risk through cross investment, so workers’ eggs are in many baskets; making co-op practices more familiar to regional workers, managers, bankers, and politicians – thus helping to overcome managerial and entrepreneurial obstacles by enlarging the number of people knowledgeable about this kind of work; developing consortia to establish economies of scale; and providing examples of successful firms for others to emulate. Furthermore, clustering also provides important political benefits: a league provides increased leverage to lobby for political support; it helps to build a strong and vibrant political movement; and it helps maintain a culture of workplace democracy that prevents workers from feeling isolated, and helps develop a new sense of the normality of worker participation. La Lega is a prime example of these benefits. Clustering together in a league can provide a self-sustaining burst of energy as positive

\textsuperscript{89} These numbers should probably be taken with a grain of salt. For instance, there are reports of enterprises claiming to be co-ops in order to avoid paying taxes without actually transferring power to the workers (C. P. Harnecker, 2005). Regardless, it is undeniable that the growth of co-ops has been astronomical.
externalities reinforce each other, knowledge acquired in one place transfers over, an example here is emulated there, etc. Networks like this are instrumental in building social movement to encourage broader changes towards economic democracy.

A final change that would be useful is the development of cooperative educational facilities. Such are invaluable for training workers and managers in co-op values and practices. Mondragon started from humble beginnings as a school. Similarly in Venezuela, the Vuelvan Caras Mission graduated 260,000 students in 2005 with training in various technical, managerial, citizenship and cooperative studies. The students were encouraged to form cooperatives, and nearly 70 percent did, resulting in 7,600 new cooperative businesses (C. P. Harnecker, 2005).

While reforms such as these are all important and eminently practical in the short to medium term, I want to propose one reform of a more ambitious nature. Imagine a simple variant of the Swedish Meidner Plan, which we might call an “Incremental Democratization Plan” (IDP). An IDP would require by law that every company set aside, say, 20% of its profits every year in the form of new shares into an internal fund controlled collectively by the firm’s workers on a one-person one-vote basis. While workers would be able to use these shares to exert influence on the firm’s operations they would not be permitted to sell the shares for personal enrichment. This would have two results. First, since the profits are not taxed, but are issued as new shares which stay in the company, the IDP would not drain corporate cash flow or reduce investment. Second, and more fundamentally, the plan has a dramatic cumulative effect. Over time workers acquire more and more say over the firm’s operations. They would be majority owners within roughly 35 years, and effective controllers much sooner (since effective control in corporations usually requires much less than 51% of ownership). This means that after a certain period, all workers would be in a position to contemplate buying out their firms and transforming them into worker co-ops. In other words, an IDP means that in a slow, non-violent, and non-disruptive way, the entire economy is radically altered, and worker

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90 The Meidner Plan was initially proposed by the Swedish Social Democratic Party in the late 1970s. I discuss it in more detail in chapter 7.
co-ops could emerge as the dominant economic form. This would constitute nothing less than a peaceful non-revolutionary revolution.

10 Conclusion: Building the Transition

For co-ops to spread throughout the economy there needs to be a mechanism for starting new ones, as well as a mechanism for transforming existing conventional firms into co-ops. As we’ve said, start-ups require a public co-op bank with an empresarial division, ideally supported by some kind of league or network to provide legal, technical, and cultural support.

Transforming small firms into co-ops can quite easily be encouraged through tax breaks, especially if there are complementary educational facilities to spark interest in such changes. Medium to large firms require firstly a legal structure of referendum or equivalent whereby workers are entitled to express their desire to transform, and then are legally permitted to buy-out the shareholders. At this stage, financial support is needed from a co-op bank to perform a feasibility study, and think through the financial possibilities of a worker buy-out. Most countries already have some mechanisms for facilitating at least partial worker ownership (such as American ESOPs). More ambitious possibilities, such as an IDP, could resemble the Danish 1972 plan or the Swedish Meidner Plan. Depending on the circumstance, these might be able to be modified to help with complete buy-outs.

Capital intensive firms, which in many cases represent the “commanding heights” of the economy, cannot feasibly be bought out by workers, but they can be bought out by the state and run through co-management. Provided these firms are run well, there is no

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91 For instance, Dow describes one possible mechanism through which large firms could be bought out: he recommends setting up a labour trust into which workers’ shares are invested, and dividends reinvested until a substantial amount of control is acquired, and then a leveraged buy-out can proceed (Chap 12, 2003).

92 In 1972 the Danish union federation LO and the Social Democratic Party proposed a plan whereby firms would be obliged to issue new shares every year, two-thirds of which would be controlled by the internal workers, and one-third to be controlled by an external public investment fund (Madsen, 1980). The Meidner (1978) plan is similar but more ambitious; it is discussed in chapter 7.
inherent reason they cannot be economically successful (enriching the state instead of draining it) as well as being somewhat democratized.

All in all we can see that in their attempts to build free workplaces men and women have often been successful in operating democratic organizations without the need for capitalists, and have done so with notable effectiveness. They have created firms of impressive efficiency and superior social qualities. However, they have often found that even in the absence of capitalist hierarchy, size and complexity have tended to recreate new forms of hierarchy based on bureaucracy and expertise, which in turn require new safeguards and continual vigilance to keep in check. The path towards workplace democracy is thus steep and in many places difficult to maneuver. But we have good reasons to think the effort worthwhile, and this chapter has demonstrated, I hope, that we have sufficient evidence to believe the goal achievable.
Part Three: The Market System
Chapter 5
Can the Market System be Democratized?

Markets make good servants but bad masters.\(^93\)

1 Introduction

It has been said that the market is the most democratic of all institutions: an immense kind of voting machine where, as Ludwig von Mises puts it, “every penny is a ballot paper” (Mises, 1936). The aim of this chapter is to explore the degree to which this is true. To what extent should democrats rely on the market for matters of economic allocation, and to what extent do we need to look to alternative institutions to achieve our goals? This chapter advances two main arguments. The first is that market systems do have democratic potential to provide consumer sovereignty but not citizen sovereignty. Neoliberal market systems are far from the democratic ideal; social democratic market systems are closer, but they still come up against strong limits in the form of inherent market failures which prevent real democracy from being possible in such an economy. The second argument is that the market is not a natural or unitary thing – it can be shaped in fundamentally different ways, and in particular it can be shaped in ways that help foster democratic businesses.

2 The Market System as a Democratic Voting Machine

Paul Samuelson (1992), in his classic economic text, described the market as a gigantic “voting machine”, constantly aggregating people’s preferences into price information for others to respond to. But is a “voting machine” necessarily democratic? What does it mean to talk of the market system in terms of democracy? There are two main ways in

\(^{93}\) This phrase has become widespread. Its origin is attributed to Beveridge’s work on the welfare state (1948, p. 322).
which market systems could be considered democratic. The first is the degree to which market systems allow for consumer sovereignty – in other words, providing the population with a roughly equal influence over what is produced. The second is the degree to which market systems allow for citizen sovereignty over economic development – in other words, providing the population with a roughly equal influence over how the economy develops over time. More investment in public schools? Less deforestation? Promotion of green businesses? More highways or high-speed train systems? Larger suburbs or denser urban areas? Should we subsidize local artists or build city infrastructure for biking?

In general, conservative economists have tended to argue that the “free market”, when not overly interfered with by the state will be democratic in both of these senses. They would not recognize a clear distinction between these two senses, reasoning that the market promotes consumer sovereignty by providing people with a say over what should be produced now and thereby directs the economy to develop in ways to meet consumer preferences as they develop (Milton Friedman, [1962] 2002; Persky, 1993). How is the market able to do this?

Consider a simple market, such as a farmer’s market, selling strawberries, apples, oranges, etc. How can the people choose which products they think society should produce, and in what proportion? In other words, how can the people indicate how many apples vs oranges they think should be produced? The market, potentially, solves this problem in a democratic way: if people simply buy what they desire, and if everyone has similar amounts of money, the demand for the various products would accurately reflect the population’s desires. If the population prefers more apples than oranges, the sellers are led, as if by some invisible hand as Adam Smith would say, to alter their production practices; some apple sellers start growing oranges instead, supplying more of one thing and less of another, to reflect the consumers’ changing preferences so that they don’t go bankrupt. In this way the market forces sellers to be accountable to the consumers; poor services or bad products will be voted out, so to speak. This is why Schumpeter said that “there exists no more democratic institution than a market” (qtd in B Jossa & Cuomo, 1997, p. 120). So given some crucial assumptions (equal dollar “votes”, existence of
competition, honesty of the parties, etc.) the market system acts to aggregate the preferences of the people in price information while simultaneously providing incentives for others to respond to this information, thus indirectly causing production to occur according to the will of the demos. What could be more democratic than that?

2.1 Market Failures

So while the market does have democratic potential critics have pointed out a number of problems with this idyllic image of the market by highlighting a number of ways in which markets can fail (Samuelson & Nordhaus, 1992; Joseph Stiglitz, 2010). Of course, the recognition that markets can fail is very common; the degree to which they do fail is, of course, much more contentious. However, even conservative economists recognize that certain failures (such as monopolies) exist in many areas and diminish the efficiency of the market (Milton Friedman, [1962] 2002).

Conventionally, economists discuss market failures in terms of Pareto inefficiencies (e.g. ref). In other words, rectifying the failure can lead to more efficient results in the sense that someone can be made better off without making anyone worse off. I want to suggest that we think about market failures in a slightly different way – not just about efficiency, but about limitations to economic democracy (in the senses of consumer and citizen sovereignty described above). In other words, the degree to which the market fails should be thought about in terms of the degree to which it fails to provide citizens with a roughly equal influence over what is produced and how the economy should develop.

What is the advantage of thinking about market failures in this way? The answer is that market allocations can be efficient (in the narrow Pareto sense), without being particularly just (Hahnel, 2002). If A has $1 million and B has $1, and it’s not possible to increase B’s wealth without affecting A, we have a situation that is “efficient” but not necessarily just. In addition to concerns about B’s deprivation the democratic concern is that A is able to exert much more influence over the economy than B (since businesses are going to care much more about what A wants than what B wants). This is a problem because in a democratic society people should have a roughly equal say over what is
produced, because no person’s preferences should count as inherently more important any others. When I buy a strawberry I am not simply purchasing a commodity I am also casting a vote for the production of strawberries. I am signaling a desire for society’s scarce economic resources to be used in one way and not another. If, however, a millionaire comes to town announcing his plan to spend millions on raspberries, it’s entirely possible that my strawberry grower will leave the business and take up raspberry growing. The millionaire’s wealth has meant that society’s scarce resources (in this case the labour and farm land) is being shifted to respond to his dollars, ignoring my preferences. Recognizing the unfairness of this doesn’t mean that equal say over the market should trump every other goal. If achieving this kind of equality places additional costs on other people, as is standard in real life, the tradeoffs must be weighed. The point is only that, other things being equal, we should desire more market democracy than less. We should desire the market to respond to individuals as individuals not as proxies for very different size bank accounts.

Let us look at six ways in which the market systems can fail to act democratically. Here we focus on neoliberal market systems; we consider social democratic market systems below.

The first and most obvious way in which market systems can fail to operate democratically is that the consumers typically have very unequal amounts of dollar “votes”. Markets respond to dollars not people. This is why Pfizer, in 2000, developed no drugs for TB (which kills about 2 million poor people a year), but it developed eight new drugs for impotence and seven for balding – the maladies of the wealthy (Bakan, 2004, p. 49). Likewise, this is why two-thirds of US grain goes to feed livestock so wealthy people can eat steaks, whilst 30,000 poor children die every day from hunger and curable disease. Society’s resources go into fancy cars, beauty products, and yachts, rather than affordable food or housing, simply because some have millions of dollar “votes” and some have very few. The extreme inequality that typifies neoliberal countries – where in the US for example, the top 10% control 69.8% of the nation’s wealth (Davies, Sandstrom, Shorrocks, & Wolff, 2008) – creates a mockery of market democracy, regardless of its potential.
A second important market failure is that of externalities. Externalities are costs (or benefits) that are borne by people who are neither the buyers nor sellers of a transaction. Externalities are inherently undemocratic since by definition externalities mean that people are affected without having a say. The classic example is of a factory which emits toxic pollution into a nearby river. The resulting costs in terms of dead fish and sick humans are termed “externalities”. Since the costs are externalized, the market price of the factory’s products is distorted; it is not an accurate reflection of social costs, and so it gives people the wrong information on which they cast their dollar “votes”. For example, it has been estimated that the true social cost of gasoline, taking into account the environmental costs of the pollution, is about $15/gallon, compared to the market price of roughly $3/gallon (Hahnel, 2002). This means that people are being led to “vote” for much more gasoline (or cars) than they would if the true social price was incorporated into the market price. Externalities act to mislead the consumer about what she is voting for; the presence of externalities is like the presence of state-controlled media in an election that consistently misrepresent the candidates’ positions. People can still vote but they’re misled about what they’re voting for. This is a major issue because externalities can be extremely serious. Global warming, which has been called “the greatest and widest-ranging market failure ever seen” (Stern, 2007) is caused by externalities – the fact that many of our most important economic decisions in terms of industry, air travel, heating systems, etc. ignore the true social cost of carbon emissions.

Neoliberal market systems are significantly undemocratic in this regard: their failure to deal with major externalities means that people “vote” based on potentially very inaccurate information. For instance, one recent study of Muller, Mendelsohn, and Nordhaus (2011) shows that even ignoring the costs of climate change, the externalized health costs of certain American industries (particularly coal-generated electricity) are actually greater than the entire value-added of these industries – meaning that market prices in these industries are allocating resources, and inducing consumers to make purchases, in an incredibly perverse manner.

Like externalities, monopolies distort market price so they do not reflect true social costs and benefits. Monopolies do this by enabling the sellers to keep prices artificially high. In
such cases the market will provide inaccurate price information for the population to “vote” on. To get a sense of the degree to which monopoly undermines the democratic potential of market systems, it’s instructive to recall that by 2008 the 500 biggest 500 firms in world controlled about 40% of world’s GDP (Foster, McChesney, & Jonna, 2011). Indeed, the authors argue that the existence of monopoly in the American economy is “greater today than it has ever been”.

Forth, public goods are those kind of goods (like national defence or sewers or highways) that once they have been provided for some are very difficult to exclude from others. Goods like this offer a strong incentive for people to “free ride”, to enjoy the good without paying for it, to use it without actually “voting” for it so to speak, which means that the market is an inadequate mechanism for the provision of such goods.

Fifth, markets are often inadequate for making long-term investment decisions, because market prices are determined by supply and demand and so can be very inadequate for long-term planning in cases where the supply is liable to change in a suddenly drastic or unpredictable way (for instance, as might happen when the population of a fish stock reaches a tipping point, such that all of a sudden positive feedbacks kick in and a smoothly declining stock suddenly collapses). In such cases, it’s entirely likely that individuals “voting” with their dollars will end up with very different results than the same individuals would actually prefer if they had the means to make decisions with the relevant information that is not contained in the prices. This is why many of the people who happily continue to buy cheap cod for their fish and chips would also likely support tougher regulations on cod fishing to prevent the stocks from collapsing if they knew the broader ecological situation. But since such information does not get transmitted through prices, the market is an inadequate mechanism for making such decisions.

Sixth and finally, markets can fail to reflect collective choice. While prices reflect the aggregate of private preferences, it’s important to realize that such an aggregate may be very different than what people think is best collectively, for society as a whole. For example, while individuals may privately buy plane tickets to fly back and forth across Europe, the same individuals may prefer that, collectively, people don’t take such flights
(and would support carbon taxes to reduce such flights). What people think is good for me, is often different from what the same people think is good for us.\textsuperscript{94} In other words, voting with one’s dollars on the basis of price information reveals the aggregate will, but this is not necessarily the same as the collective will, which can only be gauged by actually asking people what they think (A. K. Sen, 1961). It’s worth emphasizing that by “collective will” I’m not referring to anything mysterious; there is no societal entity that has any existence or knowledge separate from the collection of real flesh-and-blood individuals. The point is simply the prosaic one that people often make different choices when they’re considering what’s best just for themselves versus what’s best for themselves as part of a larger social group (including neighbours, community, or the society at large).

2.2 Could the market system be a democratic system?

Given these failures, it’s natural to ask whether the market system could ever act in a democratic way? Are the barriers to consumer and citizen sovereignty over the economy barriers that could conceivably be overcome, or are they inherent in the very structure, the very DNA, of market systems themselves? To get some clarity on this question let’s clear aside the brambles of circumstance by talking initially in idealized abstract terms.

First of all, what would be necessary to have a market system with genuine consumer sovereignty?\textsuperscript{95} If we allow ourselves a utopian moment to think through the institutional requirements, we can see that genuine consumer sovereignty would require several things. Fundamentally, it would require rough material equality (and systems of taxation to redistribute every year or so the inequality generated through normal market processes) so that people had roughly equal “votes”. Beyond that, consumer sovereignty would require that market prices be as close as possible to accurate reflections of social costs and benefits. This means that major externalities would have to be dealt with (perhaps through regulation, taxation, or subsidy), and monopolies would need to be restricted. If this were to be accomplished then such a society would indeed resemble a generalized

\textsuperscript{94} This was long ago pointed out by Rousseau who drew a distinction between the “general will” and the “will of all” (Rousseau, [1762] 1987). A similar idea is captured by Sen’s (1961) “isolation paradox”.

\textsuperscript{95} Joe Carens’s fascinating work \textit{Equality, Moral Incentives, and the Market} (1981) is an example of a serious investigation into these issues.
version of our idyllic fruit market. In such a case the market truly would be democratic – its production driven by the demands of the demos on an egalitarian basis.

Obviously such a society is very far removed from the actual market systems of today. But the crucial question is this: what is the nature of the barriers to achieving such consumer sovereignty? The important point is that it seems to me that the barriers to achieving this are practical but not institutional. The barriers are very real ones of power, politics, class-interest, ideology, etc. which although I do not want to downplay them at all, they are, at root, contingent factors that are not inherent to the functioning of the market. Real consumer sovereignty is institutionally possible even if it would be very difficult to achieve. Recognizing this is crucial, because it allows us to see that the enemy of a democratic economy in this regard is not the market itself in any fundamental structural way, but the politics and power that maintains the current unequal market systems that we live in. Such an insight has important policy ramifications because it implies that market systems can be more or less democratic – the limits are those of political opposition not institutional feasibility.

What about the second dimension of market democracy – what would be necessary to establish a democratic market in the sense of citizen sovereignty over economic development? In other words, what would be necessary for citizens to have a roughly equal say in deciding whether to promote, say, green businesses and high-speed trains at a regional level, and whether to subsidize local artists or bike lanes at a local level? The market system is not an adequate mechanism for deciding such questions because decisions about economic development require collective decisions about priorities for the future. Decisions about promoting green businesses or local artists are inherently collective decisions about what kind of externalities matter enough to require public intervention – are the negative externalities from pollution or the positive externalities from local culture worth the cost of such interventions? Decisions about transportation systems or urban development are questions about public investment – the market is inadequate for dealing with them because they involve public goods, collective decision-making, and long-term investment – all things at which we know the market often fails.
The barriers to achieving citizen sovereignty are the market failures of collective decisions, long-term investment, public goods, and externalities. But notice that unlike consumer sovereignty, where it is (at least theoretically) possible to overcome the market failures so that the market delivers consumer sovereignty, it is impossible to fix these failures from within a market framework. This is because the market is an inherently individual preference-aggregating machine, so no amount of tweaking is going to allow such a machine to provide the means for collective deliberation. It is simply not possible to achieve citizen sovereignty through the market mechanism because the kind of decisions that are required for such sovereignty – decisions of a collective, future-oriented nature – are simply not amenable to market processes. These kind of decisions require an altogether different kind of mechanism. Specifically, they require public institutions where popular representatives can discuss and deliberate about collective goals. This means that even if we were able to achieve an egalitarian society with a high degree of real consumer sovereignty, the market would still not be democratic in the sense of providing citizen sovereignty. The fundamental obstacles to citizen sovereignty are not practical or political per se, they are intrinsic to the institutional functioning of markets themselves.

So for issues of citizen sovereignty, the market is an inherently inappropriate kind of institution, whereas political institutions are inherently more appropriate. But this of course does not mean that political institutions, such as the familiar levels of government (municipal, regional, national), will be able to simply and unproblematically deliver these kind of goods. The existence of market failures does not imply the non-existence of government failures. It is undeniably true that political institutions face their own kinds of problems in providing real democracy (from corruption to rent-seeking to tyranny of the majority or tyranny of the eloquent, etc.). But in terms of citizen sovereignty, political institutions have much more promise than the market. A central goal of chapter 7 is laying out the kind of political institutions that have the most democratic potential in this regard (such as community banks and local level participatory budgeting).

What conclusions should we draw from this analysis? I think the basic lesson is that our evaluation of the democratic potential of market systems needs to be nuanced. Too often
the discussion of the market raises undue passion, with evaluations ranging from adoration to vitriol. For instance, T. S. Eliot described the market as “a system so perfect that no one needs to be good” (qtd in Daly & Cobb, 1989, p. 140), whereas Michael Albert condemns it as “the single most horrendous and destructive creation of humanity in all of history” (qtd in Allard, et al., 2010, p. 60). Such heat, it seems to me, is misplaced. I think we should take a more measured position: from a democratic perspective the market should be neither loved nor loathed.

Our analysis suggests that advocates of the “free market” are often too applauding of the democratic functioning of the market – particularly in neoliberal contexts where the market is very far from being democratic. On the other hand, socialists are often too eager to see the failures of particular markets as necessarily inherent to every market, and thus too hasty in rejecting the market system out of hand (Hodgson, 1999; A. P. Lerner, 1972). At a theoretical level at least I think we should conclude that market systems could potentially be good mechanisms for providing consumer sovereignty because they are good mechanisms for aggregating individual preferences. However, markets are not so promising for providing citizen sovereignty because they are not appropriate mechanisms for deliberating about collective, future-oriented preferences. Such decision-making requires public political institutions.

2.3 Social Democratic Attempts to Democratize the Market

In the real world, social democratic states, particularly the Nordic countries, are the ones that have gone furthest in the attempt to democratize their market systems. How have they done this?

Broadly speaking, social democratic states have attempted to improve the levels of consumer sovereignty by reducing material inequality, and correcting major price distortions by regulating certain externalities and restricting monopolies (the next chapter explores the details). Social democratic states have also attempted to improve the levels of citizen sovereignty; the main mechanism for doing this has been state-led public investment. The familiar idea is that citizens elect representatives to parliament, who then
decide on the kinds of economic development they want to achieve; these goals are then implemented through public intervention in the economy – usually through regulation, taxation, and subsidy, or direct public investment (C. Lindblom, 2001)

Unfortunately, social democratic market systems are still far from democratic. They have failed to achieve either consumer sovereignty or citizen sovereignty (though they are closer to both of these things than their neoliberal counterparts). The next several chapters builds up this critique, but here it’s useful to outline the argument. Social democracies fail to deliver consumer sovereignty because they retain substantial levels of material inequality meaning certain people have many more “votes” than others. Even in Norway, one of the most egalitarian societies in the world, the richest 10 percent control 50.5 percent of wealth (Davies et al., 2008). What stops the social democratic countries from reducing inequality further and thus actually achieving consumer sovereignty? After all, countries like Sweden had social democratic parties in power for fifty-four of the sixty years preceding 1991 (J. Pontusson, 1992). As we will discuss in chapter 7, the fundamental limits to achieving consumer sovereignty stem from the private control of finance and investment. Social democratic countries are limited in the degree to which they can redistribute wealth by the ability that private financiers and investors have to derail the economy. They have an effective “veto” over decisions of this nature, which means that democratizing the market in the sense of establishing real consumer sovereignty can only advance in step with the democratization of finance and investment.

Additionally, social democratic states fail to deliver citizen sovereignty. As we have said, the main mechanisms used by such societies to plan economic development are state regulation of the market and state-led investment. However, as we will argue in chapter 7, it is problematic that both of these things tend to happen at the highest levels of the central government, because it means that although they are formally accountable they fail to be meaningfully or substantively democratic. In social democratic societies the average person continues to possess very little influence over the economic development of her community. Again, this implies that democratizing the market in this sense of establishing real citizen sovereignty requires finding ways to decentralize and democratize public finance and investment institutions.
In sum we have seen that the market system does indeed have democratic potential. Market systems are inherently voting-machines, but they are only potentially democratic ones. Neoliberal market systems generally fail to function in a democratic way. Social democratic market systems are better, but they can still not be called genuinely democratic. A truly democratic market system would need to find ways to overcome the limits to consumer sovereignty imposed by private control of finance and investment (in order to be able to tax sufficiently to create a rough equality of “votes”). It would also require ways to deliver citizen sovereignty by establishing non-market public institutions that are decentralized enough to be meaningfully democratic. Exploring examples of such institutions is the task of chapters 7 and 8.

2.4 An aside on Consumer Cooperatives

At this point it’s useful to mention another important mechanism to provide consumers with accountability over firms’ behavior – that of consumer cooperatives. Consumer co-ops, such as Mountain Equipment Co-op in Canada are firms that are owned and democratically controlled by their member customers. They date back to the 1750s and nowadays represent the bulk of the social economy being significantly more numerous than worker cooperatives. (In chapter 8 we’ll examine credit unions which are a financial kind of consumer cooperative).

By allowing consumer to have a say in the election of a firm’s board of governors, consumer co-ops are an important complement to a democratized market. At least in the short term, consumer co-ops are one of the most promising routes to increase the amount of democratic and egalitarian oversight of consumers over business. Indeed, in a number of places, like North America, it’s easier to envision a spread of consumer co-ops (perhaps galvanized by friendly tax breaks) than it is to envision an increase in consumer sovereignty that would require significant redistribution of wealth (not to mention restriction of monopolies and major externalities).

Of course, while consumer co-ops are useful for expanding the influence of consumers over firms’ practices, they risk undermining the say of internal workers. A consumers co-
op cannot be simultaneously a worker co-op. This is a problem because while both workers and consumers are affected by a firm’s practice, and therefore should both have some kind of say, workers are generally much more significantly affected. Whereas a consumer is normally only lightly affected by a firm’s practices, since her main concerns are simply the product and the price, workers are affected much more deeply and consistently by the internal work structure, the pace, the relations with co-workers, the schedule, the breaks and vacation time, and so on and so forth; what is a matter of preference and utility for the consumer is a matter of freedom for the worker. Both the severity and duration of the effects a firm’s practices are significantly more important for workers than consumers. This means that while consumer co-ops should be supported, the most exciting form is that of multi-stakeholder co-ops that attempt to give influence to workers and consumers in rough proportion to which they are affected.

3. The Flexibility of Market Systems

Although markets have existed in some form since time immemorial, the “market system” is a fairly recent human invention. A market is simply a place where goods and services are exchanged for money – such as in village markets throughout history or farmers markets today. The market system, however, refers to a political-legal structuring of the economy whereby the bulk of economic activity is coordinated through buying and selling. In this section it will be argued that there is no unique kind of market system: markets can be embedded in very different institutions to produce a wide range of incentives and competitive practices. There are huge differences, for example, between the American neoliberal market system and the Swedish social democratic market system. Moreover, while both of these market systems can be roughly categorized as “capitalist”, it’s entirely possible to have market systems that are socialist. There can be a market system where property is owned by the state (as existed in Yugoslavia under Tito). There can be a market system where the firms are co-ops, finance is provided through democratic banks, and inequality is mitigated through taxes and transfers – such as the system advocated here. The important thing is to resist the automatic conflation of
markets and capitalism because such thinking freezes our imagination and limits our possibilities.

Adam Smith described the emergence of the market system as a natural outgrowth of humanity’s “propensity to truck, barter, and exchange one thing for another” (A. Smith, [1776] 1986, Chapter 2). Today many conservatives, taking their cue from Smith, champion the idea of a “free market”, i.e. one that is unregulated and unaffected by the state. But the idea of a “free market” is conceptually confused. Karl Polanyi ([1944] 2001) famously described the ways in which despite the rhetoric of “free markets”, the market system has, since its beginnings in feudal Britain, always been an inherently political system. It is a system that has been built and constructed by political and legal means, and it is a system that inherently depends on political-legal institutions of the state for its basic functioning.

This means that it is a mistake to think of the market system as something distinct from the state. In reality it is always embedded in the state; it is always institutionalized in various political-legal structures. The market system (or more accurately, the “market-state complex”) is shaped by a large number of political-legal parameters. For example, the state determines the scope of what can and can’t be sold (e.g. usually not body parts, drugs, husbands or wives, votes, etc.), who is allowed to participate (e.g. minimum ages and foreign worker legislation), and sets key prices (taxes, interest rates, minimum wages). The state defines the basic laws of business: defining the rights and obligations of various market actors, determining property laws and enforcing contracts. The state creates a whole host of legal regulations determining how businesses may or may not run, from labour law to health and safety requirements. It determines how easy it is to declare bankruptcy, set up a corporation, or form a trade union. The state creates a whole set of business institutions and infrastructure to regulate exchange itself: e.g. courts to deal with bankruptcies and frauds, Central Banks to be lenders of last resort, Treasuries to protect the authenticity of the currency, police officers to enforce contracts, roads and telephone services to enable business to function, and so on. In all these ways it’s apparent that the

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96 Ellen Wood (1999) offers a penetrating analysis of the origin of capitalism. Though she differs from Polanyi in various respects she too highlights the importance of state involvement – particularly in terms of the importance of the enclosure movement.
market system is deeply integrated into the political apparatus of the state. Indeed, even Friedrich Hayek, the free marketer \textit{par excellence}, recognized that the question of state interference or not is a false alternative. The idea of “laissez-faire”, he said, is misleading because the state \textit{always} acts (1944, p. 80). But even this way of putting it is slightly misleading because it’s not a question of the state acting on the market, since the market is always institutionalized in various ways \textit{in} the state. So, the fundamental question, as Polanyi ([1944] 2001) reminds us, is not “free market” or “intervention”, but rather, intervention “for whom” and “for what”?

Talk of the “free market” is misleading because there is nothing natural about any particular market system. The market system is a political construction, which like every political construction can be shaped differently. Ultimately, given sufficient political will, each and every aspect of the market system is up for grabs.

From an economic democracy perspective, the question is this: how should we strive to shape the market differently (beyond the ways we’ve already discussed for consumer sovereignty)? While there are a number of areas of importance, I want to focus here on two dimensions that seem particularly germane: scale and fostering democratic businesses.

\section{Structuring the Market System to Democratically Limit its Scale}

The scale of an economy refers to its physical size relative to the containing ecosystem.\footnote{More specifically, scale refers to “the physical volume of the throughput, the flow of matter-energy from the environment as low-entropy raw materials, and back to the environment as high-entropy wastes” (Daly, 1992, p. 186).} While the market system functions to allocate goods in an economy at any particular scale, it is unable to determine an optimal scale itself (Daly, 1992, 2007); left to itself, the market’s internal logic is to grow and grow. Determination of the desired scale, therefore, must be a political calculation made from without. Indeed, as the negative impacts of growth (global warming, deforestation, extinct fisheries, desertification, forced migration, destruction of indigenous lands and cultures, etc.) come more and more to outweigh the
positive benefits, the question of putting a limit on growth, at least on the growth of throughput if not necessarily on development itself, becomes a pressing issue for democratic concern. Society has to collectively decide how much resources to conserve and how much it’s willing to use up in the never-ending search for growth. Indeed the question of scale is so pertinent because it represents the focal point of the clash between two titanic forces: the capitalist drive to grow and the ecological imperative to sustain.

Unfortunately, there is currently very little democratic deliberation here. The issue has historically been a political black hole. Governments almost never discuss the issue in terms of public policy; finance ministers are not beholden to anyone to balance growth with sustainability; extractive industries are rarely forced to produce public documents about the extent of their activities. The benefits of growth have been taken for granted by all sides of the political spectrum for so long that the question of scale has never been central to mainstream political discussion. This is perhaps starting to change with green issues becoming more prominent. But by and large, the drive for growth continues unabated, even though every day it starts to look more and more like ecological suicide.

A question of such monumental importance must become a democratic issue – and a central one at that. There should be clear and up-front public policy discussion on the total amount of throughput the economy can be permitted to have. Scientists and specialists need to determine the amount of growth in throughput the ecosystem can safely absorb. But it is the public, through their elected representatives, that must be empowered to decide how they will balance the desire for growth with the desire for sustainability. The government can then respond to the demos’ wishes by increasing or decreasing taxes on extractive industries, or placing a cap on the legal limits of certain types of extraction – the primary point at which the economy extracts from the environment – in order to increase or reduce throughput. Imposing rigorous taxes (or

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98 Important heterodox exceptions are representatives of the “degrowth” movement, such as Georgescu-Roegen (1971) and Daly (2007).
99 The increasingly clear scientific consensus is that without a 90% drop in our carbon emissions in the next couple of decades we will inevitably see a 2% rise in temperature, which is the critical tipping point at which many of our ecosystems will likely collapse. The interior of the Amazon Basin will become void of vegetation, two billion people will face water shortages, countries like Bangladesh will get flooded, de-housing millions and millions, and on and on (Monbiot, 2006).
caps) across the economy would alter the parameters of the market. The relative costs of a series of goods would change, and such changes would ripple throughout the economy moving prices in various ways. The market itself would be unaffected (buying and selling would continue as before) but consumers would adjust their purchases and businesses would adjust their investment to take into account the new prices (thereby indirectly taking account of the new ecological parameters).

This said, it might be wondered whether democracy is really the issue here. Perhaps the problem is not so much lack of accountability, as it is a cultural issue that the majority of people simply prioritize short-term economic interests over longer-term ecological sustainability, and the system simply reflects that. There is undoubtedly an element of truth in this, but it does not follow that democratization is therefore useless – far from it. Indeed, it’s clear that there is a group of people – for instance in the oil, gas, coal, and automobile industries – who have a strong vested interest in keeping the electorate disenfranchised in terms of their ability to limit scale. And because of the privileged position of business (C. Lindblom, 1977) – their control over investment and jobs – these people have sway in government far exceeding their numbers or their lobbying contributions. The only plausible counter-force to this power of capital is that of the democratic majority. Realizing this potential requires a mixture of environmental education alongside the establishment of democratic structures to ensure accountability: knowledge and power. So while increasing democracy would not magically change people’s understanding, empowering them is an important step in this direction. Once people are asked to choose the scale of the economy they think best, they are faced with the responsibility to choose well. They can no longer ignore the issue, or claim they did not know. Education is clearly invaluable, but it needs to happen within a democratic framework, so that democrats can say to people: you are free to choose, so do so, and remember that what you choose for yourself you are also choosing for humanity.100 The demos will undoubtedly make bad decisions from time to time, but ultimately we should put more faith in a democratically-empowered citizenry to educate themselves to make good decisions about scale, than we should have in a corporate elite, who in the ongoing

100 Sartre (1975) would say that freedom always means that “in choosing for himself he chooses for all men”. Such existential humanism seems especially pertinent vis-à-vis ecological questions.
vacuum of accountability will simply continue to ignore environmental concerns in the
pursuit of their own self-interest.

3.2 Structuring the Market System to Promote Democratic Businesses

It’s often argued that democratic business organizations (such as co-ops and credit
unions) are doomed because they cannot compete successfully in “the market”. The story
is a familiar one: co-ops operate differently than other firms, they don’t simply profit
maximize but strive for additional social goals (such as worker empowerment, job
security, pay equity etc.), and therefore make less profit than the cut-throat competition.
Eventually they are forced to either change their structure or go bankrupt. This is usually
referred to as the degeneration thesis (Gibson-Graham, 2003).

On this point Marxists have tended to be just as dismissive as neoliberals about the
possibilities of alternative business practices within the so-called “free market” (Mellor,
Hannah, & Stirling, 1988, Chapter 3). It is, however, a mistake to think that firms’
actions are rigidly determined by the market system. In fact, firms are shaped by two
general forces: market competition as well as governance structure. If we think of firms
as cars in a race, the market is the kind of road (its shape, surface material, etc.), and the
management is the driver. So if there are different kinds of cars competing, the kind that
will win a race is, of course, partly determined by the driver and partly determined by
which car is better suited for the particular road. We are not surprised that a tank beats an
electric car on an off-road race, but, equally, no one should disagree with the proposition
that the road could be changed (flattened, paved over, etc.) so that the electric car would
win.

Democratizing the market system in the sense of structuring the system so that
democratic businesses can flourish would require substantial changes to the market

101 For instance, in standard Marxist fashion, Wood claims that “once the market is established as an
economic ‘discipline’ or ‘regulator’… even workers who own the means of production, individually or
collectively, will be obliged to respond to the market’s imperatives – to compete and accumulate, to let
‘uncompetitive’ enterprises and their workers go to the wall” (1999, p. 119).
system. This brings up the fundamental question – are such changes possible? I think the answer is yes. The market system is indeed malleable in this regard. Indeed, when we look around the world today we see that there is in fact a wide range of institutional variety of market systems. The US market system functions very differently from the Swedish one (and both function very different to China).\(^{102}\)

Consider a historical analogy. Those who hold to the degeneration thesis often argue that co-ops like Mondragon are doomed; they will ultimately be driven under through competition with multinational corporations in today’s corporate market system. To see the problems with this way of thinking consider instead that we’re in 19\(^{th}\) century Britain, and examining the competition that occurs between a unionized progressive firm, for instance a general store, and a corresponding “regular” profit-maximizing store.

First, note that the institutional realities of this market system are substantially different from our own. There are no health or safety regulations. Parliament was generally reluctant to regulate the market, arguing that regulation would “infringe on personal liberty in … the free exercise of Industry, of Skill and of Talent” (cited in Kirby, 2003, p. 95). The workers in the unionized store are in an extremely precarious position, constantly under threat from anti-combination laws which threatened fines and even jail time for union workers. In addition, most markets were systemically supported by child labour. Child labour would have made up about one-third of the workforce\(^ {103}\) in the regular store, although the workers would have prevented such labour in the union store.\(^ {104}\) There was no welfare system to speak of. Unemployed people were sometimes able to get minimal parish support. Others were jailed as vagrants or committed to workhouses. There were no minimum wages or limits to working hours (though the union store would have done its best to insist on living wages and a ten-hour day).

\(^{102}\) The next chapter examines this institutional variability more closely.

\(^{103}\) According to Tuttle, the proportion of the workforce under age 18 was close to 50 percent for the entire period 1835–50. According to Horrell and Humphries, more than 10 percent of 5-9 year-old children and more than 75 percent of 10-14 year-olds were in the labor force (Humphries, 2003).

\(^{104}\) The most influential legislation to reduce child labour were the Factory Acts of 1833, 1844, and 1874 (Humphries, 2010; Kirby, 2003).
Now think about the competition that occurs between these two stores. The unionized store tries to establish living wages, a ten-hour day, basic health and safety conditions, and prevents children from working – the regular store does none of this. So just as the critics say that Mondragon is doomed, they are likely to feel that the unionized store is likewise condemned. And in a narrow sense, of course, this is true. The socially preferable union firm is likely to be driven under. But here’s the point: in a broader sense there is absolutely nothing inevitable about the failure to compete of the union firm (or of Mondragon today). We know this for 100 percent certainty because the unionized firm that is a rarity in the market system of 19th century Britain is the standard in many market systems today. Whereas the “regular” firm of that era no longer exists – largely because it has been outlawed. Thus in a different market system we can see that entirely different kinds of firms succeed. By the same logic, there is absolutely nothing inevitable about the failure of co-ops like Mondragon. If the market system is altered sufficiently away from promoting profit-maximizing corporations and private banks towards promoting co-ops and credit unions, then there is every reason to think that the firms that today appear fragile and rare, can become the norm.

It is common to hear things like “the only kind of firms that are viable are the ones that survive”, or that “such-and-such is impossible because markets won’t allow it”. The problem with statements like this is that they are inherently tautological. The kind of firms that survive are precisely the ones that are best suited to competition within that particular market system – but that says absolutely nothing about other possibilities in other market systems. As we pointed out earlier, it’s misleading to think that there is such a think as “the market” in any universal sense at all; all there is in fact are various market-state complexes, various ways in which the market is embedded in the state. And so those who talk about “market forces” or “market competition” or “what the market demands” in the abstract, divorced from a particular political-legal-historical context, are quite literally talking nonsense. There is no difference between “the market” and its political-legal institutionalization. The market is its political-legal institutionalization. Whatever imperatives a particular market system in a particular time and place has, flow from that political-legal structure, and nowhere else. Indeed, what else could there be? Recognizing this is crucial because it frees us from the constrictive thinking that there is only one
possible market arrangement. It unleashes the freedom that many things (though of
course not every thing) is possible. And so there is no inherent reason why it shouldn’t be
possible to alter the market system so that different types of businesses, particularly
democratic ones, come to out-compete others and flourish throughout the economy.\(^\text{105}\)

### 3.3 Promoting corporations over cooperatives

Far from being a level playing field, the market systems in countries like the US and
Canada have been constructed over time to be undemocratic, in the sense that they have
been shaped, partly by design, partly by the inertia of positive feedback, to favour
undemocratic businesses, specifically corporations over cooperatives. There are three
main ways in which market systems serve to foster undemocratic corporations over
democratic co-ops. The first is that corporations have benefited from having a well-
established, effective legal structure. This makes it easy for new corporations to be set up
since there is wide familiarity with doing so, and a well-established legal framework
exists delineating corporate rights and responsibilities. Not so for cooperatives. In many
US states, for example, there is still no easily accessible legal form; cooperatives are
recognized only as a subsection of corporations. Corporations benefit from having a
robust operating structure developed over the years which is recognized and codified by
law, whereas those wishing to start a cooperative must do so under the auspices of
corporate law that is at least partially foreign to its purpose. For example, some of the
most well-known American co-ops – the Plywood co-ops of the North-West – were
structured in the standard corporate fashion by allocating individual shares to each
members (and just having no outside shareholders). As discussed earlier, however, this
kind of legal structure proved inherently flawed and led to the cooperatives disintegrating
over time.\(^\text{106}\) The situation is much better in Italy, for example, where there is a well-

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\(^{105}\) Of course, the issue today is that competition is structured not simply by a domestic market system, but
by an international system as well. The next chapter discusses the implications of globalization for the
prospects of economic democracy.

\(^{106}\) This process is described in chapter 6. See in particular, footnote 65. As is described there, the solution
adopted by Mondragon and Italian co-ops is to separate the membership rights of belonging to the
cooperative, from the property rights to the capital assets. This can be done by setting up internal capital
accounts for all the workers. So each year, the profits are divided among the workers and go into their
internal capital accounts. When a worker retires he or she simply withdraws the funds from their account;
established cooperative legal structure (codified by the Basevi law) which provides guidelines for a legally-recognized cooperative form that is robust and sustainable (Ellerman, 1984).

Second, corporations benefit from having structural advantages for raising finance. One reason for this is that the law endows corporations with rights of limited liability (Bowman, 1996). This allows unlimited numbers of people to combine their capital, remain anonymous, not necessarily do any of the direct work, yet all the while be sheltered from full financial responsibility, which means that corporate investors are legally provided with limited risk of loss but granted unlimited potential for gain. So limited liability greatly facilitates corporations in acquiring financial resources. Historically, limited liability proved to be an immensely significant innovation, as it allowed for massive capital accumulations to fund major projects – like national railways – that ignited the industrial revolution and cemented corporations as the dominant form of business. In addition to limited liability, corporations have benefited from the existence of extensive stock and bond markets, which can be essential in helping them attract finance. Cooperatives, on the other hand, have not been so lucky. Although cooperatives have limited liability too, it is not nearly as useful for them in terms of raising finance since they cannot lure finance by offering to exchange it for ownership or control (Everett & Minkler, 1993). What would be more useful for co-ops is to have a well-established cooperative version of a bond-market (so that co-ops can raise funds by promising to pay back interest, but without having to sacrifice workers’ control rights), but corporate market systems do not provide this. Another reason why corporations are structurally favoured in terms of raising finance is that banks tend to be more familiar with them. Banks tend to be biased against co-ops because they are less familiar, and the worker-owners have less personal money to invest themselves, thus making financiers more wary. Additionally, it’s more costly for outside creditors to monitor large numbers of workers than it is a few capitalist investors – thus again reducing the credit available to them (Samuel Bowles & Gintis, 1994).

when a new worker joins, he or she acquires membership and simply starts up a new capital account – but the memberships themselves are not for sale, so don’t acquire the value of the internal accounts.
Third, corporations benefit from a market system which provides a wide range of training and educational services that inculcate millions of people with the ideology and know-how of the corporate business form. Countries like Canada and the US have public schools and technical colleges to train workers, business schools to train corporate managers, and consultancy firms to offer advice and strategic help. None of this exists for cooperatives. Much less societal resources go into training cooperative workers or managers in how to operate democratic businesses, or training consultants to advise them.

For all of these reasons, cooperatives, as alternative democratic businesses, have been forced to compete according to the dominant competitive rules in an environment built to foster hierarchical profit-maximizing firms. The deck has long been stacked against them. Cooperatives have had to survive the best they can in an inhospitable political-legal environment, like a fresh water fish in an ocean of sharks.

Yet the contingency and malleability of the market system means that there is no fundamental reason why we cannot modify the market environment so as to help democratic businesses flourish. (Of course there may be partisan opposition to doing so, but that is another matter). And indeed, this is not only a theoretical possibility. There are a number of real world examples where the market environment has successfully been changed resulting in great flourishing of democratic businesses. One example is Venezuela where the combination of tax breaks, and new educational facilities to train students to open their own cooperative has led to a massive explosion in the number of co-ops from 800 in 1998 to 100,000 in 2006 (Hahnel, 2007). A second example is the Employee Stock Ownership Plan (ESOP) movement in the US, which promotes worker ownership. ESOPs acquired legislative support in 1974, and have since grown to obtain assets of over $500 billion (Blasi, Kruse, & Bernstein, 2003; Dow, 2003).

Concretely, what changes to the market system would be most useful in helping democratic businesses flourish? Probably the most simple change in terms of altering the relative competitiveness of the different types of businesses is the tax rate – changing the ratio of taxes that corporations versus cooperatives pay (or private banks versus credit unions), by raising them for the former and/or lowering them for the latter. Indeed,
offering tax breaks has been the single most important factor galvanizing the massive growth of co-ops in Venezuela and ESOPs in the US. Additionally, clear legislation enabling the easy set-up of co-ops into a sustainable structure (like that of the Mondragon or Italian co-ops) would be very helpful. Further, governments should enact laws that give workers the right to buy out their employers (as discussed in chapter 3), as well as helping to finance the buyout (perhaps by way of democratic community banks with departments dedicated to this purpose, as discussed in chapter 7). In addition, new financial instruments should be developed to allow outsiders to invest in co-ops without diluting workers’ control, such as “participation bonds” (McCain, 1977). Furthermore, the state should expand its funding of cooperative schools and training programs to help mobilize the expertise necessary for successful cooperative operations.

What would be the costs to society of making these kind of changes? The public costs need not be prohibitive. Introducing legislature to make co-op formation easier is free. Beyond this, the increased costs of providing financial help to co-ops (particularly in terms of facilitating buy-outs) and funding more cooperative educational facilities is expensive, but such costs can be at least partially offset by increasing taxes on corporations while decreasing them on co-ops. However, it might be objected that doing so risks promoting fake co-ops (as businesses start calling themselves co-ops without changing their actual practices), as well as unfairly favouring one kind of firm over another.

Preventing fake co-ops requires some kind of administrative monitoring system. One possibility is requiring a certain percentage of a firm’s workplace to sign a declaration that they are indeed a co-op, before they receive the tax breaks. This need be no more complicated or expensive than the current process for recognizing unionized workplaces. It’s true that such tax breaks would favour co-ops over corporations, but there is nothing particularly paternalistic in this. It only compensates for the myriad advantages that the market system has bestowed on corporations over the years. Indeed, corporations get the

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107 Progressive governments wishing to foster democratic firms face a tradeoff in that the faster they wish to see changes happen, the more they need to spend on promoting co-op education, helping co-ops buy-out their employers, etc.
108 This has been reported as a pervasive problem in Venezuela (C. P. Harnecker, 2005).
equivalent of a permanent government subsidy in the form of the legal privileges of incorporation, and have done so for 150 years. It’s important to remember that corporate income tax is a voluntary tax since people are free to form partnerships instead and not pay the tax – but then of course they wouldn’t get the corresponding legal privileges, such as limited liability, ability for shareholders to come and go easily, etc. So the fact that American companies paid $278 billion in corporate income taxes in 2005 is evidence of the immense and ongoing value that state-provided legal incorporation has (Baker, 2006).

So while changing the market system to help foster democratic businesses would likely cost the government money, it would also bring a wide-range of benefits. As shown in chapter 4 increasing co-ops throughout the economy potentially brings enormous benefits: more democracy at work (and when done well, a greater sense of empowerment and self-determination for workers), more equality in income, stronger ties to the community, and even better health and happiness (that tend to flow from increased equality of status and trust). Deciding how much the public should pay for these kind of benefits is of course an open question that involves real tradeoffs. As a leftwing Milton Friedman might say: there are no free freedoms. But while it would be meaningless to attach a particular number to the value of these reforms, I’ve argued throughout this work that these kind of freedoms are indeed worth a lot.
Chapter 6

Democratizing the Market System

1 Introduction

Last chapter the argument was made that market systems have substantial democratic potential. They have the potential to act like democratic voting machines and they have the potential to be shaped in very different ways to promote different kinds of businesses. This chapter aims to substantiate these claims by examining the empirical extent to which this potential has actually been realized in various places. The first section shows how various states have been able to improve the consumer sovereignty of their markets (democratizing market system in terms of increasing citizen sovereignty is discussed next chapter). The second section shows the feasibility of shaping market systems differently so that democratic businesses can flourish. The example of northern Italy provides important evidence of this. In this section we also consider the important objection that globalization may pose a threat to economic democracy.

An important and recurring contrast will be made between the Liberal Market Economies (LMEs) meaning the US, Canada, UK, Ireland, Australia, New Zealand, and the Social Market Economies (SMEs) of western Europe, particularly the Nordic variety of Norway, Sweden, Finland, Denmark. This contrast is useful, particularly in an era of market fundamentalism, in reminding us of the ever-present feasibility of shaping market systems in very different ways.

2 Democratizing the Market System by Improving Consumer Sovereignty

109 Although there are many ways to characterize the varieties of capitalism, I follow here the distinction used by Pontusson (2005). SMEs are divided into Nordic and Continental, which includes Austria, Belgium, Germany, Netherlands, and Switzerland.
Last chapter we saw that market systems act like voting-machines, providing the population with a level of indirect say over what kind of things are produced, through the act of voting with their dollars. Unfortunately, the democratic potential of contemporary market systems to provide real consumer sovereignty is usually undermined by deep material inequality and distorted by widespread monopolies and externalities. The market system is only able to act as a democratic voting-machine once these things are minimized, so the question for us becomes: do we have examples of states successfully doing this?

2.1 Reducing Monopolies and Externalities

It is nothing new for most states to attempt to make their markets more responsive and accountable to consumers by developing anti-trust legislation in order to break up monopolies. In the US this tradition stretches from attempts to regulate Rockerfeller’s Standard Oil, to Bill Gates’s Microsoft – the underlying idea being that monopolies allow for unacceptable concentration of power of firms to raise prices arbitrarily and ignore consumer preferences since they know consumers have no alternative choices.

Less established or well-known than anti-trust legislation is legislation designed to deal with the price distortions that arise from major externalities. The basic remedy for dealing with negative externalities comes from the economist Arthur Pigou ([1920] 1960). The idea is that in order for prices to accurately reflect relative scarcity and demand, i.e., for prices to accurately reflect the number of “votes” each product has received, the cost of externalities needs to be included into the cost of doing business. For example, if a firm’s production causes pollution as a byproduct that imposes costs of $1000 on others, there needs to be a way to force the business to pay for this cost, to internalize the externality. Internalizing the costs means the business is required to pay $1000, some of which gets passed on as increases in prices so that they come to reflect social cost more accurately, becoming a truer ballot for citizens to vote with.

There are two ways to internalize costs: a tax (commonly called a “Pigovian tax”), or a cap-and-trade system. Most economists agree that these are largely equivalent from an
economic point of view, though there are important practical differences between them. Considering the case of negative environmental externalities, a pollution tax means that firms know the cost of their emissions, but government does not know how much total pollution will end up being emitted. On the other hand, with a cap-and-trade system, the amount of pollution is known in advance, but the firms’ costs of emissions is unknown and liable to change (Krugman, 2010a).

In terms of practical policy, cap-and-trade systems have become much more widely used than taxes. The basic idea behind this approach is that the government sets a cap, or a limit, on emissions (hopefully on the basis of precautionary scientific data). This cap is then divided into quotas and allocated to individual firms. The method of allocation is extremely controversial. Quotas can simply be given to current emitters, which is obviously favoured by business, and therefore makes such a system easier to implement. Or they can be auctioned off, which raises revenue for the government but makes it much harder to achieve political consensus to implement. Either way, companies are only permitted to emit the amount that they have allowances for. But within this limit they are free to trade their quotas, to buy, sell, or bank them for future use. The advantage of this system (as opposed to standard command-and-control state regulations) is that it allows for flexibility, decentralized decision-making, and market incentives to change behaviour. As the cap gets lowered it acts just like a tax on emissions. So firms have an incentive to lower their emissions, partly to avoid being fined, partly in order to make money by selling the quotas they don’t need. Thus the more a firm is able to innovate to reduce its emissions, the more of its quota it can sell. Firms thus acquire a direct incentive to change their own behaviour. The inherent flexibility in the system means that different companies are free to try to lower their emissions in different ways and at different speeds – which is much less damaging for businesses than having to conform to a one-size-fits-all directive passed from government. Over time the cap gets reduced leading to lower and lower emissions. So the basic picture is that government sets the cap, but allows the market to determine the allocation of emissions within that cap.

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110 Robin Hahnel makes the case that progressives should theoretically prefer taxes over cap-and-trade programs, but that in practice it’s much more likely to get progressive results from cap-and-trade programs than taxation (Hahnel, 2010b).
Cap-and-trade systems are increasingly proposed as mechanisms for dealing with major externalities, including the biggest issue of all – global warming from carbon emissions. Advocates range from mainstream proponents of the Kyoto framework, to radical climate justice activists (cf. Hahnel, 2010a), though of course there is furious debate about the details. For our purposes, the central question is whether or not there is evidence that cap-and-trade programs can be successful in internalizing externalities, and, in the case of negative environmental externalities, actually protect the environment.

The Acid Rain Program (ARP) was initiated in the US in 1990 under Title IV of the Clean Air Act, to deal with the effects of acid rain. It was the first large scale cap-and-trade program ever initiated for pollution purposes (Joskow, Schmalensee, & Bailey, 1998). The program legislated a declining annual cap, aimed at reducing emissions to 50 percent of 1980’s levels. Based on this declining cap the Environmental Protection Agency (EPA) allocated each firm in the industry a number of “allowances” (i.e. permits to emit tons of sulfur dioxide) based on their historic production levels, plus bonus allowances under a number of provisions (Stavins, 1998). The allocations were given to firms, not sold (much to the chagrin of many environmentalists). The allowances can be bought, sold, or banked. Since the cap establishes the overall level of sulfur emissions, the EPA does not have to specify exactly where or how reductions are made – allowing an important amount of flexibility. The system provides an incentive for firms to reduce their sulfur dioxide emissions since they can make money by selling their allowances (thereby offsetting the cost of adapting their factories).

The ease of trading has allowed an effective market to develop. Trading occurs via the EPA’s online system, with trades processed in less than a day. Administration of the system requires only one full-time employee. Furthermore, the system allows firms to bank allowances for use in the future. This is useful because it contributes to the political success of the program since once firms build up a bank of unused allowances, they have a vested interest in maintaining the value of those credits and therefore in ensuring the program continues (Napolitano et al., 2007).

111 There is a small annual auction for allowances – representing only 2-3% of quotas – which was designed to “jump-start” the market. The funds raised by the auction are given back to firms in proportion to their allowances (Joskow et al., 1998).
The fact that the ARP uses the market as opposed to state directives means that different firms are able to adjust their practices in ways that make the most sense for their specific circumstances – by installing new smokestack “scrubbers” in some instances, or shifting to lower-sulfur coal in others, by reducing quickly, or buying more allowances and reducing more slowly. This is important because different types and ages of factories have very different reduction costs. Whereas it would have been extremely expensive for firms to comply to a one-size-fits-all government regulation (e.g. mandating the use of a specific kind of technology that every firm had to use), the cap-and-trade method allows for substantial savings – estimated at over 50% compared to having to conform to a uniform standard (Burtraw & Szambelan, 2009).

There is wide agreement that the sulfur cap-and-trade program has been successful. The system effectively put a price on sulfur emissions, preventing the associated costs from being externalized, and thus providing a less distorted price for the electricity generated by the coal burning factories. This meant that consumers are able to “vote” on how much electricity they want at its true social cost. The system has been an environmental success as well. By 2009, sulfur emissions had dropped to 5.7 million tons, well below the mandated cap of 8.95 million tons and down 67% from 1980 levels. Consequently, the amount of acidic sulfur returning to earth has dropped by roughly 50% across the eastern United States (Malakoff, 2010). In many places, the local environment has recovered substantially, though further reductions will be necessary for full ecological recovery from the effects of acidification (Burtraw & Szambelan, 2009).

So while the ARP program provides evidence that cap-and-trade systems can work well, there are several necessary cautions. Environmentally, the most important issue is whether the cap is set sufficiently low, on the basis of precautionary scientific evidence (not industry preference), and with sufficiently strong penalties for failing to meet one’s quota. Politically, there is intense controversy between selling quotas, and giving them

112 Some environmentalists have argued against the very idea of a cap-and-trade system on the basis that it is immoral to sell the rights to pollute (Goodin, 1994; Sandel, 1997). While it may be true that some kinds of pollution (such as coal) are so damaging to the environment that there is a case for an outright ban, other kinds of pollution, such as sulfur or carbon dioxide, are not like this. We do not want to stop carbon emission absolutely – that would spell the end of industrial society – but to limit it to safe and sustainable amounts. Goodin (1994) is right, then, to argue that while we cannot allow the market to decide on what the
away. Giving them away provokes less industry opposition, but it also reduces revenues that governments might collect to invest in ecological restoration.\footnote{For example, the initial cap-and-trade program for certain New Zealand fisheries (called “individual transferable quotas”) worked by giving private fishers a fixed annual quota of the total fishing stock. This means that in order for the amount of overall fishing to decline the government itself has to purchase some of these quotas back from the fishers (Newell, Sanchirico, & Kerr, 2005).} Economically, the quotas need to be allocated in a way that doesn’t prevent new firms from entering the market, since it is often new firms that are the leaders of innovation. Finally, there is an ethical issue, which is the same for all market systems: is it fair for wealthy participants to be able to buy more quotas and pollute more, simply because they are wealthy? This is a particularly thorny issue on the global level, where any satisfactory international cap-and-trade program would clearly have to have some mechanism for preventing rich countries from simply buying their way out of emission reductions, particularly since they caused most of the problem in the first place – such as the Greenhouse Development Rights Framework.\footnote{The Greenhouse Development Rights (GDR) framework is a proposal for sharing the cost of dealing with global warming in a manner that is just and fair by taking into account different country’s responsibility for causing global warming (its climate debt) as well as their capacity for fixing it (with the assumption that people below a poverty threshold have a primary right to development and so rightly have less obligation to reduce their emissions). The basic idea is that GDR allows for a clear and logical calculation of every country’s responsibility via a Responsibility Capacity Index, which can then serve as a basis for paying for climate costs or setting national caps (Baer, Athanasiou, Kartha, & Kemp-Benedict, 2008).} There is no easy solution to this problem, but note that it’s a critique not of cap-and-trade \textit{per se}, but the market mechanism itself. Such a critique brings us back from the specific issue of cap-and-trade to the broader issue of market equality, to which we turn now.

2.2 Reducing Inequality

Probably the fundamental issue in terms of democratizing the market is the issue of wealth inequality. Even radical market abolitionists should agree that reforming the market so that the participants have roughly similar levels of wealth would make the system operate in a way that is much more democratic than presently happens. Markets in this situation would be much more responsive and accountable to the preferences of larger numbers of people. In particular, reducing inequality by bringing people out of caps should be (they must be chosen politically and scientifically), a cap-and-trade system may well be an effective policy enforcement mechanism once the caps are chosen elsewhere.
poverty is a means of *enfranchising* the poor by giving them a vote in the market; and for marginalized people, indeed anyone who is not part of a co-op or credit union, their only direct source of power and say over the economy is through the money they spend in the market.

Although the radical left has always been suspicious, if not outright hostile to markets, I think it cannot be denied that here and now increasing equality *would* have a profoundly salutary effect on the democratic nature of the market.\(^{115}\) Of course, it’s also true that wherever we have markets in practice we also have substantial inequality. The right is always quick to praise the democracy of the market in theory while ignoring the plutocracy of its practice. But if we’re willing to step beyond dogma, there is a serious question here: what are the concrete ways that inequality can be realistically but substantially reduced to render the market a fairer voting-machine?

The first point to make is that market societies can be *hugely* variable in terms of the amount of inequality they produce. Denmark and Brazil are both market societies, but Denmark is one of the most equal market society in the world, while Brazil is among the most unequal.

Indeed, the Nordic countries are the most egalitarian market societies on the planet (after Japan). A worker in the 90\(^{th}\) income percentile earns 2.23 times as much as a worker in the 10\(^{th}\) percentile, whereas a similar worker in the continental Social Market Economies (SMEs) earns 2.64 as much, and in the Liberal Market Economies (LMEs), 3.77 times as much.\(^ {116}\) In the developed world the US has the most unequal wages – a 90\(^{th}\) percentile worker makes five times a 10\(^{th}\) percentile worker; Norway is the most equal, where the corresponding worker earns only twice as much. The standard measure of inequality is the GINI coefficient, which represents the percentage of total income that would have to be redistributed in order to achieve perfect income equality. The GINI of the Nordic

\(^{115}\) It might be objected that market societies are never likely to have perfect equality, and so can never be truly democratic in the sense of every participant having precisely the same number of dollar-votes. Strictly speaking this is true, but it’s also true that increasing equality would increase the democracy of the market (in terms of consumer sovereignty). The fact that we may never reach perfection should not prevent us from aiming for real improvement.

\(^{116}\) Unless otherwise stated, the statistics in this section are drawn from Pontusson’s *Inequality and Prosperity* (2005).
countries is 25.2; the continental SMEs is 26.7, and the LMEs is 33.0. One can get a sense of the scale of these differences by realizing that the difference in inequality between the SMEs and LMEs today is similar to the difference in inequality that existed in the US between 1979 (pre Volker and Regan) and the vastly higher levels that existed two decades later.

How have the Nordic countries managed to reduce inequality to such an extent? Four institutional practices have been crucial.

The first important feature for reducing inequality is the tax and welfare system. Nordic countries have high levels of progressive taxation. Total tax revenue in 2008 was 45.05% of GDP in the Nordic countries, compared to 30.62% in the LMEs.\footnote{These averages are the author’s calculations derived from OECD statistics obtained from: http://www.oecd.org/ctp/taxdatabase} This taxation funds a generous, universal welfare system, which goes a long way towards redistributing wealth to the low-income population. Social spending in the Nordic countries is a massive 25.6% of GDP (compared to 17% in the LMEs) – this figure includes spending on social assistance, unemployment insurance, family allowances, pensions, and social services (it does not include labour market programs or education). While continental European SMEs spend similar amounts (24.5% of GDP) as the Nordic countries, they are generally less successful in reducing inequality. After taxes and transfers Nordic countries manage to reduce inequality by 32.9% compared to the continental countries 25.7%. In other words, the Nordic countries receive more bang (of inequality reduction) for their buck. Why is this so? The most important difference between the Nordic countries and other social welfare states is in terms of how welfare is provided. Esping-Anderson points out that the Nordic welfare systems are characterized by universalism, i.e., providing a large range of public services available for all, whereas the continental SMEs disperse benefits to specific targeted populations through means testing (Esping-Andersen, 1990). In other words, the main difference between the Nordic and continental styles of welfare provision is that the former emphasizes universal, free-at-the-point-of-access services, while the latter focuses on targeted cash transfers. In order to see the extent of the free services provided we can observe that in the Nordic countries 16% of
the entire adult population is employed in welfare-related positions (such as public health, education, welfare employment, etc.) – meaning that the welfare sector is huge – while a smaller than average portion of social spending, 62.7%, goes to direct transfers. In the continental countries, by contrast, only 5% of the population is employed in welfare services, (so it’s a much smaller sector) but a much larger percentage of social spending (87.2%) goes towards cash transfers. The bottom line is that Nordic style universalism has proven to be significantly better at reducing inequality than the continental style of social transfers (Esping-Andersen, 1990; Jonas Pontusson, 2005).

How successful is taxation and the welfare state at reducing inequality? The percentage of poor people (defined as those earning less than 40% of the median income) that are brought out of poverty by the welfare system in the Nordic countries is 81.3%, compared to 69.9% in the LMEs, with the US system being the worst performer, bringing only 44.3% of poor people out of poverty. Perhaps the clearest way to measure inequality reduction is to measure the difference between market income (before taxes and transfers) and actual disposable income. Expressed as a GINI coefficient, the Nordic countries taxes and transfers reduce inequality from 35.2 (market income) to 23.6 (disposable income), compared to a reduction of 41.8 to 32.4 in the LMEs. This means that the Nordic countries achieve a 32.9% reduction of inequality through taxes and transfers (compared to 25.7% for continental SMEs and 22.6% for LMEs). And this figure understates the real amount of redistribution that occurs because it ignores services, which are the focus of the Nordic model. The evidence thus speaks for itself: Nordic welfare states have been able to achieve substantial reductions of inequality.

The second institutional mechanism for reducing inequality is unionization and centralized bargaining. Probably the single most important source of inequality is wages, and probably the single most effective equalizer of wages is strong unions, and particularly the presence of an institutional system of centralized collective bargaining. It is an empirically robust generalization that wherever there are unions, there tends to be more wage equality (for evidence see Austen-Smith (2008)). Union density, i.e., the

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118 The contrast is most extreme between Sweden and Netherlands. Sweden spends only 65% of its total social spending on transfers whereas Netherlands spent 98%. On the other hand, Sweden employs a massive 20% of adults in welfare related services, whereas Netherlands employs only 4%.
percentage of unionized workers of the employed labour force, in the Nordic countries is 71% compared to only 26% in the LMEs (the US is at 14% and Sweden is the highest at 79%). The evidence shows that changes in union density are a pretty good predictor of wage inequality trends across the OECD. For instance, the decline in union density in the US in the 1980s can account for about 20% of the rise in wage inequality (M. Wallerstein, 2008, p. 252).

Furthermore, the data strongly indicate that the more that wages are determined in a centralized fashion (either through centralized collective bargaining or parliamentary action) the more income equality results (M. Wallerstein, 2008). The Nordic countries are well-known for having strong institutions for centralized wage bargaining. Almost every medium to large firm belongs to an employer association that bargains with unions on their behalf. So collective bargaining can take place for an entire sector or region across the economy. Collective bargaining covers 83% of the employed work force in the Nordic countries, 75% in the continental SMEs, and only 36% in the LMEs.\footnote{This is why the decline in union density across Europe does not spell doom for the welfare state, since by all measures the levels of union coverage remain very high.}

Nordic countries not only have strong unions and established institutions for centralized collective bargaining, but they also have a solidaristic wage policy, which does a lot to further equalize wages. This policy aims to equalize pretax income by raising the wages of the lowest earners and limiting the earning of the highest earners, thus reducing wage differences between plants in the same industry, between industries, between regions, and ultimately between occupations. By all accounts this policy has been extremely successful in compressing wages (Moene & Wallerstein, 2008).

The third crucial practice for reducing inequality is through policies of full employment. The Nordic countries were very successful at achieving full employment from the 1950s to the 1980s (unemployment worsened in the 90s, and recovered somewhat in the 2000s). On the union side, full employment has always been a central goal. And having institutions for national wage bargaining facilitates this as it allows the unions to exercise wage-restraint in exchange for full employment.
On the government side, several policies have been very helpful in maximizing employment. Monetary policy and fiscal policy (i.e. keeping interest rates low and keeping government spending high), particularly in order to compensate for business cycles, has been very useful in keeping employment high. The Nordic governments also undertake massive investments in public education. Public spending on all levels of education is 6.2% of GDP (compared to 4.8% in the LMEs). Additionally, the governments have been successful at creating employment for women – by 1983, the Nordic countries had 70% of working-age women employed, as compared to only 48.4% in the LMEs. This female participation in the labour force is encouraged by policies of generous parental leave insurance as well as expanded public child care, which make it easier for women to enter, and remain in, the workforce. A final important employment policy is that of Active Labour Market Policies (ALMPs). This is originally a feature of the Swedish state which has since been emulated elsewhere. It involves policies for making it easier for unemployed people to find new work – by enrolling them in training programs to upgrade their skills, by offering relocation subsidies, or by employing them directly by the state. Government spending on ALMPs is 1.3% of GDP in the Nordic countries, versus only 0.5% in the LMEs.

The fourth and final institutional practice for reducing inequality is that of encouraging workplace democracy. As documented in Chapter 4, worker co-ops tend to have much smaller wage differentials than conventional firms. Not only this, but co-ops allow for the level of income inequality to be directly under the democratic control of the workforce, and hence able to be changed if it is seen as too egregious. Although the Nordic countries do not have massive cooperative sectors, they do have institutionalized worker participation in the form of co-determination. Worker representatives sit on the Boards of all large firms, which at the very least reduces inequality through the increased bargaining power that it provides to workers. Although workplace democracy has probably played less of a role in reducing inequality in the Nordic countries than other factors, it has likely played some role, and it could undoubtedly be much more influential in reducing inequality if workplace democracy (in the form of worker co-ops) were to spread. Here again it’s useful to notice the interconnections between different areas of
democratization: democratizing the workplace is also useful for reducing inequality and hence democratizing the market. Once again we see that democracy sustains democracy.

What can we conclude from all this? Principally, that the Nordic example makes it undeniable that it is possible for market systems to substantially reduce inequality – and therefore substantially improve the democratic voting-machine nature of the market. Nordic systems provide much more similar numbers of votes to different people, and to a larger extent than anywhere else, these states enfranchise the poor to be able to vote at all.

That said, it is commonly objected that the Nordic example is a bad model because it is economically unsustainable. Don’t Nordic countries embody the worst of inflexibility and eurosclerosis? Hasn’t their drive for equality fundamentally undermined growth and efficiency? Indeed, the idea that there is a fundamental tradeoff between equality and prosperity has been hugely influential. For instance Arthur Okun famously insisted on the existence of this tradeoff by maintaining that “we can’t have our cake of market efficiency and share it equally” (qtd. in Jonas Pontusson, 2005, p. 4).

However, the Nordic example demonstrates that the assertion that one must always choose between equality and prosperity is, at least sometimes, completely wrong. In this case the evidence is clear: GDP per capita is virtually the same in LMEs as SMEs $29,483 vs $28,883 (that is $29,624 for Nordic countries and $28,291 for the continental countries). And although the LMEs grew slightly faster than the SMEs between 1980-2000, at 2.3% per year compared to 1.9%, this superiority of the LMEs is almost entirely due to the “Irish Miracle”. If we exclude the fastest growing economy from each category (Ireland and Norway), the average growth rate turns out to be exactly the same for both: 1.8%. The conclusion that Pontusson draws is hard to deny: “there is no consistent association whatsoever between economic affluence and the size of the welfare state” (2005, p. 165).

So although overall prosperity in the Nordic countries is clearly comparable to the LMEs, it might still be worried that their focus on equality undermines the capacity of the economy to create new jobs. Indeed, it is true that during the 1990s unemployment was a serious issue for many European countries – unemployment was substantially higher in
the Nordic countries, while they were much slower at creating new jobs (with only 0.1% employment growth between 1990-2002, compared to 1.7% in the LMEs). However, this unemployment disparity largely (and shockingly) disappears when we take into account people who are unemployed because they are in prison. For thirteen European countries, average male unemployment in 1995 rises from 8.3% to 8.5% if prisoners are included in the unemployment numbers. In the US, the figure jumps from 5.6% to a stunning 7.5%.

Indeed, Western and Beckett (1999) show conclusively that a large part of the decline in male unemployment in the US from 1983-1995 is due to the expansion in the prison population. It should go without saying that the Nordic costs of providing the unemployed with welfare are much less, in every sense, than the costs of jailing them.

Furthermore, even though the notion of consistent unemployment of the Nordic countries remains a part of much North American discourse (particularly in the pages of the Wall Street Journal), the reality is that the situation has clearly changed from the 1990s. Indeed, even discounting the prison population, from 2000-2003 the unemployment average for Nordic countries was virtually the same as that for LMEs (5.5% vs 5.6%). Similarly, it’s important to note that the common notion of “eurosclerosis” is largely a myth. European employment rates have consistently improved since 1997, and are now doing just as well, if not better, than American rates, as is illustrated in the following graph, which shows prime-age employment – the percentage of adults aged 25-54 with jobs – for the 15 old members of the EU versus the United States (Krugman, 2010c).
So how is it that Nordic countries have been able to have both growth and equality? In a nutshell, I think the answer is that while equality may in certain instances diminish incentives to work hard, that is only half the story, since economic growth requires not just incentives but also capabilities. For instance, a child can be presented with maximal incentives (a $10 million gift or threatened with starvation), but regardless she is not going to be a productive worker because she has such limited and undeveloped capabilities. Actual productivity requires the fostering of capabilities, investing in the child’s future through education, care, protection, etc. Similarly with workers. Whatever incentives may be lost from softening the rat race is compensated in the Nordic countries by the increased capabilities that come from society’s investments into the population’s welfare.

More precisely, Nordic countries have been able to create a number of complementary institutions that promote both growth and equality. First, economy-wide collective bargaining allows for wage restraint, and thus for higher employment with less inflation

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120 Chang makes this point with regard to development in his excellent work on the subject Bad Samaritans (Chang, 2007).
(because without centralized bargaining, if a union pushes up wages above productivity gains, the employers usually respond by simply raising prices, which therefore only benefits some workers at the expense of inflationary losses for others). Second, solidaristic bargaining not only increases equality of wages but it also indirectly benefits the efficiency of the economy. This is because wage-compression (raising wages of those at the bottom and lowering those at the top) squeezes the profits of less-efficient firms, driving them out of business, while simultaneously restraining the wages of high-paid workers in more efficient firms, making them even more profitable and able to expand, thus pushing the whole economy towards more efficiency. Third, large government spending on things like education, worker-training, and women’s ability to leave the home improves equality as well as enhancing the capabilities and productivity of workers. Fourth, worker participation schemes tend to increase equality as well as increase productivity (through increased trust and reduction of alienation, as we saw earlier).

Taking a step back now, we can appreciate that it is indeed possible to drastically increase the amount of equality within market systems. The Nordic states provide a vital model of how transition to a more democratic market (in the sense of an equal voting machine) could and should occur. Indeed, substantial reductions of inequality occurred in all western countries in the trentes glorieuses following World War Two. The high point of market equality came in the 1970s, particularly in the Nordic countries. Since then, however, inequality has become much worse in the LMEs and slightly worse in the Nordic countries as neoliberal ideology became dominant. There is no fundamental reason why we could not return to those 1970 levels – but it might be asked if this is as good as it gets. Is it possible to have more equality than the high point of 1970s social democracy within market systems?

The basic problem is that as the strength of workers and unions grows, workers gain higher wages, increased employment protection and social security. These things act to reduce incentives for workers to work themselves to the bone, and ultimately reduce profits. To an extent this can be offset by the increased productivity that comes from capacity-enhancing education, active labour market policies, female involvement,
workplace participation, etc. as the Nordic countries have been remarkably successful in
doing. But at a certain point the increasing strength of working people starts to inevitably
encroach on private profits and private power. From 1945 to the 1970s the strength and
power of unions steadily grew, but it was, as GDH Cole remarked in an earlier epoch, an
entirely negative kind of power – prohibiting what the employers could do. This created
all kinds of difficulties for employers who complained (with some justice) that they could
not run their firms the way they wanted, and that smooth operations were increasingly
being upset by antagonism and obstinacy. The move towards equalization cannot
continue unabated within the parameters of a structurally unequal system. At a certain
point in the 1970s, social democracy reached the limits of what was possible within a
capitalist framework. At this point, a fork in the road appears. Societies can either
maintain private control over businesses and seek to reestablish private profits and power
by sharpening incentives to work harder and increasing dependency (cutting wages,
reducing welfare, dismantling unions, etc.), as was the chosen course in the US and UK.
Or, countries can start to replace private control of investment by public and cooperative
control – in other words, by starting to democratize the economy. Either the power of the
unions to impose restrictions is broken, or the negative power of prohibition is
transformed into a positive power of control. “Instead of having the brake in their hands,
the Trade Unions… assume control of the steering-wheel” (Cole, 1920, p. 20). In the late
70s this was the choice between Thatcher and Regan’s neoliberalism on the one side,
versus Benn and Meidner’s economic democracy on the other. In my view the wrong
fork was taken. But with history as our guide we can hopefully take a different route the
next time we are presented with such an opportunity.

The basic lesson of the 1970s, therefore, is that social democracy can only take equality
so far (Samuel Bowles, Gordon, & Weisskopf, 1983; Adam Przeworski, 1985). In many
ways Sweden was and still is the paradigmatic social democracy. Yet while it has
achieved much more social equality than most other countries, it has not managed to
alleviate substantial poverty, wealth inequality, or worker powerlessness. This means that
for anyone who thinks that this situation is good, but not good enough, we need to
recognize that social democratic goals are unlikely to be obtained by social democratic
institutions. The levels of equality that most social democrats desire are only likely to be achieved by moving beyond social democracy into economic democracy.

3 Shaping the Market System Differently

3.1 shaping the market system to limit Scale

As environmental limits to growth become ever more pressing, the necessity for society to impose some limits on the scale of the economy becomes ever more necessary. I am not aware of any state that has yet instituted rigorous comprehensive mechanisms for limiting the physical scale of their economy – such as broad limits or caps on environmentally sensitive industries that are set according to precautionary scientific data on the amount of throughput the environment can sustain. That said, there are some encouraging partial examples in particular fields. For instance, many states have instituted limits on the amount of fish that can be caught, in order to prevent collapse of the fisheries, particularly since the UN’s Food and Agriculture Organization has estimated that “75% of the world’s fisheries are fully or overexploited” (Hilborn et al., 2003, p. 15.10).

Other important examples of limiting scale are experiments with caps in various cap-and-trade programs – for instance the program instituted for sulfur emissions in the US. Although the “trade” aspect of this program has already been discussed, here the “cap” element is pertinent. The Clean Air Act amendments of 1990 created a sulfur trading program with annual declining caps. These caps were then divided into “allowances” for emissions for various firms. Compliance with the caps is ensured through systematic monitoring and substantial fines – if a firm emits more sulfur dioxide than it has allowances for, it is penalized over $3000 per ton, as well as being required to offset the excess the following year. This had led to compliance rates of over 99% (Napolitano et al., 2007; Stavins, 1998). The caps have been very successful at reducing emissions. By
2009, sulfur emissions had dropped to 5.7 million tons, well below the mandated cap of 8.95 million tons and down 67% from 1980 levels (Malakoff, 2010).  

Setting limits on scale is a hugely important parameter for societies to establish over their markets, and a key mechanism by which markets come to be embedded under societal control. Since markets can clearly not set their own sustainable limits, left to themselves they will continue to deplete the oceans and poison the airs. So while it’s encouraging that caps are emerging in different sectors, transition to a democratic market society requires taking these examples develop much further in ways that expands and integrates them across the economy, particularly vis-à-vis fossil fuels.

### 3.2 Shaping the Market System to Foster Democratic Businesses

The most common argument made against economic democracy, by neoliberals and Marxists alike, is that democratic firms – such as co-ops or democratic banks – will be unable to survive because of the way “the market” works. The argument is that competition in “the market” will inevitably lead to the dominance of the most profitable firm (for neoliberals this is the most “efficient” firm, while for Marxists it is the most “exploitative”). But in either case, the argument is undergirded by a vision of a free market, a realm of pure competition, ahistorical and unencumbered by any institutional specificity. So for example, the argument goes that Mondragon will either survive by abandoning its co-op values, or it will remain true to its values and be driven bankrupt by more avaricious competitors.

There are two deep problems with this argument. The first is a straightforward empirical matter: *even in* the corporate market systems we’re familiar with, co-ops are able to function about as well as profit-maximizing firms. This is essentially due to the productivity advantages that derive from a more empowered workforce. However, the deeper and more fundamental problem with this line of argument has to do with the

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121 Unfortunately, not all caps have been successful. For example, Phase I of the European Union Emissions Trading Scheme, totally failed to limit carbon emissions as the cap was actually higher than total emissions (B. Jones, Keen, Norregaard, & Strand, 2007).
whole abstract conception of “the market”. The last chapter challenged the conceptual idea that markets provide a level ground for competition. It was argued that market systems are never free of institutional specificity, but are always embedded in particular institutional arrangements that foster certain types of firms over others. Here I want to add that this is not simply a theoretical argument. In practice we can see that different market systems around the world have been constructed in very different ways leading to very different results.

We can see evidence for this is the institutional diversity that we can witness between market systems (cf. Hall & Soskice, 2001). Consider the difference between the US and Sweden. The American market system is a liberal market economy. Tax rates are low – accounting for 26 percent of GDP – resulting in a starved state. Public spending on social programs is only 14.6 percent of GDP, resulting in a minimal welfare system, below average social services, and paltry pension guarantees. The individualism of the system is also seen in the extremely low levels of collective bargaining – less than 15 percent of workers are unionized. Firms are governed by shareholders who see the company as their private property; workers tend to be seen as exchangeable goods, often entering and leaving a variety of different workplaces during their working lives. When firms require external finance it is largely provided by the stock market, which arguably leads to an obsession with short-term profits in order to appease shareholders and ward off hostile takeovers. The American system is noted for its extreme wealth, with several hundred billionaires, as well as its massive racialized poverty and enormous jail population (Western & Beckett, 1999). The country is extremely unequal: its GINI coefficient is 36.8, worse than Russia; a worker in the 90th percentile makes almost five times more than one in the 10th percentile; the average CEO makes 200 times the typical worker (Baker, 2006, p. 42). Twelve percent of the population live in poverty (i.e., live on less than 40 percent of the median income), which doesn’t include the substantial non-status population (about 10 million people) which is extremely marginalized and precarious.122

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122 Statistics from this paragraph and the next are from Pontusson (2005) and the OECD Tax Database: http://www.oecd.org/document/60/0,3746,en_2649_34533_1942460_1_1_1_1,00.html.
The Swedish market system operates significantly differently. It is a much more social and universalistic system. Taxes are much higher – accounting for 46 percent – funding a much more socially active state. Social spending is 27.5 percent of GDP, almost double the American amount, resulting in a much more robust public sector, with generous levels of welfare, universal services and extensive training and educational programs. There are high levels of unionization (79 percent of workers), with most large firms belonging to employer associations, which facilitate a quasi-corporatist market system whereby the working class through the large trade unions is able to engage in regular collective bargaining rounds. Firms are not governed purely by shareholders but partially by stakeholders. Though not quite as extensive as Germany, Sweden has had a system of code determination since the 1970s, which allows unions to appoint two members to the Board of Directors of every joint stock company with more than twenty-five employees. Finance is traditionally arranged through banks as opposed to stock markets – which arguably engenders longer-term perspective and planning (Robert Pollin, 1995). Active Labour Market Programs are relied on more than the threat of extreme poverty to get unemployed people back to work. Inequality is substantially lower, and only six percent of the population (unfortunately, mostly women) is poor; the GINI is 25.2; a worker in the 90th percentile earns slightly more than double a worker in the 10th percentile; average CEO makes twelve times that of employees.123

To reiterate, the point of this contrast is to highlight the fact that the institutional diversity of markets systems is very real. Such contrasts are even more stark in non-western countries, such as Japan or China. It takes willful blindness to conflate all the existing varieties of market systems to “capitalism” tout court.

The institutional diversity of capitalism demonstrates that it is indeed possible to construct different kinds of market systems. So we can ask: what would a cooperative market system look like? In Chapter 4 I argued for certain important features: cooperative financial institutions (such as co-op banks), tax support, educational infrastructure, sensible laws ensuring reinvestment and preventing sell-offs, etc. Yet this is not merely

123 For example, in 1999, the CEO of the Swedish telecommunication firm Ericsson made a total salary of $1.1 million while the CEO of Motorola, an American competitor, made $58.9 million (Randoy & Nielsen, 2002).
theoretical. Northern Italy provides a real world glimpse of the beginnings of a cooperative market society in practice.

Perhaps the most developed example of a cooperative market economy is the region of Emilia Romagna in Northern Italy, where 8000 co-ops (of all kinds) account for about 40 percent of the region’s GDP, and 24 percent of the population works in or is a member of a cooperative (Ammirato, 1996, p. 2; John Restakis, 2010, pp. 56-57). Worker co-ops alone constitute 12.75 percent of GDP, and dominate in many industries, including construction, agriculture, food processing, wine making, transport, retail, machine production. Indeed, in the town of Imola, with a population of 100,000, fifty percent of the people are stockholders in the area’s 115 co-ops, and over 60% of the town’s GDP comes from the co-ops. So Emilia Romagna shows that it’s entirely possible for co-ops to constitute a central portion of a vibrant and dynamic economy. Indeed, anyone who doubts the economic viability of cooperatives should ponder the fact that this particular region – the region with the highest density of co-ops in the world – is also one of the richest regions in all of Italy and indeed one of the most prosperous regions in all of Europe.

This has been accomplished by creating both internal and external support systems. Internally, co-ops have supported themselves through establishing networks and consortia which provide a web of mutual-support, helping co-ops access credit, increase market share, problem solve, etc. Externally, the market system has been shaped in important ways over the years so as to promote co-ops. The main features of this co-op friendly market system include tax breaks (on co-op income that is invested as indivisible reserves); privileged access for co-ops to bid on public works contracts; financial support (e.g. the old National Institute of Cooperative Credit, and the contemporary National Labour Bank); legal provisions that mandate a sustainable business structure (for instance by requiring significant reinvestment of profits and forbidding sell-offs); and development funds for helping promote new co-ops (for instance legislation from 1992

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124 In addition, the region has been a world leader in the move towards providing social services through social co-ops, which are organizations that are publicly funded but democratically controlled by the workers and users of the services (Gonzales, 2010). In Bologna, 87% of the city’s social services are now provided through municipal contracts with social co-ops (John Restakis, 2010).
requiring that every co-op contribute 3% of its profits to a fund devoted to developing new co-ops and helping worker takeovers of conventional firms). Together these things have started to alter the basic structure of the market system to allow co-ops to flourish. Emilia Romagna is thus an important model of how transition could be enacted towards a market system that fosters democratic firms.

3.3 Globalization

While I’ve been arguing that it’s possible to democratize the market system, this is not at all to say that doing so is easy. As we’ve seen, market systems are not natural phenomena, but are deeply political because the way they work depends to a large extent on the kinds of political institutions in which they are structured: the laws, parameters, and infrastructure, that gives them shape. But precisely because market systems are political, they are also \emph{politicized}. They are deeply contested because their outcomes tend to consistently favour certain groups and social alignments over others. Since democratizing the market involves expanding popular influence, reducing inequality, and fostering democratic businesses, it is likely to find staunch opposition among those powerful groups that benefit from current market arrangements. But for these very same reasons it is also stands to benefit many more people than it harms, which means that the feasibility of transitioning to a more democratized market becomes a contextual question: what are the balance of forces in a specific country, how broad are the social movements, how strong are the various ideological positions, etc?

So while every country will likely have its own obstacles and difficulties in terms of moving towards a more democratized market, it’s often thought that globalization presents the most significant and comprehensive constraint. While shaping the market in democratic ways may have been possible in the past, hasn’t globalization rendered national experiments with different types of market systems obsolete? Isn’t globalization forcing different market systems to converge? This is an important and immensely controversial question.
There are three ways in which globalization could potentially undermine economic democracy: trade with the south produces a race to bottom; mobility of corporate capital drives down taxes; and mobility of financial capital makes it harder to borrow money on international financial markets (the latter two boil down to the claim that globalization makes it harder for states to pay for economic democracy). Let’s look at these three areas in turn. Since no country has a robust system of economic democracy, we obviously cannot examine the effects of globalization directly. But we can look at the effects of globalization on the welfare state, which in many respects is a close cousin to economic democracy. So using the welfare state as kind of proxy for economic democracy allows us to evaluate the degree to which globalization does in fact constrain national policy.

3.3.1 The Race to the Bottom

A standard argument is that international competition – particularly trade with the global south – creates a “race to the bottom”. The idea is that socially decent firms in the northern world, for instance those that are unionized or environmentally conscious or are cooperatives, will be driven under by competition from harsh firms in places like China and India that employ workers in sweatshop conditions. This is the degeneration thesis again, this time applied to the global arena.

While this is a common perception, the evidence is actually quite mixed. In many ways, the image of low-cost goods from the South flooding the OECD is simply wrong. In the early 1960s OECD imports from non-OECD countries (excluding OPEC) accounted for 23% of trade. By 1994, i.e., after several decades of globalization and the “race to the bottom”, southern imports actually accounted for less – representing 20% of imports (Garrett & Mitchell, 2001, p. 153). In other words, most trade in the North continues to happen between countries in the north and internally (many kinds of businesses, from haircuts to dentists, provide inherently localized services and so are not threatened by global trade) – and this is unlikely to change anytime soon.

Moreover, while sweatshops in the south may, through their grim working conditions, be able to keep labour costs very low, this creates harsh competition only in certain low-skill industries (such as clothing or low-tech assembly). In industries where the products
require a skilled and knowledgeable labour force, however, it may well be that having a 
less-alienated workforce (such as may be achieved through cooperation) is actually more 
productive than having to discipline a sweated one. Meaning that the race to the bottom 
may not be a general worry, but only a concern in certain industries.

But even in areas where it seems likely that odious competition will undermine decent 
domestic firms (such as unionized firms or co-ops), it is entirely possible to protect them. 
Tariffs are the basic protectionist mechanism that states have used for hundreds of years 
to protect themselves from competition that they saw as unfair or debilitating. Indeed, 
Ha-Joon Chang’s groundbreaking research has brought to light the large extent to which tariffs have been used by practically every developed country. Not only have tariffs been extremely widely used, but they have been a key ingredient in the development of many countries. Britain used extensive tariffs in the early years of its industrialization, up until the 1840s. Between 1816 and the World War II, the US, now the paragon of free trade, had one of the highest average tariff rates on manufacturing imports in the whole world. And from 1950-1970 Japan used similar, if more sophisticated, policies of tariffs to protect infant industries and develop its exporting capacity. Of course, once these countries achieved trade dominance, they were often quick to criticize the use of tariffs by other countries, in a hypocritical process that Chang (2003) refers to as “kicking away the ladder”.125

This is not the place to engage in in-depth analysis of the relative costs and benefits of tariffs. But even a cursory glance at recent history shows that tariffs need not be prohibitively costly – indeed, the most prosperous nations on the planet depended on them for their development. So it is instructive to note that even though protectionism is now unfashionable, tariffs and infant industry protection were used extensively in South-East Asia over the last fifty years and helped to spur some of the most dynamic economic growth in history.126 This means that tariffs can be an important policy tool for countries

125 While tariffs are still often used today, the establishment of various free trade regimes, such as the North American Free Trade Agreement, makes it harder for countries to unilaterally impose tariffs
126 The development of the East-Asian countries – particularly Japan, South Korea, Taiwan, and Singapore – after World War II was the fastest economic transformation in history. These countries made extensive use of tariffs and other kinds of state instruments to guide their development and shelter their economies from global competition (Chang, 2006).
to strategically protect themselves from the race to the bottom, foster development, and protect the kinds of firms they value.

### 3.3.2 The Mobility of Capital

A second common argument is that globalization increases the mobility of corporate capital. This means that corporations find it easier to leave states with high tax rates (and/or engage in transfer pricing\(^{127}\)). This creates tax competition as states feel obliged to cut their taxes in line with other states to attract corporate investment. The end result is that states find it increasingly difficult to engage in independent fiscal policy, and the continual downward pressure on corporate taxation makes it harder and harder to pay for the welfare state (or economic democracy).

While this argument is logically coherent, the bulk of the evidence does not support its conclusions. In fact, increasing mobility of capital has not led to a decrease in the effective tax rate on capital\(^{128}\) (Dreher, 2003; Garrett, 1998; Garrett & Mitchell, 2001; Quinn, 1997; Swank, 2002). Indeed, Garrett finds that since 1985, capital taxation has gone up in every OECD country that there is data listed for except the US – by an average of 5.7%. Capital tax rates declined by 2.7 points in the United States, but they increased by more than 10 points in Finland, Japan, and Sweden (1998, p. 815).

There are several explanations for this. One important point is that countries with higher taxes also tend to have better public goods (such as government services and

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\(^{127}\) Transfer pricing is the practice of multinational companies using their subsidiaries in different countries to over or under charge each other so as to ensure that profits occur in places with the lowest taxes. Notorious examples of transfer pricing include a US firm exporting bulldozers to itself for $528 a piece, and a Japanese firm importing tweezers from a subsidiary at $4896 each (Chang, 2007).

\(^{128}\) It is important to note that in many places statutory rates of corporate taxation, i.e. the legal rates that corporations must pay, have in fact fallen (Plumper & Troeger, 2009). In the average OECD country average corporate tax rate fell from about 50% in 1983 to about 30% in 2003 (Genschel, 2005, p. 65). However, the statutory, or legal, rate is not necessarily a good measure of what corporations are actually paying. The effective tax rate on capital is a much better measure, because it captures the amount that capital is actually paying. In Garrett and Mitchell’s words, “the effective capital tax rate is calculated as the sum of households’ capital income taxes, corporate income taxes, taxes on immovable property, and taxes on financial and capital transaction, divided by the total operating surplus of the economy (i.e., profits)” (2001, pp. 158-159). So there is an open question as to why statutory rates are falling but effective rates are not.
infrastructure), which make business more profitable and so entice investment (Swank, 2002). Garret and Mitchell (2001), as well as Rodrik (1997), have argued that increased globalization produces increased desire for welfare in order for the citizens to compensate themselves from the resultant insecurity. Similarly it’s perfectly conceivable that a population would start to prefer societal equality and social justice to constant material accumulation (Wilkinson & Pickett, 2010). Additionally, Pierson (1996) points out that retrenchment of the welfare state is difficult to carry out as it takes away concentrated benefits while providing only dispersed savings. Finally, it’s clear that regardless of globalization, many types of capital are largely immobile, and many types of firms may well desire to stay in their home base. The bottomline is that corporations have complex incentives; by no means is the tax rate the sole factor on which they base their investment decisions.

From the perspective of economic democracy, the most important question is whether states still have fiscal autonomy. Can states today follow an independent fiscal path, for example, by raising taxes in order to pay for a transition to economic democracy? The answer, I think, is solidly yes. To see this, the most important thing to realize is that over the last several decades of globalization average tax rates and amounts of social spending have not diminished, but in most cases have actually gone up (Swank, 2002). The average tax take in the EU is now 40% of GDP – this is much higher than during the earlier era of relative economic closure of the 1950s-60s (Genschel, 2005). Likewise, the amount of social spending in the welfare states has increased too. In the OECD, the average change (from 1985 to 1994) in social spending was an increase of 10.9% (Garrett, 1998, p. 816). Corporate taxes have been no exception. Between 1982 and 2005 total corporate tax revenues in the OECD increased from 2.5 percent of GDP to 3.7 percent (Loretz, 2008). This evidence is unequivocal: it is still entirely possible for states to levy high levels of taxation to fund their desired social programs (be it a welfare state or a form of economic democracy). States have just as much fiscal room, if not more, than they did in previous years. From an economic perspective, the welfare state is not in any danger.

And even if in the future it appears that capital mobility is starting to undermine tax rates, countries can always look to capital controls (which for a variety of reasons are an
important component of economic democracy). Countries’ tax systems can be particularly effective kinds of capital controls. Indeed, in the 1980s and 90s, practically all the OECD countries revamped their tax systems to make them more globalization proof (clamping down on transfer pricing, tax havens, etc.) (Genschel, 2005). At the moment, however, it is clear that political will, not corporate capital mobility, is the real obstacle to economic democracy.

3.3.3 Financial Pressure on Deficit Spending

The final way that globalization can potentially undermine economic democracy is that the mobility of financial capital makes it harder for countries to deficit spend, i.e., borrow money to engage in expansionary spending. Financiers are wary about significant borrowing because they know that if governments are paying their bills through borrowed money they have an incentive to promote inflation in order to effectively reduce their debts. So in practice we see that financiers often “punish” countries who follow expansionary policies with high interest rates. This can be particularly problematic when countries are in a recession, since this is precisely the time when borrowing is most needed, yet it is also the time when financiers’ preferences for austerity (higher taxes and lower inflation) run directly counter to the expansionary needs of the country.

What is the evidence? It is true that countries with persistent budget deficits do find it harder to borrow than more austere countries (Garrett, 1998; Swank, 2002). In other words, the globalization of finance has somewhat narrowed the range of possible policy options, since it’s somewhat harder than before to engage in spending that is funded through borrowing. While there has always been a relationship between the amount a country borrows and the amount of interest it is charged, globalization allows finance capital to move so quickly that nowadays any policy that might produce inflation sends herd-following bond traders charging instantly for the door seeking a better deal elsewhere, causing interest rates to quickly rise and public programs to cost more. While in the past countries could borrow money to pay for their programs based on their long-run expectations of growth, today global finance is so quick, interconnected and focused on maximum short-term profits that deviations from austerity are punished much more
quickly and harshly. American political strategist James Carville once said “I used to think that if there was reincarnation, I wanted to come back as the President or the Pope. But now I want to be the bond market: you can intimidate everyone” (The Economist, 1995).

Of course, this constraint is tighter the more that countries need to borrow and looser the less that countries need from financiers. Nothing about globalization forces countries to borrow more. If a country wishes to spend more, it can always do so through increased taxation instead of increased borrowing. Indeed, it’s likely that financial markets don’t particularly care whether a country is heavily interventionist or not, whether the government spends a large percentage of GDP or a small one – as long as the spending is covered by taxation, not borrowing (Garrett, 1998).

So how can countries protect themselves from bond market vigilantes? The simplest method is to balance the books (at least over the business cycle). The less one needs to borrow to cover costs, the less one can be held hostage by volatile markets. Beyond this, the most important tools for increasing countries’ financial independence are capital controls and a national central bank. Capital controls (such as a Tobin or financial transaction tax) make it less attractive for financiers to dump domestic bonds at the first sight of inflation. And having a central bank that can buy the government’s debt is an important tool for financing government when financial markets are inaccessible. Indeed, this is why the US and Britain have suffered much less financial pressure in the current economic crisis than countries like Spain, Italy, Ireland and Italy – they have their own lender of last resort that the EU countries do not (Grauwe, 2011).

3.3.4 Summary

129 The example of Spain shows the extent to which financial markets can undermine national sovereignty in the absence of a domestic currency and central bank. Whereas Greece has faced huge financial pressure, there is nothing particularly surprising about this given that the country simply spent much more than it ever had. Spain on the other hand, had very low levels of debt up until the recession of 2008. The recession caused the debt to rise (as government tax receipts drastically fell and welfare costs went up) which was then severely punished by international financiers. Since Spain does not have an independent currency, it cannot lend to itself, so it has no choice but to obey the financiers and engage in harsh austerity, which is devastating given that unemployment is already at 20% (Grauwe, 2011).
In sum we can see that globalization does pose some challenges for countries wishing to move in the direction of economic democracy. Probably the most serious constraint is that odious competition risks undermining socially decent firms. But while all of the constraints are serious, they are not as debilitating as they are often thought to be. Odious competition is only a problem in certain specific industries; corporate mobility has not reduced countries’ abilities to levy high taxes; and financial mobility is only a constraint to those countries who are heavily indebted (especially to those that do not have their own central bank).

Overall, globalization is not nearly the implacable threat to economic democracy that it is often feared to be. Indeed, those who think that globalization inevitably undermines the prospects of economic democracy are also logically committed to the claim that globalization undermines the welfare state – since both require high government spending, both seek to promote socially decent kinds of businesses, etc. Yet the welfare state is manifestly not being undermined. Or if it is, the deterioration is happening incredibly slowly. Moreover, a country wishing to deepen its welfare state (or pursue economic democracy) retains substantial fiscal room to maneuver and can acquire even more ability to do so through the implementation of things such as tariffs and capital controls. This is not to say that such protective measures would be costless, but that it’s not at all obvious that the economic costs exist would outweigh both the economic benefits as well as the democratic benefits of having the political autonomy for a country to independently direct its own future.

4 Conclusion

This chapter has sought to provide empirical support for the claim that it is possible to democratize the market system. Part of the difficulty with this endeavor is that no single place possesses all the elements of a robustly democratized market, meaning that examples are inevitably dispersed. Nevertheless, it is true that we can see the constitutive strands of a democratized market alive and well in various places. The sulfur cap-and-
trade program and, particularly, the Nordic welfare states illustrate the possibilities of dealing with major externalities and reducing inequalities so as to improve the democratic potential of the market voting-machine. The example of Northern Italy shows exciting glimpses of a new kind of cooperative market system that serves to foster democratic firms. Such examples are important because they not only confirm the possibility of democratizing the market, they also provide useful roadmaps for guiding transition.

We have seen that market systems have democratic potential. Social democratic states have been most successful in realizing this potential. But even here real democracy has proven elusive. Private control of finance and investment have acted as a barrier beyond which egalitarian impetus of social democratic states have been unable to pass. This means that acquiring genuine market democracy – both in sense of consumer sovereignty and in sense of citizen sovereignty over economic development – requires finding ways to transcend such limits. That is the task to which we now turn.
Part Four: Finance and Investment
Chapter 7

Should Finance and Investment be Democratized?

“Control over investment is the central political issue under capitalism precisely because no other privately made decisions have such a profound public impact” (Adam Przeworski, 1985, p. 218).

Since investment is the only guarantee of society’s future, it must be a subject of social deliberation (Joshua Cohen & Rogers, 1983, p. 161).

1 Introduction

Every society produces wealth, part of which is consumed, and part of which is invested for future consumption. The kind of investments that are made play a defining role in shaping society’s future. So those who control the financial and investment processes have significant control over the shaping of that future.

Any attempt to think through the possibility of reforming society must deal with the fact that when leftwing regimes have been democratically elected in the past, they have tended to get immediately battered and bruised by an economic storm from those who control finance and investment. More often than not, the attack from financiers and investors is so strong that it forces the government to abandon their plans for reform – thus making a mockery of the people’s sovereignty.

In 1981, Francois Mitterrand was elected in France promising “une rupture avec le capitalisme”. Immediately financiers (institutional investors, short-term speculators, currency traders, bond traders, etc.) withdrew huge sums of money from the country – the capital flight measured $1billion per day by inauguration. Massive speculation against the currency forced the country to devalue the franc again and again. At the same time, business owners led by the National Council of French Employers (CNPF) called for a hiring freeze and started to slow investment as their confidence in Mitterrand’s ability (or desire) to protect their profits crumbled. Less than two years later, with inflation and unemployment skyrocketing, the government admitted defeat and reversed its socialist policies (Morray, 1997; Singer, 1988).
In 1999, Hugo Chavez was elected in Venezuela bringing a radical shift to Venezuelan politics away from neoliberalism – focusing on social programs and expansive anti-poverty initiatives, providing education and healthcare, engaging with the indigenous population, and redistributing the nation’s massive oil wealth. The response was immediate and predictable. Financiers orchestrated large-scale capital flight – estimated at $26 billion over two years (equal to 40% of the entire oil revenues during this period) (Parker, 2005). Yet even more devastating was the investment strike organized by the Venezuelan opposition and business elites. Businesses closed their doors, locked out workers, and the oil industry was shut down. The investment strike brought the economy crashing down – losing 24% of GDP in three months, close to great depression numbers.\(^\text{130}\)

In tumultuous times like these we see that those who control finance and investment possess a powerful veto over government policy. Yet such power is apparent even in normal times. It is a daily occurrence to hear a business declare that its taxes must be cut in order for it to maintain investment and employment, or a politician to explain that environmental regulation is not possible because it will result in job loss. This is why Charles Lindblom (1982) famously said that the market is a “prison”, since democratic attempts to reform the system automatically trigger punishments in the form of unemployment or a sluggish economy, thereby imprisoning democratic policy making within the limits of what will keep business happy. Indeed, a central theme of this book is that social democratic attempts to democratize the economy run into precisely these limits – the limits of the private control of finance and investment. This chapter and the next thus seeks to explore ways in which we might break out of this prison and overcome such limits on our democracy.

The overarching argument of this chapter is that the current system of private control of finance and investment is undemocratic in the sense that it undermines popular sovereignty. There are two reasons for this: it keeps the population structurally dependent

\(^{130}\) For a good analysis of the Venezuelan economy during the Chavez years see Weisbrot (2009). Although these actions came close to toppling the government, Chavez was eventually able to renationalize oil, implement capital controls, and reassure private business that they wouldn’t get expropriated, resulting in huge economic growth in next five years.
on, and hamstrung by, an unaccountable minority. And secondly, it deprives the public of an active democratic say (in the sense of providing meaningful involvement as well as broad control) in deciding how to allocate finance and investment, and thus how to form its own future. This chapter makes the case for four kinds of fundamental reforms: democratizing finance through *capital controls and democratic community banks*; and democratizing investment through the spread of *worker co-ops*, supplemented by *public investment rooted in local communities*.

Before beginning, it’s useful to clarify several terms. From a democratic perspective, the main issue of finance and investment is the issue of “sovereignty”. Sovereignty is commonly understood to refer to the ultimate political authority within a given territory (Philpott, 2009). For a country to be democratic, it must first of all be sovereign (it can’t be controlled by a foreign army or a secret cabal). But although a monarch can be sovereign, in a democracy, sovereignty must be vested, ultimately, in the people. In this chapter, sovereignty is assumed to mean popular sovereignty; in other words, sovereignty means that ultimate political authority to direct the country rests with the people or their elected representatives. Popular sovereignty does not imply any kind of mystical or transcendental unity of the people, but simply refers to the will of the majority of the population.

I understand sovereignty as having two main dimensions. A negative dimension, whereby sovereignty refers to *not being dependent* or under the control of another power. And, secondly, a positive dimension, where sovereignty means *being able to actively self-determine*. This idea of self-determination is usefully broken down into two further dimensions: meaningful involvement at a local level, and broad accountability at higher levels. Although the two dimensions of sovereignty are clearly bound up together it is useful to keep them distinct because they often imply very different policies about reform. For instance, reforms to minimize dependence may do very little by themselves to augment self-determination.

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<sup>131</sup> This distinction is similar to the famous distinction between positive and negative freedom (Berlin, 1969)
What exactly is meant by finance and investment? Finance refers to the mobilization of savings to be used as credit to firms (or individuals or governments). Essentially it can be thought of as the lending of money. The main (non-government) sources of finance are banks, stock and bond markets. Investment refers to the active spending of money by a firm (or individual or government) to increase or maintain its productive capacity – for example, purchasing buildings or office space, buying machines, hiring or training new workers, etc. So if a business wants to open a new office, it borrows money from the bank (or sells some shares on the stock market), to raise the necessary funds. The money that is raised I’m calling “finance”, whereas the actual spending of the money by the firm for the new office I’m calling “investment”. So, for instance, Bank of America finances Shell, which then invests in building an oil rig. This is a slightly, but not entirely, idiosyncratic use of the terms.¹³² Often one hears the word “investment” being used to describe both of these spheres of action. However, it is useful to have a distinction because nowadays the two economic activities of mobilizing people’s savings, and actually engaging in real production, are largely separate activities that tend to happen by different people in different places (Cui, 2000). If one prefers, “finance” and “investment” could be renamed “financial investment” and “real investment”, though I refrain from this usage.

Financiers and investors represent the two sectors of the group of people usually called “capitalists”. Investors are essentially employers (business owners, managers, board of directors). Generally, their money comes from making profit. Financiers are essentially money-lenders (bankers, stock brokers, money managers, etc.). Generally their money comes from providing credit and receiving interest payments. It is worth noting that in recent years, for the first time in history, the assets of financial corporations have surpassed those of non-financial corporations,¹³³ as finance has become increasingly central to contemporary capitalism.

¹³² For instance, Sherman et al.’s well-known text follows this distinction (2008, p. 386). Although buying stock is usually called “investing”, this is conceptually misleading because it conflates the providing of money with the actual spending of that money for real productive purposes. It is often the case that one can buy shares, without that act having any consequence whatsoever for the firm’s actual productive capacity. This is why it should be called “finance” not “investment”.
¹³³ In Canada, this happened in 1990 (Stanford, 1999, p. 26).
2 Finance

From a democratic perspective there are three main problems with the current financial system that we will examine in turn. The first is that private control of finance undermines popular sovereignty by restraining government policy. After making this argument we will explore how capital controls might serve as a potential remedy. The second problem is that the system of private finance fails to provide the public with an active say over the direction of finance. Finance is allocated in ways that diverge from popular preferences (especially if we think that each person’s preferences should count the same); the allocations are not particularly accountable, nor are they particularly fair. The third problem is that the current financial system does very little to aid the survival of democratic workplaces. As we’ve seen, a crucial factor determining the sustainability of workers’ cooperatives is their ability to access finance on good terms. Insofar as the financial system facilitates this, it goes a long way to spreading democracy throughout the economy. I argue that these last two problems are better served by a system of Democratic Community Banks (DCBs) than the usual social democratic practices. I focus on DCBs and capital controls because they seem to me to be the most fundamentally important reforms for democratizing finance over the long term. The next chapter looks at a couple of other possibilities for democratizing finance – such as expanding credit unions and democratizing pension funds – that are important steps in the right direction and are more practical in the short term.

2.1 Financial Dependence and the Restriction of Government Policy

Mainstream economics typically conceptualizes these issues in terms of the “trilemma” or “impossible trinity”. Originally presented as a theoretical model for open economies by Mundell (1963) and Fleming (1962), the model now forms the basis of international political-economy since open economies have become the norm. The trilemma shows that of three presumed desirable goals – stable exchange rates, free mobility of capital,
and autonomous monetary policy – it is only possible to have two of them. While the logic of the trilemma is indisputable, the standard characterization of it as a technical choice of complex economic variables obscures the degree to which there are fundamental questions of power and democratic freedom here. For example, there is wide agreement on the usefulness of having stable (if not totally fixed) currencies to maintain stable trade relations and stable purchasing power of the citizenry. The model makes it clear that to achieve this it is necessary to sacrifice either monetary policy or capital mobility. This is true enough, but what is presented as a technical economic choice glosses over the fact that what is really at issue here is that the ability for private financiers to move their capital at a whim *directly contradicts* the ability of a population to exercise democratic control over its economy. In what follows I suggest that we try to see under the technical tradeoff to the social issues of power and freedom that lie just beneath the surface.

How does private control of finance restrain government policy? Consider what happens in a country when a new progressive government gets elected and begins to introduce policy changes aimed at increasing the prosperity of the worst-off. Progressive governments typically initiate two kinds of overlapping policies: policies aimed at high if not full employment, and policies aimed at promoting social justice.

Full employment is important (indeed I would argue that it is so important that it should be a central plank of all progressive programs) because it is the most effective way to increase the wages and living conditions of the majority of the population. In addition, the epochs of full employment have also been the times when societal inequality has diminished the most – such as the US during the 1940s and 1950s (Goldin & Margo, 1992) – because this is when the incomes of the poorest increase most substantially. Yet not only is full employment useful for improving living standards and levels of equality, but it is also vital for empowering workers to achieve workplace demands because of their stronger bargaining position. As Kalecki (1990 [1943]) famously argued, and as Bowles, Gordon and Weisskopf (1990) and others empirically demonstrated, full employment softens the main disciplinary measure that employers have – the threat of the
sack – and so enables workers to bargain more forcefully for improved workplace conditions – from increased holiday time to participation in managerial decision-making.

The standard policies for achieving full employment are monetary and fiscal stimulus. Monetary stimulus works by a Central Bank increasing the amount of money in the economy and so lowers short-term interest rates. Lower interest rates are expansionary because they make it easier for businesses to get loans to expand their business, hire new workers, etc. Fiscal stimulus can work through tax cuts, or more commonly for progressive governments, through deficit spending.¹³⁴ Deficit spending simply means that the government borrows money from their own citizens (or foreigners) by selling government bonds and then spends the money in order to increase the overall level of demand in the economy to boost employment. Keynes famously said that it didn’t particularly matter what the government spent the money on – it could pay people to dig ditches then refill them – it was the spending that was important for reducing unemployment. But of course, progressive governments should target such spending into socially useful projects (schools, hospitals, social housing, etc.).

The problem is that policies aimed at full employment almost always conflict with the desires of financiers because full employment tends to lead to inflation. Inflation, i.e. a general rise in prices, is the worst nightmare for financiers because it eats up the value of their money.¹³⁵ Of course, inflation is also a problem for those on fixed incomes – such as pensioners or students – but groups like this tend to be compensated in other ways by progressive government policy. Likewise, inflation is not necessarily a major problem for the majority of workers (at least not nearly as damaging as unemployment) provided the economy is growing and wages are increasing. This is why, for example, American workers have historically done much better under Democratic governments than Republican ones, since the progressive policies resulting in higher levels of employment benefit them much more than the inflation hurts them (Bartels, 2004). It is only the richest segments of society (and those, like financiers, who earn their money through...

¹³⁴ For recent evidence of the effectiveness of fiscal stimulus during the Great Recession see Romer (2011).
¹³⁵ For example, say a banker lends $1000 to X today. At this time that money can buy, e.g., one computer. At the end of the year, X pays back the $1000 (plus an interest payment). However if there has been substantial inflation the banker’s $1000 now is worth less (because the computer now costs, say $1100). So in effect, inflation has made the banker poorer in real terms.
lending) that do worse with lower unemployment and higher inflation than the other way around. Indeed, the countries that have historically achieved the most rapid and significant improvements in standard of living and poverty reduction – such as South Korea during the 1960s and Venezuela in the 2000s – have done so with inflation levels near 20%, substantially higher than the now-orthodox 2% (Chang, 2006; Weisbrot et al., 2009).136

While policies of monetary and fiscal stimulus were very helpful in maintaining full employment in the decades following World War Two, they depended to a large extent on having relatively closed borders to capital. Most countries in this period used extensive capital control to prevent money from fleeing the country. In other words, from the 1950s-1970s the combination of capital controls and left political success in elections meant that many developed countries, particularly in western Europe, were able to insist on a compromise between workers wanting full employment and financiers wanting low inflation that generally favoured the workers. Things started to shift from the 1970s, with the elimination of capital controls by neoliberal governments who increasingly saw inflation as the central problem and unemployment as a “voluntary” choice rather than a structural problem (W. Mitchell & Muysken, 2008). Indeed, during the neoliberal era many Central Banks not only became independent of government but they were forced to give up their dual mandate (of focusing on employment and inflation) in order to focus exclusively on inflation.

The increasingly open borders gave financiers enormous power to restrain government policy of full employment. Monetary stimulus became much harder to achieve because financiers worried about the inflation that often accompanies such expansionary measures, or simply wishing to seek higher interest rates in other countries, are able to engage in capital flight. Capital flight refers to the act of financiers sending money

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136 This is not to say that inflation is never a problem. Very high levels of inflation, so-called “hyperinflation” is disastrous because it makes it basically impossible for a market economy to function since the price signals, which are the basic data of such systems, become totally unreliable. However, the evidence shows that modest levels of inflation, below roughly 20%, do not pose serious problems for growth or employment (Bruno, 1995; Joseph Stiglitz, 1998). On the contrary, it is generally much better for the population as a whole to have lower unemployment with higher levels of inflation than the other way around (Hahnel, 2002).
outside of the country. Hand-in-hand with capital flight is currency speculation (sometimes called “currency attack” if serious enough). This is when financiers speculate against the currency by selling the domestic currency and buying a foreign one. Financiers may do this partly for conscious political reasons of wishing to undermine government policy, but more often for straightforward economic reasons of self-interest, wishing to protect the value of their money which they expect to depreciate (due to capital flight and inflation). Selling the currency makes it lose value. Others then see the depreciation and rush to join in the flight in order to protect the value of their money, leading to the currency falling even more, and often creating a self-fulfilling prophecy. So the main result of capital flight and currency speculation is that the currency depreciates – this makes the average citizen poorer, because all their goods that come from abroad now cost more.

Likewise, fiscal stimulus through deficit financing becomes much harder. As discussed last chapter, free mobility of capital makes it much harder to stimulate the economy this way because if bondholders become worried about potential inflation from government spending, they can sell their domestic bonds en masse and send their money outside of the country to buy different currencies. This mass selling of bonds will make long-term interest rates rise, which chokes off expansion and slows the economy (Glyn, 1995). At the beginning of the Clinton administration, the Wall Street Journal described the power of so-called “bond vigilantes” in this way:

> [If Clinton] proposes big spending programs or policies that accelerate inflation – bondholders' deepest fear – the reaction could be swift and painful…. If thousands of investors world-wide dump U.S. Treasury bonds, they could drive up long-term interest rates, which move inversely to

137 The fact that most financiers see their activities in terms of rational self-interest, not as politically motivated “attacking” of government policy, in no way changes the real impact that they have. People who drive 100km/hr through residential neighborhoods are not consciously attacking the safety of that community, they’re acting in ways that are in some ways rational (getting from A to B as quickly as possible). But their potential impact on the community is still detrimental enough that such actions are legitimately restrained.

138 Currency attack is particularly dangerous for third-world countries. If a small country’s currency is attacked, the prices of local goods can become massively devalued; this allows foreign investors and speculators (usually from the North) to come in and buy everything at rock bottom prices, causing a shift of ownership and control from South to North, and thereby threatening to undo many of the gains of the anti-imperialist era (Hahnel, 1999).

139 Fiscal stimulus is still possible through tax cuts, but they are not usually compatible with broader goals of progressive governments.
bond prices, hobble America's economic growth and even plunge the nation back into recession (Sease & Mitchell, 1992).

For similar reasons, open borders make it harder for the government to implement social justice policies – such as implementing higher taxes or regulating the financial sector or promoting democratic banks – because financiers can “veto” such policies by engaging in substantial capital flight and currency speculation. Indeed, if capital flight is severe enough the progressive government can suddenly find itself with spiking interest rates, and a tumbling currency, which makes the economy falter and the population poorer. Clearly a difficult state of affairs. The end result of which is that the system of private control of finance effectively narrows the range of feasible progressive government policy.

2.2 Capital Controls

The most basic tools for a population to reduce its vulnerability and protect itself from destabilizing capital flight or currency speculation are capital controls. Capital controls are regulations on how money can be brought in and taken out of a country. After World War Two virtually every major country (the US being the exception) used extensive capital controls in order to guide development, increase financial stability, and protect national sovereignty. In the 1980s and 90s, however, capital controls were largely abandoned in the northern world, due to the rise of neoliberal beliefs in the superiority of the free market and unfettered capital mobility.

The basic argument in favour of capital controls is that they are invaluable in protecting a country’s democratic sovereignty (Fred Block, 1992; J. Crotty & Epstein, 1996; G. A. Epstein, Grabel, & Jomo, 2005). Firstly, to the extent that capital can leave the country, it can simply avoid democratic oversight. If people can send their capital to places like the Caymen Islands to avoid regulation or taxation, then democracy loses its grip. Clearly democracy requires that all people within the borders of its jurisdiction be subject to the same rules and regulation. But capital mobility allows certain people – particularly the wealthy – to easily avoid the financial regulations that they dislike by sending capital across the borders (Shaxson, 2011). Yet without at least somewhat sticky
borders there can be no clear demarcation of the demos – no group of people bound by the same laws – and with no demos there is no demos-cracy. Secondly, free mobility of capital means that those who control large amounts of financial wealth can always threaten the government with leaving. And since finance is so integral to the continual functioning of the system such threats have real force. If financiers can credibly threaten to engage in capital flight against various government policies, then governments lose substantial autonomy to pursue their elected mandate. These are the two basic reasons why democracy and mobile capital threaten one another.

Capital controls reduce the force of capital flight and currency attack, and therefore serve to shift the balance of power between the worker-oriented coalitions on the one hand, and the small coalition of financiers on the other. In this vein some progressive scholars argue that capital controls are a vital ingredient for restoring a decent class compromise (J. Crotty & Epstein, 1996).

Objections to capital controls usually have a moral and a pragmatic dimension. On moral grounds, right liberals and libertarians tend to object to the idea of the state interfering with one’s personal control over their own money. One journalist of the Financial Times described controls as “one of the most potent weapons of tyranny which can be used to imprison citizens in their own country” (Brittan, 1998). Likewise, Friedman ([1962] 2002) sees controls as a kind of financial repression and a terrible infringement on personal liberty. Such objections are fallacious for the straightforward reason that a democracy can legitimately restrict all kinds of individual actions for the sake of other people’s freedom. One’s right to use private property is never absolute. One can own a car and paint it any colour, but one cannot drive it any speed one chooses. One can own a knife and use it to cut any fruit one wishes, but one cannot use it as a weapon (except perhaps for self-defence). Property can be used freely at the individual’s discretion only up to the point that it becomes a source of unfreedom for other people. So what is really at stake here is a disagreement about which kind of freedoms are more important: the freedom for people to do what they want with their money, or the freedom of a people to be able to enact its own laws and policies without being undermined by financiers. It seems to me that both of these freedoms are important, so some kind of balance will
inevitably be necessary. That said, it seems hard to argue that it is more important for multimillionaire financiers to be able to send millions of dollars to any country in the world instantaneously in order to speculate on slight deviations in interest rates, than it is for a democracy to function according to the will of the majority. While one may well object to specific controls as being too harsh or authoritarian\textsuperscript{140} (just as one could object to overly harsh sentences for speeding), it is nonsensical to reject controls \textit{per se}, since the freedoms they protect are often more important than the freedoms they restrain.

Perhaps the most common objection to capital controls rests on efficiency grounds. It is often argued that there is a trade-off between efficiency and prosperity on the one hand and state sovereignty on the other. People in Western countries, it might be argued, have sensibly chosen to forfeit some of their democratic autonomy for more prosperity. Yet it is not at all clear that free mobility of capital really does lead to greater growth or prosperity, particularly when one factors into account the potentially massive economic costs of financial instability that comes hand-in-hand with mobile capital. The Asian crisis of the late 1990s and the worldwide financial crises of 2008-2011 show the tremendous costs of financial instability and have led to renewed calls across the political spectrum for capital controls on purely economic grounds (Palley, 2009). The following chapter reviews the empirical evidence on this question. But even if there is an economic cost to capital controls, it is not at all clear that such costs outweigh the political benefits of increased economic democracy. What is clear is that while many politicians are quick to denounce the cost of capital controls, most are unjustifiably silent as to the political and social costs of financial oligarchy.

2.3 Private Finance and Public Accountability

The central function of finance is to mobilize savings to be put to productive use: to match savers with investors and so fuel economic growth. In the northern world, the main institutions for accomplishing this are banks and stock and bond markets. Banks provide

\textsuperscript{140} The old South Korean law threatening execution for breaching foreign exchange controls is a case in point (Chang, 2007, p. 14).
finance through the provision of credit (loans, mortgages, credit cards, etc), and stock or bond markets through the issuing of shares or bonds.

The most important thing to recognize about finance is that it is absolutely vital for contemporary economies to function. The contemporary left tends to ignore finance, seeing it as epiphenomenal or overly abstract – but this is a mistake. Many businesses require substantial money up front – to pay labour or fixed capital (such as machinery or office space), and other inputs – before they can even begin to make money. Other companies require constant loans for their day-to-day operations (perhaps because they only make big sales once or twice per year). Finance can be thought of as the oil in a car engine – lubricating and facilitating the moving parts of the economy. Without it, the engine seizes up and eventually breaks down.

In fact, finance is so important to today’s economy that it really a public utility – like a water system or an electricity grid. Society is largely dependent on it. If banks and stock markets stop providing finance, businesses go bankrupt, people lose their jobs and then their livelihoods. The 2008 financial crisis demonstrated this all too clearly – when the Lehman Brothers bank fell, followed swiftly by Washington Mutual in October 2008, it sparked a widespread credit freeze. The credit freeze provided a brutally clear illustration of our dependence on finance – without the banks lending money, businesses started collapsing and jobs were destroyed by the millions. The economy came scarily close to the edge of the abyss. Finance is a public service because it is so widely and generally needed for contemporary society to function smoothly.

In the neoliberal context, financial decision-making is left almost entirely to the market. Financiers (either through banks or institutional investors) lend money to businesses on the basis of their profitability – with the underlying belief that profitability serves the public interest by reflecting popular demand. Unfortunately, neoliberal financial systems provide a public service with very unsatisfactory results. In North America and the UK in particular, financiers increasingly control huge amounts of resources. The two largest banks in the US – Citigroup and Bank of America – direct an enormous $4 trillion in assets, about one-quarter of the country’s entire GDP (Simon Johnson & Kwak, 2010, p.
The increasing prominence of the finance industry is a startling fact of the modern world. Indeed, in the US over 30 percent of all profits were captured by the financial sector (Cameron, 2011). This is particularly striking when one recalls that the purpose of finance is simply to be an intermediary between savers and investors. It’s hard to believe that it’s necessary for financial services to be so expensive for society – that it’s necessary, for example, for Goldman Sachs to pay its employees an average of $367,000 (Treanor & Wintour, 2012) – particularly when we recall that western countries grew much faster in the decades after the war than in recent years when post-war banks were much smaller, bankers made a more modest income, and finance as a whole was a much more staid affair.\footnote{Financiers tend to justify their salaries on the basis that they are experts in managing risk, the results of which produce large benefits for the real economy. But of course, given that these so-called expert risk-managers recently misjudged risk to such a colossal extent that they sunk half the world in recession, there are clearly valid questions to be asked about the real contribution of the financial sector (Haldane & Madouros, 2011).}

A cursory glance around neoliberal societies shows many socially problematic projects receiving steady financing, while many socially useful projects get nothing. Banks are more likely to finance tobacco companies or tar sands than workers who want to start their own cooperative business. Private finance often goes to build strip malls and urban sprawl while ghost towns are left to decay. The casinos and condos never lack for financing; whereas social housing and cooperatives are invariably starved for funding. The main reasons for such results are the market failures that we identified last chapter. Finance is not allocated in a way that respects consumer sovereignty because of consumers have such different amounts of dollar “votes”, and finance is not allocated in a way that respects what I’ve called “citizen sovereignty” because the market is not an appropriate mechanism for allowing collective, future-oriented decision-making.

While it is one thing to argue that the Anglo-American model of profit-driven “free market” financial allocation is deeply flawed, progressives risk arguing against straw men if they ignore the important position of social democrats. In what follows I want to contrast a social democratic perspective with an alternative view that what is actually needed is a deeper democratization of the financial system via the implementation of democratic community banks.
In contrast to neoliberal countries, the standard social democratic position is that the market by itself is not an adequate mechanism for the allocation of finance and investment. Most social democrats recognize that the state must regulate the market to improve consumer sovereignty (so that finance is directed by private financiers in ways that is more reflective of what the population, considered more equally, really wants), as well as recognizing that the market is an inherently inappropriate mechanism for providing citizen sovereignty and so the state must engage in a certain amount of direct investment itself to make the long-term or public investments that citizens may collectively desire but are not adequately provided through the private market. A regulated market combined with state-led public investment – that, in a nutshell, is the social democratic approach (C. Lindblom, 2001; Rawls, 1971).

While this perspective has a lot to recommend it (particularly compared to the more traditional “free market” perspective), I want to contrast it an alternative based around democratic community banks. As will be described in more detail below, I envision DCBs as local, public, not-for-profit banks, which are managed by Boards that are democratically elected by the bank’s community members. DCBs make financing decision using price signals as a guide, but because of the unavoidable distortions and inadequacies that accompany price signals, they are supplemented with democratic input from local constituents.

The main problem with the social democratic approach is that it relies on the central government to be the democratic representative of the population’s collective and public interests. But while the central government is formally accountable to the population it is far too removed from the actual citizenship to provide much meaningful democratic engagement on these issues. Consider the examples mentioned last chapter. Should society promote green businesses and high-speed trains at a regional level? Should we subsidize community artists or bike lanes at a local level? For a social democratic society to decide about financing green business or local artists requires deciding whether the externalities involved (the negative ones of pollution or the positive ones of local culture) are important enough to warrant intervention. If the state decides that they are, the usual method of dealing with externalities is pigovian taxes. The idea is that the central
government calculates the cost (or benefit) of a common externality and offsets it by introducing a tax (or subsidy) (Krugman, 2010a). This “internalizes” the externality and corrects the price of the good, thus allowing private financiers to serve the public good by trying to maximize their own profit. For example, Rawls argues that one of the tasks of government (via an “allocation branch”) is “identifying and correcting, say by suitable taxes and subsidies… the more obvious departures from efficiency caused by the failure of prices to measure accurately social benefits and costs” (Rawls, 1971, p. 276).

Likewise, social democratic societies deal with questions of transportation systems, from trains to bike lanes, by having the state decide whether such public goods are collectively important enough to warrant taxing the general population in order to provide them.

There are several problems with the social democratic response. The most significant one is institutional: in the social democratic scheme the central government is the main institution responsible for deciding which market failures to respond to – in particular, which externalities matter and which public goods warrant social provision – yet is a particularly inadequate institution for the job. The central government is incredibly inaccessible to the average person affected by market failures; a single person in a 30-million person country has essentially no influence in such matters, particularly since her vote is a sign of acceptance or rejection of the totality of government’s policies, she has basically no ability to express her like or dislike of a particular externality or public good. The broadness of government’s responsibility makes it particularly unresponsive to popular opinion on specific economic policies like this. Moreover, since elected politicians have to make decisions on such a broad range of issues they cannot be expected to have particular expertise in dealing with the wide range of externalities and public goods that might exist.

Another problem is that the basic tools that social democratic governments use to respond to market failures – such as pigovian taxes and direct investment – are very blunt and imprecise tools. Rectifying an externality by introducing a new tax affects the entire national economy in one blow. A pigovian tax may be suitable for dealing with a major economy-wide externality, but it is totally inappropriate for responding to the thousands of smaller, localized externalities that exist in every economy. Using national pigovian
taxes for local externalities is like trying to swat a fly with a wrecking ball. The inherent bluntness of pigovian taxes is part of the reason why in practice we’ve seen that central governments have been very slow and cumbersome at actually rectifying externalities. It should give all social democrats cause to pause when they consider that even social democratic governments have only managed to implement pigovian taxes (or analogous cap-and-trade systems) on a small handful of externalities, such as sulfur and cigarettes.

Such institutional problems are compounded by the realization that market failures are in fact not at all rare – they are pervasive. Consider externalities again. Every real economy contains billions and billions of externalities. The auto industry produces massive environmental externalities in the form of carbon emissions, but it also produces a host of lesser externalities, from noise pollution to traffic jams to highway expansion to smog to road accidents to danger for bicycles etc. Living in a society means that our lives are inextricably interconnected; people’s actions invariably ripple out in waves of “externalities” constantly affecting one another. So while the social democratic solution can perhaps help with the most major externalities, pigovian taxes are much too bureaucratic and unwieldy to offer pragmatic responses to the countless others. This means that we can expect social democratic systems to finance sweatshops over unionized firms or firms employing disabled people; we can expect them to finance casinos and chain stores but not the struggling local daycares or environmentally-friendly companies, not to mention the thousands of low-profit local community endeavours (the bike stores and community gardens, conservation projects and artistic studios), since no government is likely to try to introduce hundreds of new taxes and subsidies to account for the myriad externalities that exist.

Democratic community banks would likely perform better for two reasons. They would be institutionally more democratic. A fundamental advantage of DCBs is that they decentralize decision-making about responding to market failures such as externalities.

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142 The mainstream view that externalities are rare is part of an “empty world” view of economics (Hahnel, 2011). Indeed the most celebrated proposition of welfare economics – that a competitive market economy will be socially efficient – is only valid when externalities are non-existent. It is perhaps understandable that Adam Smith gave little thought to externalities living in a world of 800 million people, but in our contemporary world of 7 billion, it is incredibly unrealistic to think that our economic relations do not constantly affect other people. On the pervasiveness of externalities see Hunt and Arge (1971).
Indeed, the underlying principle here is that financial decision-making should be decentralized as much as possible to make it democratically meaningful (within a framework of broader democratic accountability\textsuperscript{143}). This significantly improves accountability. It is easier for decision-making at this level to be transparent, and it is easier for an average person to influence policy at this level. Why would any social democrat prefer decisions to be made at the rarefied heights of central government than at local levels where democracy is more meaningful? Additionally, DCBs have the potential to be institutionally more effective. If externalities are pervasive in nature and varying in intensity, we need institutional mechanisms for dealing with them that are specialized in focus and flexible in response. DCBs are a more natural place than government to make decisions about weighing profitability versus social importance since they can focus entirely on questions of this nature; they are not weighed down with hundreds of other concerns and so can be more specialized, quicker, and nimbler in their actions. Importantly, DCBs can make financing decisions on a case-by-case basis which allows them to be sensitive and selective in their response to externalities – for example, by providing loans to one green firm with a lot of potential, but denying such loans to another green firm that appears corrupt and badly run. This allows for a much more fine-tuned allocation of finance than the social democratic pigovian method which are particularly blunt tools (for instance instituting a state-wide subsidy for all green firms).

A final problem with social democratic financing is that it’s not geographically sensitive to the needs of diverse communities. In small, rural towns as well as larger depressed areas and “rust belts”, people’s savings go into local branches of large banks, which are then transferred into national and international pools of capital, then sent around the world in search of the highest levels of profitability. The chances are that the bulk of the savings from such towns will not be reinvested in the community from which they came, instead profit-seeking finance acts to suck capital out of such communities in search of higher profits elsewhere (Gunn & Gunn, 1991). In other words, the geography of financial allocation matters. While directing capital to areas of high profitability may benefit the people in those areas, the social democratic market systems offers no

\textsuperscript{143} The next section discusses some tools for achieving higher level accountability.
mechanism for any kind of fairness about returning capital to the areas it came from. The familiar result is that some communities end up receiving much more financial support, year after year, than others, making some communities flourish and leaving others to rust. As we’ll see below, DCBs have the potential to be much fairer in this regard since they recycle capital on a per capita basis to the communities from which it came.

2.4 Democratic Community Banks

Instead of the social democratic model of a regulated market with a central government responding slowly and bluntly to market failures, what is needed is a new financial model that is deeply democratic. The most fundamental reform required for democratizing finance is the institution of a public banking sector that is decentralized and controlled from the ground-up by the communities within which they are rooted. Democratic Community Banks (DCBs) could overcome the problems of dependency on private profit-maximizing banks by providing an alternative source of credit that is reliable, stable, and operated as a public service. They would also allow for sovereignty in the more active sense by providing a means for the local community to exercise some control and accountability over the allocation of finance. They would thus give communities a real tool for furthering their self-determination.

A democratic banking system would be one that fulfills four requirements.\textsuperscript{144}

First and foremost, such banks must be \textit{democratically accountable to their membership} – i.e. all those who use the bank, depositors and borrowers. Imagine a system of DCBs where the Board of Directors of the banks are directly elected by the entirety of the bank’s members on a one-person one-vote basis. In this way the DCBs are like publicly-funded credit unions (though DCBs should additionally have some representation of internal workers too). To protect the quality of the democracy, DCBs should be required to have high standards of transparency, open books, ease of recall of elected members, frequent elections (perhaps once per year), and limits to the number of terms anyone can serve.

\textsuperscript{144} The following model has some similarities to that of Schweickart (1996, 2002) as well as Bowles, Gordon, and Weisskopf (1983).
Second, the DCBs would be *public not-for-profit institutions*. Their funding would come from the depositors as well as the state (with public funds allocated in proportion to the number of members) and their salaries would be those of public servants. In other words, DCBs can be seen as publicly-funded credit unions or as democratized and decentralized public banks. To qualify for state funds a DCB would have to commit itself to allocating finance to local businesses and community projects according to the dual criteria of profitability *as well as* social value (such as maximizing employment, environmental sustainability, etc.), though the specific priorities of each DCB would be determined by the elected representatives each year. To the extent that social values and profitability contradict, compromises must be made. One possibility is for projects to be evaluated in terms of both their wealth-creating potential as well as their social merit (e.g. the extent to which they promote employment, arts and culture, empower female, disabled, indigenous peoples, increase environmental sustainability and social justice, etc.) The elected Board could then decide the portion of funds to be allocated to valuable projects that are money-making and what portion to allocate to valuable projects that are not. Likely a Board would have mixed priorities about how to balance these, which is not particularly a problem insofar as it represents the mixed priorities of the larger community.

David Schweickart (2002) makes the important suggestion that democratic banks be funded by a general capital assets tax – a tax, in other words, on the collective productive wealth of society.\(^{145}\) Funding the banks in this way means that the society’s wealth is in effect being recycled to various communities through the public banks, under the

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\(^{145}\) While Schweickart (2002) advocates public banks under municipal control, the model here is different because DCBs are directly democratic. In Schweickart’s system the average citizen would have very little democratic say since the only way she can attempt to influence financial decision-making is by voting in municipal elections (the local governments then direct the public banks on how to operate). The bank itself has no reason to listen to her. This retains the basic social-democratic problem that the state (in his case the municipality) which is deciding financial priorities is far removed from actual popular influence or accountability. DCBs are much more democratic because an individual can exercise influence by directly voting for the Board (which is a vote *directly* for financing priorities as opposed to a vote in a municipal election that is a vote for financing priorities amongst a thousand other issues); DCBs are likely to be much smaller than municipal governments so there are more possibilities to exercise one’s voice; moreover, an individual can influence DCBs by threatening exit, which is a threat that would have little force in Schweickart’s system.
authority of community representatives. In this way communities come to have an active say in the allocation of finance, and a real tool for directing their own self-determination.

Third, the DCBs would be decentralized and at arm’s length from the state. Having several DCBs in a community as opposed to one gigantic nationalized “People’s Bank” means that accountability can exist on a meaningful scale. The DCBs are totally open, meaning people can come and leave as they wish, just as people do with credit unions today. Keeping the DCBs semi-autonomous from the state is necessary to prevent politicking – politicians influencing the actions of the DCBs for their own advancement, which is often a problem with public banks. Furthermore, since it is impossible to predict in advance the best form of a DCB, and in the spirit of plurality and democratic experimentalism, it seems reasonable to allow any group of individuals to start their own DCB (as long as it fulfills the basic mandate of democratic organization and mixed lending criteria). DCBs would receive public funding based strictly on the size of their membership. In other words, each DCB would receive X amount of dollars per unique member. This is important because it makes the distribution of financial resources sensitive to the population, thereby remedying the current situation where some neighborhoods and regions get hugely disproportional funding compared to others.

So while DCB funding is strictly tied to membership, it makes sense that the bank’s employees have salaries that rise with increased membership. This gives DCBs incentives to grow, not in the capitalist sense of profit-maximizing, but in the democratic sense of seeking out new members. This provides an incentive for DCBs to try to appeal to an increasingly broad base of potential clients – in particular seeking out poor clients and setting up DCBs in poor neighborhoods just as much as rich ones since every new customer is equally important in terms of bringing new state funds. Moreover, since DCBs can lose funding and ultimately risk being shut down by losing clients, they have increased incentive to respond to members’ wishes. DCBs are thus structured to be especially sensitive to their members’ preferences: since unhappy members can go elsewhere, they have the power of exit to another DCB as well as that of voice within their own DCB.
Allowing a plurality of DCBs means allowing for competition between them – with each fighting to acquire more members. It is likely that this would result in increased accountability as well as specialization, with different DCBs focusing on different areas (perhaps serving different types of co-ops or offering different social emphases). What would happen if a DCB wishes to focus largely on profit-maximization? Is there a risk of it degenerating into a capitalist bank? It seems unlikely, because the democratic structure militates against a unitary drive for profit. Consider what happens if a DCB starts focusing solely on profit-maximizing. It could initially make more money, and then (if legally permitted) it could offer more attractive loans, which gets it more customers, which in turn gets it more public funds. But this trajectory is likely to get quickly undermined since new customers are also voting members. And since everyone has social preferences beyond that which are likely to be achieved by profit-maximization alone, the new members would inevitably start pushing the Board back towards reconsidering social factors beyond profit in their financing. It is thus unlikely that a pure profit-maximizing ethos would take over a democratic (and therefore heterogeneous) membership.

Fourth and finally, DCBs would be required to have a department specifically oriented towards helping local worker co-ops flourish. Supporting cooperatives and financing worker ownership would be a central component of the bank’s operations, requiring a specialized staff. We can imagine each DCB having a department dedicated to this task, researching likely markets, bringing together potential co-op members, performing feasibility studies, providing loans as well as technical managerial advice.

How well would DCBs perform in comparison to social democratic financing through private banks and state intervention? While the democratic advantages of DCBs are obvious, it is important not to idealize them. There are several areas of principal concern: would they be corrupt, would they be wasteful, would they be inefficient, and would they be inexpert?

The potential for corruption in DCBs stems primarily from the vagueness of their mandate to consider social criteria. Social criteria – for example making decisions about what kind of externalities matter – are inherently fuzzy and difficult to measure.
objectively. This is potentially problematic because it opens the door to corruption (for instance, it may be easier for bankers to disguise nepotism under vague “social” criteria). As Jossa (2004) points out, making choices based on criteria that are difficult to define leaves ample room for discretionary and/or arbitrary decision-making. But of course the problems here are precisely the same as those faced by social democratic planners. The most basic measure to prevent this sort of corruption would be a yearly audit. DCBs would require a financial as well as some kind of social audit (preferably performed by an external body). This would allow every member of the DCB to see the records of the year’s financing decisions. Such transparency allows an opposition to critique the incumbents and try to get themselves elected with promises of changing various practices. It’s clear from looking at political democracy that public offices can indeed suffer corruption. Though they can also retain cultures of integrity and public spiritedness. Taking a broad view it seems hard to imagine that the kind of corruption possible in a DCB, with elected officials, transparent records, and salaries at public servant levels, is anywhere near as pernicious as the kind of corruption that often exists in today’s private banks, which are not transparent, have little public regulation or oversight, and have personal fortunes of millions of dollars at stake. (See Francis (2010) for one study of the prevalence of fraud in contemporary banking).

Another potential problem with DCBs is the worry of waste associated with soft budgets. Soft budgets mean that firms are continually bailed out by the authorities, wasting huge amounts of money, in order to avoid paying the political costs of unemployment – which was a source of huge problems in the USSR (Kornai, 1992). For instance, just because a firm is a co-op doesn’t mean that the DCB should indefinitely subsidize it. To do so means wasting resources that might be better used elsewhere. DCBs themselves do not have soft budgets; their funding is not discretionary but tied to the size of their membership. If that deteriorates, so does their funding, even to the point of closing down altogether. But would the firms or co-ops served by the DCBs face soft budgets? This is possible, particularly in smaller DCBs where much of the membership is tied to a particular source of employment (say in a single factory town) since such members may well wish to continue bailing out their company even if it’s becoming obsolete. Interestingly, this is less of a problem for large DCBs because their heterogeneity makes
them less likely to be captured by any one group. Regardless, this problem points to the
importance of developing clear and stringent standards as to when certain firms (and
social projects) should have their financing cut and be allowed to die. The DCBs should
not try to keep ailing firms alive indefinitely because market systems are only able to
increase productivity (and thus prosperity) through waves of what Schumpeter called
“creative destruction”. Yet although “creative destruction” is an important process, when
it happens through private banks it can be brutal and heartless, where old factories and
towns are simply abandoned, leaving ghost towns where the people are unemployed and
unemployable. DCBs are superior to private banks in that they can soften this process. If
their member firms are going obsolete DCBs, as public bodies, have much more of an
interest than conventional banks in finding new opportunities for them, helping them
retool, retrain their workers, and find new markets.

Connected to this issue one might wonder if there is any reason to suspect that DCBs
would lead to serious inefficiency by insufficiently financing profit-maximizing firms,
thereby slowing innovation. This seems unlikely. If anything DCBs should act as a spur
to innovation since they are able to finance a much wider range of firms than only those
which are thought likely to quickly turn a profit. DCBs can be more patient and long-term
with their financing (since they’re not controlled by shareholders demanding instant
profits), as well as helping to develop co-ops and other socially-innovative types of firms
that are left out in the cold by the private banking sector.

A final potential disadvantage with democratizing banks is the risk that financial
expertise would get overruled by brusque popular sentiment (a fear shared by all the great
anti-democrats from Plato to Burke to the IMF). It’s clear that democratic banks would
require specialists. Democracy cannot mean every community member directly
participating in every financing decision or loan application. Clearly competent
specialists are needed to evaluate the economic and social targets of various proposals, as
well as develop clear guidelines for what counts as meeting those targets. But, the
important point is that this expertise would be rooted in service of the members – because
their bosses are elected by the community (and their incentives for job promotion would
be tied to how well they serve the community in terms of funding successful projects and
attract new members). Expertise would thus be heavily used, but it would be the servant of the people, not the other way around.

In sum, DCBs possess several important advantages over social democratic financing. In essence both systems use planning techniques to overcome market failures. And so both have the potential for corruption, waste, inefficiency, and lack of expertise – though there is no reason to expect that these will be worse for public bankers than for more traditional public servants. The key question, then, is whether it’s better to have such planning managed by small, specialized banks, or large, bureaucratic states? I think DCBs would be a more democratic way to manage finance in the direct sense that such banks are more accountable than government structures. Decentralizing financing decisions from central government to local DCBs provides regular people with increased influence over how finance is allocated. DCBs are also more democratic in the indirect sense that financing decisions are likely to be more in line with what the public interest since they’re better able to respond to market failures in an effective way than social democrats with their blunt tools of tax and subsidy. Finally, DCBs are likely to be more just in the sense that they are geographically sensitive and fair, operating to ensure that capital follows people not profit.

Yet even if one accepts the desirability of DCBs, it may well be wondered how plausible they are. Would DCBs need to constitute the entire banking sector? DCBs are exciting because they offer a flexible range of possibilities in terms of scope. In the shorter term, they could serve as an important supplement to private finance – smaller DCBs could be created alongside private banks, or, in countries where public banks already exist, there is perhaps room to democratize them and place them under local control. This would mean that firms would have the choice about whether to try to obtain their finance the usual ways – from banks, stock markets, or begging rich individuals – or from a DCB.

This would bring about competition between private banks and DCBs – what would be the result of that? Many firms would prefer to operate with DCBs – co-ops for sure, as well as other firms whose short-term profitability is questionable. But because private banks have such large resources and are therefore able to offer very competitive rates for
loans to firms, it is possible that a division would emerge between profitable firms preferring banks and less-profitable ones preferring DCBs. In a sense this is not a bad thing – part of the point of DCBs is to provide finance to firms that are socially valuable even if they’re not profitable. But it does mean that DCBs will not outgrow private banks on the basis of monetary competition. For DCBs to make serious inroads into the banking sector they will need exogenous support, either by the state providing certain competitive advantages (such as tax breaks similar to what many credit unions enjoy today), or shifting resources from private banks to public ones (e.g. through a kind of Meidner plan, as will be discussed in the next chapter).

Over the long term, however, obtaining real financial democracy – overcoming dependency and increasing popular accountability – would require democratizing enough of the banking sector so as to actually serve the general public need of stable, regular financial provision. The more the sector is controlled by DCBs the more the population acquires a say (on a per capita not per dollar basis) in how its collective wealth should be recycled. In the longer term, DCBs would ideally compose the entirety of the financial system – replacing the stock market and private banking system. While small private lending is unobjectionable, ultimately the main pillars of society’s finance cannot be private institutions, but must be public, accountable ones.

While this is clearly a long-term prospect, bank-based systems of finance are not at all unheard of (Gerschenkron, 1962). Japan, France, and Germany have all had them (Robert Pollin, 1995). Indeed under Mitterrand, France’s banks were about 90% public (though not locally controlled or particularly democratic). So it’s clear that it is possible to have fully functioning financial systems that are based around banks without having to rely on stock markets. Although the exact type of DCBs that I’ve been discussing do not yet exist, there are a variety of similarly structured banks that do exist and point to their general feasibility. The Caja Laboral Popular (Mondragon’s bank) is one inspiring model – not only is the bank itself run in a democratic fashion, but it has been very successful in financing the Mondragon Cooperatives, some of the most successful co-ops in the world. More broadly, practically every country in the world contains credit unions, many of which have proven to be eminently sustainable over the long term. They provide
a striking model of the feasibility of democratically-controlled financial institutions. Both of these models provide firm and fertile ground for the future development of DCBs – a prospect we consider further in the next chapter.

3 Investment

The remainder of this chapter focuses on how contemporary private investment works. We examine why it is a democratic concern and then investigate how it could be democratized in a way that provides meaningful participation at a local level within a framework of large-scale accountability.

Investment refers to the active purchasing of things so as to maintain or increase productive capacity – e.g. when firms upgrade their factories, buy more office space, or hire more workers. Slowing investment or disinvesting is the opposite – it involves reducing production and firing workers. In the normal course of a capitalist economy, profits → investment → jobs and increased profit. Chancellor Schmidt put it this way: profits today are investments tomorrow which are jobs the day after (Adam Przeworski, 1985, p. 43). Business owners operate to make a profit. They will invest in the case that it seems likely that such investment will increase their profit. For investment to happen there needs to be, first and foremost, prior profit levels – this is the single most important factor determining investment levels (Samuel Bowles et al., 1990). In addition, business requires confidence – partly that the business environment is stable, as well as confidence that there will be demand for their products. So, for investment to happen – which is after all what society is interested in, the increased jobs and prosperity that result from investment – business has first of all to be profitable and confident.

The thing that is crucial to recognize is that we, society as a whole, are extremely dependent on the actions of investors because of what has been called the “privileged position of business” (C. Lindblom, 1977). Adam Przeworski (1985) describes the dilemma particularly well. Consider, he says, the perspective of a democratically-elected leftwing government. The fundamental problem of which, and the main reason why
progressive reform is consistently so hard to achieve, is the problem of investment. To see why this is so recall that left governments tend to get elected by broad coalitions of unionized workers, students, retirees, the unemployed, etc. on a variety of promises to increase wages, pensions, workplace and environmental regulations and so on. However, these things inevitably bite into profit margins. So as soon as the government starts implementing its promises, private profits start falling (because for example, business owners are now forced to pay higher minimum wages, grant maternity leave, clean up their pollution, pay higher taxes etc.). This reduces the incentive to invest (since why would one go through the effort of investing if one is less likely to profit from it?) If the government changes are drastic enough, and business confidence becomes seriously shaken, investment rates can plummet. Companies lay off their workers, cut back their activity, and stop buying from other firms, which makes those downstream firms lay off workers too. So the amount of taxable revenue going to government starts to shrink, and there is much less money to fund the social programs that the government promised. There can only be social programs like welfare if there is sufficient investment and productive activity happening to tax to pay for it. Wealth has to produced before it can be redistributed. So those who want welfare find that they have a direct interest in making sure production happens steadily. This means that, given private control of investment, even the most radical welfare-rights organizations, for all their anti-capitalist rhetoric, still find themselves dependent on business proceeding basically as usual.

So with mass layoffs and programs being cut, the average person may well conclude that she was better off under the former conservative government – at least then she had a job. If the investment crisis continues the population comes face to face with a stark choice: be progressive and starve, or reactionary and eat. The investment crisis swells into an economic crisis which fractures political coalitions, and leftwing governments find themselves facing a crumbling economy, mass unrest, and even rightwing counterrevolution (Chile under Allende is a classic example of this).

This, then, is the paradox: the very capacity of left governments to intervene in the economy depends on the profits of the businesses which bear the intervention. Przeworski puts it this way: “this is the structural barrier which cannot be broken: the
limit of any policy is that investment and thus profits must be protected in the long run” (1985, p. 42). Another way to see this “paradox of investment dependence” as I call it, is to recognize that, on the one hand, it seems clear that employees and employers often have opposing interests: lower wager = higher profits. However, on a deeper level, employees are dependent on their employers being happy, because if they’re not, if profits are falling and confidence is shaken, then investment slows and everyone suffers. Employees thus find themselves in the paradoxical situation of having to care about the happiness of their bosses, and mitigate their own demands for improvements, because they’re dependent on their employers continuing to invest. This means that what is good for the employer is usually bad for the employee, but, and this is the paradox, what is bad for the employer is also usually bad for the employee. So the private control of investment means that workers find themselves in a structural straightjacket, unable to protest the inequities of their circumstances too vehemently without risking making themselves even worse off. This is what Lindblom (1982) meant when he called the market a “prison”.

So in normal times, the stability and growth of the economy depends largely on the profit levels and the confidence of business owners who are making investment decisions. As Stanford says, we are dependent on profit-seeking private investment as the spark-plug for economic growth (1999, p. 254). This means that government policy is ultimately constrained, and popular sovereignty ultimately undermined, to the extent that the government cannot risk overly undermining business profits or confidence. This is why governments, even progressive ones, find it so difficult to make important social justice advances, like redistributing wealth – because what would happen if they tried? Any attempt to engage in substantial redistribution would be less likely to generate actual equality as it would be to lead to investment slowdown and economic recession. You would get collapse and depression far before you would get equality.

In tumultuous times, employers often use their control over investment as a weapon, usually called “capital strike” or “investment strike”. If this is used collectively with other investors, it can serve as an effective veto over government policy. Investment strike means that businesses refuse to invest; they lay off workers, close factory gates, cancel
orders from other companies, hoard money (or send it abroad), and thus bring the economy to a grinding halt. In practice, what often happens is that progressive governments find themselves hit with a deadly one-two combination of investment strike which causes a recession, forcing governments to borrow, followed by a financial strike (currency attack and lending freeze) which prevents the government from borrowing, leaving it in a desperate situation. Although the term “investment strike” implies a certain degree of conscious political activity on the part of investors, it’s important to notice that precisely the same results occur when investors are not thinking politically at all, and are just following the structural logic of their economic self-interest by cutting back investment because they think they won’t make money. It is the structures, more than the individual politics of a few rich men, that is our main concern.

3.1 Investment and Democracy

Although investment has long been seen as a crucial structural issue of capitalism, it has rarely been recognized as a central issue for democracy. It might be objected that if you own a private business, the decision to invest or not is yours, and yours alone – it is not a democratic concern. In chapter 3 I argued that workplace decisions, including investment decisions, should in fact be accountable to the workers. In this chapter, the perspective is complementary but broader. The perspective is not the individual firm, but the society as a whole. Clearly investment decisions of individual firms affect the workers in those specific firms (and so they should have say). But also, the actions of investors, taken as a class, affect the society as a whole. So from a democratic perspective, the question is about the broad public or macro-effect of investment decisions on an economy-wide scale.

From this larger perspective, investment is currently undemocratic for two reasons, similar to finance.

(i) Society is critically dependent on the actions of a class of investors to maintain stable investment, which undermines the nation’s sovereignty. A classic example is that of redistribution. For instance, many liberals following John Rawls think that a just society
requires redistributing wealth, however, a society that attempts to redistribute would find itself hamstrung in that it is unable to do so without risking economic meltdown. The society’s dependence thus undermines its sovereignty. By “investor class” I mean those people who are structurally in a position to make private investment decisions – managers and owners – about 5% of the population. Although there are sometimes divergences between managers and owners, they constitute a class in the sense that they broadly share the same interests vis-à-vis profit maximization, and so can generally be expected to act in similar ways. The control that investors have over the economy represents significant social power because their decisions have massive public ramifications. Yet it is clearly undemocratic for such a powerful minority to be able to undermine popularly elected governmental policy – it makes a mockery of popular sovereignty.

(ii) There are basically no mechanisms by which regular people can have any active say over the direction of investment. The future direction of society – which to a considerable extent is determined by current investment – is neither accountable to nor controlled by the other 95% of the population.

So how can investment be democratized (in the sense of reducing our dependence on a class of private investors and allowing for greater popular involvement and accountability)?

The social democratic response is now familiar. On the one hand, social democratic states strive to increase consumer sovereignty so that private investment decisions respond more accurately to the population’s desires. On the other hand, social democracies use the state to deliver a degree of citizen sovereignty by engaging in direct public investment. The problem with the first approach is that consumer sovereignty will remain a dream so long as there is such inequality in the number of dollar “votes” that different citizens have, and it is impossible to fundamentally improve this situation so long as private investors can “veto” any move to redistribute wealth. This means that it is

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147 I say “basically no” because most states do provide some public investment, with some limited accountability.
necessary to start democratizing investment in order to achieve real consumer sovereignty: democratizing the market and democratizing investment go hand-in-hand. The problem with the second approach is the same as we saw earlier vis-à-vis finance: the state, particularly the central government, does not allow for meaningful democratic engagement in discussions about public investment at local levels.

This begs the question, how could public investment be organized in a more democratic manner? The basic answer, I believe, is that we need to spread worker cooperatives as well as a public investment system with decentralized institutions that can be meaningfully democratic at local levels within a framework of higher-level democratic accountability. We need institutions for participatory democracy embedded in larger structures of representative democracy.

3.2 Cooperatives

The expansion of workers’ cooperatives throughout the economy is a crucial mechanism for expanding the number of people who can exert influence over investment decisions in a decentralized fashion. Since co-ops allow workers to direct investment themselves (at least indirectly through election of the board), the more an economy comes to be directed by self-managing workplaces, the greater the numbers of people who come to have some say over the broad contours of investment, at least as it pertains to their own firm.

Cooperatives also help to democratize investment by reducing societal vulnerability to capital strike. Co-ops are far less likely than standard businesses to go on investment strike in any way similar to that which occurred in Mitterrand’s France or Chavez’s Venezuela, since this would require co-op workers choosing to fire themselves. That said, it is true that cooperatives do not provide any general public control over investment: they are still essentially private organizations, acting in the marketplace to maximize their own profits, and so are not ideally suited to rectify market failures or provide means of citizen sovereignty.
3.3 Local Level Control Over Investment: Participatory Budgeting

In an important work on democratic theory, Josh Cohen and Joel Rogers (1983) made a case similar to the one here emphasizing the democratic importance of public investment. However, they (as well as other theorists like them) were quite vague about the institutional specifics of what a more democratic investment system might look like. Although public investment is not at all unusual, what is more unusual is the insistence here that for public investment to be meaningful it should be largely rooted at the local level, and democratized through active citizen participation. Most countries today have “public” investment that is largely dislocated from the actual public – a vote every four years is an extremely narrow avenue through which to express investment preferences. The local level is the area where the least public investment is presently done, yet it is where the most democratic potential lies.

Imagine if the state were to devolve substantial funds to the cities that then could be allocated to neighborhood assemblies, which are democratically controlled. That way local people in their neighborhoods could engage in a meaningful way, deliberate about their own investment priorities and make decisions on an equal one-person one-vote basis. One important example for this is the participatory budgeting of Porto Alegre, Brazil, where the state devolves about $200million/year which the citizens themselves decide to spend in a participatory fashion. The process started in 1989 and has now spread to more than 140 municipalities across the country. Residents meet in neighborhood assemblies to deliberate on spending priorities and elect delegates to implement these priorities. In many ways participatory budgeting has been a great success: there has been a flourishing of participation in local investment decisions that would be unheard of in the global north. About 50,000 people participate every year, mostly through local neighborhood meetings to set investment priorities, and the numbers have been growing consistently. Especially important is the fact that the process has involved the previously marginalized. A World Bank report describes how participatory budgeting has allowed low-income people to use the new democratic mechanisms to
focus investment towards their social priorities, such as schools, public housing, sewage and water connections (Bhatnagar, Rathore, Torres, & Kanungo, 2003).

In some ways, even more impressive are the Communal Councils in Venezuela. These are neighborhood assemblies of 200-400 families (or smaller in rural or indigenous areas), which have been empowered by the state to democratically decide on local investment projects. Since their initiation in 2006, the Communal Councils have grown enormously, with more than 19,000 now in existence around the country, constituting the central pillar of Venezuela’s unfolding so-called “participative and protagonist democracy”. They are largely autonomous from the state, though they are supported by state funds – in 2006 they received $1 billion out of a national budget of only $53 billion (Fox, 2006).

To reiterate, public locally-controlled forms of democratic investment have much to recommend them in terms of augmenting popular sovereignty – both in the sense of protecting the citizens from the damage inflicted by investment strike, as well as in the active sense of empowering more and more people to take an active role in deciding investment decisions that will intimately and concretely affect their lives. It is at this level that serious numbers of people can be brought into the investment process, and thus where self-management and self-determination start to move from the realm of rhetoric to reality, with its empowerment as well as its messy imperfections, and so where democratic investment policies need to focus. The next chapter analyzes these examples more closely to weigh their strengths and weaknesses compared to the contemporary system of private control of investment.

3.4 Higher Level Control over Investment

In reflecting on the possibilities for democratizing finance and investment the primary focus of this chapter has been on the local level. The rationale being that this is the level at which democracy has the most grip, where participation is the most meaningful and self-determination the most achievable. However, this focus should not be taken to imply that the local level is the only scale that matters. For democracy to be real requires not
only meaningful participation at local levels but also accountability at higher levels. As a rule of thumb it is desirable for public investment to happen at a scale that is appropriate for the issue in question. Participatory budgeting can happen at local levels, whereas higher levels require other public bodies.

In particular, democratic accountability of investment at the highest national level is necessary for two kinds of issues: major geographically-diverse market failures and macroeconomic Keynesian demand-management for full employment.

In terms of major market failures, consider the externalities associated with green businesses. It may well be sensible industrial policy for the government of Canada, for example, to help transform the area around Windsor (and the US government vis-à-vis Detroit) from a regular car manufacturing zone into a green car manufacturing zone. Likewise it may be sensible environmental policy to try to replace the short-haul flights in southern Ontario with a system of high-speed trains. However, even if the population desired to institute such changes, they would require huge investments at levels which are most likely beyond the capacity of DCBs to respond to. What is required is public investment by a body that operates at a sufficiently large geographical scale, is publically accountable, and technically expert. The options here range from a ministry of the central government (as is standard today) to a State Bank to a National Investment Fund. For example, it is possible to imagine a National Investment Fund that engages in occasional but major investment projects. It would depend on funding from the state and so would need to be transparent in its operations to prevent corruption. It could perhaps function like democratic Central Banks are supposed to function, in other words, with a mandate that is set by government on an annual basis, but which actually engages in day-to-day work independently from the government to prevent any “politicking” (Fischer, 1995).

The other high-level need is in regard to the government being able to pursue policies to manage aggregate demand to maintain high if not full employment. As we’ve seen a major tool that governments require to achieve this is that of capital controls. Capital controls do not need to be used all the time, but it is very important for them to be “on the books” so to speak, so that they can be enacted quickly and effectively when they’re
required. Another tool that governments require for macroeconomic management is a Central Bank that will orchestrate monetary policy in line with fiscal policy and in line with the overall priorities of the government. With both of these tools in the government’s toolbox the state is in a much better position to be able to use the levers of fiscal and monetary policy to maintain aggregate demand at levels necessary for maintaining high employment.\textsuperscript{148}

To sum up, we’ve seen that democratizing investment requires three main things. It requires the spread of cooperatives. It requires an increase in public investment, partly to reduce the population’s dependency on private investors, partly to be able to respond adequately and democratically to market failures at a local and national level. Third, and most importantly, the majority of public investment should be re-shifted from its current position at the top to the bottom, so that it’s filtered through meaningfully participatory structures.

4 Conclusion

It is a common understanding in liberal societies that citizens must have equal political rights and, as Rawls would say, “roughly equal” political power (2001, p. 46). Yet the private control of finance and investment undermines this basic equality. We in the West are not equal in our fundamental rights of citizenship so long as a privileged few have near veto power over our government’s policies, and so long as we are denied an active say in influencing the direct of our society’s evolution by way of its investment into itself. Another way to say this is that through the contemporary workings of finance and investment, large inequalities in property ownership come to be transmuted into deep political inequality. And though the former inequality may be acceptable to some, no progressive can accept the latter.

\textsuperscript{148} As an alternative to relying on fiscal and monetary policy, some economists have proposed a jobs guarantee, whereby the government takes on the role of being the employer of last resort by offering minimum wage jobs to anyone who wants to work (e.g. W. Mitchell & Muysken, 2008).
I have argued that our current system of private control of finance and investment is severely undemocratic because it arrogates to a small minority the power to undermine and curtail the sovereignty of the population. Democratizing finance and investment is crucial for allowing a population to break out of the “prison” of the market. It does this in part by enabling sufficient policy autonomy for a population to decide to foster meaningful consumer sovereignty (e.g. by engaging in substantial redistribution), as well as by providing concrete institutions for citizen sovereignty – institutions within which the population is empowered for the first time to have an equal say in shaping their collective future.

A society that is able to achieve such reforms would be fundamentally democratic. It would have freed itself from the hostage of the financial and investor classes. Indeed it would have freed itself from the need of a capitalist class at all.
Chapter 8

Finance and Investment Democracy in Practice: Capital Controls, Credit Unions, and Participatory Budgeting

1 Introduction

If there is one lesson from the 2008 Great Recession that seems nearly incontrovertible, it’s that today’s international investors and financiers are among the most powerful people in the world. Presidents make way to them, parliaments kowtow to them, media reports their every move, and populations rightly fear them. When Lehman Brothers and Washington Mutual fell in 2008, other banks across the world quickly collapsed, yet the US government as well as other countries found trillions of dollars to bail out their banking systems with public dollars (McNally, 2011). The necessity of keeping the banks solvent, and keeping credit flowing, was seen, correctly, as absolutely fundamental for the survival of the system itself. But the way of doing so was of course up for grabs. Fast forward two years, and the US banks, saved with public money, are flourishing, as Wall Street pay and bonuses break record levels at $144 billion (Rappaport, Lucchetti, & Grocer, 2010), while their prior debts are socialized by forcing harsh austerity on the population. In country after country, austerity programs are forced on the populations in order to save the banks.¹⁴⁹

Although the financial crisis is not the main concern here, it focuses our attention on one particularly relevant aspect of current banking systems across the West: their undemocratic nature. While the last chapter argued that the current system of private finance and investment is deeply undemocratic, this chapter examines real world examples of institutions that have been developed to overcome these democratic shortcomings – providing protection against a powerful elite, severing dependence, and

¹⁴⁹ In the UK nearly 500,000 public sector jobs have been cut; in France the retirement age has been raised; in Greece, public pensions and bonuses have been frozen while taxes have been raised; in Spain, government workers face a 5% pay cut while personal income taxes are increased; in Romania, government wages are cut 25% and pensions 15%, and so on (BBC, 2010).
establishing accountability so that the population attains some voice and means to self-determine.

Three main areas are explored. In the first section we look at the efficacy of capital controls. The second section examines various institutions of democratic finance – public banks, credit unions, and Mondragon’s bank the CLP. The third section looks at institutions of democratic investment – public investment at the state level and participatory budgeting at the local level. The final section inquires into the possibilities of transition towards these democratic structures. Overall, the central argument is that these democratic institutions, although not well-known, are indeed practically feasible, and their implementation results in important improvements in the status quo.

2 Capital Controls

Earlier the case was made that capital controls are crucial for democratizing the economy. They are important because they allow a population to maintain a degree of sovereignty by reducing vulnerability to capital flight and allowing space for government to pursue policies of full employment and social justice that are otherwise very hard to achieve. Controls are the fundamental mechanism for anchoring capital within a democratic jurisdiction, thereby limiting the degree to which financial wealth, through threat of flight, can transform itself into political power. Though controls are important for economic democracy, their importance is much broader than this – they should be of interest to all progressives because they are a vital ingredient for any kind of progressive reform. Any attempt to defy the global market’s logic of a race to the bottom – be it to defend the welfare state, extend environmental regulations, engage in independent economic policy or endogenous development – is exceedingly difficult, particularly for smaller and poorer countries, if capital can simply leave on a whim for greener pastures.

Capital controls have a long history. In helping to construct the Bretton Woods system after World War II, Keynes strongly advocated capital controls as a vital component of the new global economy. “Nothing is more certain”, he said, “than that the movement of
capital funds must be regulated” (qtd in B. J. Cohen, 2002, p. 104). In the post-war period, most countries followed his advice and used controls of some sort to guide their development and pursue independent policies. Indeed, capital controls were arguably a vital element of the development of many nations, including Japan, Korea, Sweden, and Germany (J. Crotty & Epstein, 1996). The East Asian tigers used controls extensively, helping them to achieve the fastest economic growth in human history (Chang, 2006; J. E. Stiglitz, 1996). In 1975, 17 industrial countries and 85 developing countries had some types of capital controls in effect. Even by 1990, 11 industrial countries and 109 developing countries still had them (J. Crotty & Epstein, 1996, p. 29).

With the rise to dominance of neoliberalism, free trade and free mobility of capital became central, widely accepted aspects much of the economics profession. Capital controls were seen as anathema. Mainstream economists tended to dismiss controls on the grounds that they were impossible to effectively implement, they would inevitably lead to corruption and cronyism, and perhaps most importantly, that they would create inefficiencies and reduce economic growth. In 1997 the head of the IMF called for amending its Articles of Agreement “to make the liberalization of international capital movements a central purpose of the Fund and to extend the Fund’s jurisdiction to capital movements”, thus making abolition of capital controls a basic condition of membership (Fischer, 1997, p. 11). The US went so far as to make capital controls illegal in its various free trade agreements.

However, the mainstream faith in unrestrained mobility of capital has weakened drastically over the last fifteen years. The first shock was the Asian crisis. In 1996, five Asian countries (South Korea, Indonesia, Malaysia, Thailand, and the Philippines) received net private capital inflows amounting to a massive $93 billion. A year later they experienced an estimated outflow of $12 billion – a turnaround, in other words, of $105 billion in a single year, an amount equivalent to more than 10% of the combined GDP of these economies (D Rodrik, 1998, pp. 1-2). Not only were these unrestrained flows devastating to Asian economies, but it was hard to ignore the fact that many of the countries that seemed to recover best from the crisis were precisely those that had used capital controls – such as China, India, and Malaysia. Increasingly, influential economists
started to support controls in certain instances, arguing that financial markets were very particular types of markets, characterized by asymmetric information, herd behaviour, and self-fulfilling panics. They argued therefore that controls were often useful for maintaining a country’s monetary autonomy, preventing instability, and warding off financial crisis (Bhagwati, 1998; GL Kaminsky & Reinhart, 1999; Krugman, 1998; Magud & Reinhart, 2006; D Rodrik, 1998; Joseph Stiglitz, 2002).

The second shock to the faith in free capital mobility came from the Great Recession of 2008-2010. This led the World Bank to state that “In 1997-98, the words ‘capital controls’ were forbidden and stigmatized. Now the problem of capital is so systematic and huge globally, it has now become universally acceptable to have a certain type of temporary capital controls” (Porter, 2010). Indeed, even the IMF, in a remarkable about-face, declared in February 2010 that “there may be circumstances in which capital controls are a legitimate component of the policy response to surges in capital inflows” (Ostry et al., 2010, p. 15). The era of implacable hostility towards capital controls has come to an end.

In what follows I argue that the existing evidence supports the contention that capital controls are indeed feasible. They are not prohibitively damaging to a country’s economic performance, and are ultimately an effective means for increasing national sovereignty.

2.1 Feasibility

While it is widely accepted that the present system of free mobility of capital risks undermining important aspects of national sovereignty, there is much controversy about whether capital controls are at all viable in the contemporary world. For instance, John Dryzek in his important work Democracy in Capitalist Times recognizes that capital mobility is “severely eroding the autonomy of states” (1996, p. 82). Yet he thinks that controls could only work if they were negotiated on an international level involving the agreement of most major powers – a prospect which he sees as “highly improbable”. The standard argument is that contemporary technology allows controls to be easily evaded,
with evasion consistently increasing over time (Carvalho & Garcia, 2008; Edwards, 1999). Additionally, skeptics argue that controls will inevitably lead to black markets as people try to profit by evading them.

While there is indeed evidence of the difficulty of implementing controls (Magud & Reinhart, 2006) the bulk of the evidence shows that these arguments are overly pessimistic. Palley’s (2009) evaluation of the existing literature is that the majority of the empirical evidence indicates the practical feasibility of capital controls (Edwards & Rigobon, 2005; G. Epstein, A, 2005; Gregorio, Edwards, & Valdes, 2000; Yeyati, Schmukler, & Van Horen, 2008). Critics are right to point out that controls can sometimes be evaded – indeed, all regulations and forms of taxation are occasionally evaded, but that is hardly an argument against regulation per se. Controls appear to work best with strong macro-economic fundamentals, and require sufficient state capacity for comprehensive administration. Successful controls require nimble and dynamic application (i.e., closing loopholes, giving up on aspects of controls that aren’t working, etc.) (G. Epstein, Grabel, & Jomo, 2003; Valdés-Prieto & Soto, 1998). But when this is accomplished controls can indeed operate successfully over the long term (as Epstein et al., (2003) show with their case studies of China and Singapore). Indeed, Epstein et al. conclude their survey of numerous countries’ experiences with capital controls by advising “cautious optimism regarding the ability of developing countries to pursue various capital management techniques” (2003, p. 39).

What about Dryzek’s argument about the need for multilateral implementation? Of course global adoption, as Keynes wanted, would be most effective, but nevertheless it is noteworthy that there are examples of smaller countries which have effectively and unilaterally introduced controls (as the example below of Malaysia shows). In terms of feasibility, the key insight is that at the end of the day there is nothing fundamentally different between implementing capital controls and collecting taxes (J. Crotty & Epstein, 1996). Both can be evaded, both require a bureaucracy to enforce, but ultimately, both are fundamentally feasible. Likewise, the argument that advanced technology makes controls impossible is unconvincing. Does anyone think that new technologies makes general taxation impossible? There is no reason why the state cannot use the same kinds of
advanced techniques and technologies to regulate capital flows as financiers use to evade such regulation. Moreover, the most convincing argument about the feasibility of controls is that since the onset of the 2008 financial crisis, more and more countries have started to unilaterally implement them, such as Brazil, Indonesia, South Korea, Taiwan, Thailand, and Iceland (Gallagher, 2010). When push comes to shove, and countries decide that controls are in their interest, the question of their theoretical quickly evaporates in practice.

Consider the example of Venezuela. Chavez was elected in 1998 initiating a dramatic and progressive shift in Venezulean politics, redirecting profits from the country’s sizable oil reserves away from the old oligarchy and towards social programs focusing on health, education, and poverty reduction.\textsuperscript{150} Financiers responded with massive capital flight. Twenty-six billion dollars left the country in two years, equivalent to roughly half of the government’s entire annual budget (Parker, 2005).\textsuperscript{151} The capital flight put serious pressure on the country because a depreciation of the currency has the effect of making the population poorer (since imports come to cost significantly more). Currency controls were instituted in order to reduce the capital flight and thereby stabilize the exchange rate.\textsuperscript{152} At the beginning of January 2003, when the capital flight was at its peak, the government’s foreign reserves (which are funds held in reserve to stabilize the currency from capital flight) were dropping fast, from $11.93 billion at the beginning of the month to $11.05 billion twenty days later. At this point currency controls were introduced, immediately diminishing the outflow of capital. By the end of the year reserves had actually grown to over $20 billion – testifying to the feasibility of implementing controls even by a small country like Venezuela (Pandya & Podur, 2004; Rivas, 2004).

\textsuperscript{150} The social improvements under Chavez have been dramatic. For details see Weisbrot et al. (2009).
\textsuperscript{151} Additionally, international financiers shut off credit to Venezuela driving lending rates up to 1406 basis points. This is a measure of EMBI\textsuperscript{+}, which is an indicator from JP Morgan, which refers to the interest rate that is to be paid above the rate of 30-year US treasury bonds, which are assumed to have a risk-rating of zero. In other words, at this time Venezuela could only borrow at rates of a massive 14% interest above the going rate for 30-year US bonds – essentially making foreign borrowing impossible (since rates above 7% are generally thought to be unpayable) (Rivas, 2004).
\textsuperscript{152} Currency controls are a common form of capital controls that operate by requiring exporters to sell their foreign currency to the government for domestic currency at a fixed exchange rate. That foreign currency is then sold to importers at the same rate. This enables the government to control the amount of domestic currency leaving and dollars entering the country.
2.2 Economic costs and benefits.\textsuperscript{153}

Neoclassical economists have long argued that the major problem with capital controls is that they bring substantial economic costs: they create inefficiencies and distortions, increase the cost of capital, raise barriers to investment, and ultimately slow growth (Edwards, 1999; Forbes, 2007; Prasad, Rogoff, Wei, & Kose, 2003). However, other economists have pointed out that controls bring a range of economic benefits. The three most important are, firstly, shifting the composition of incoming investment by discouraging short-term speculation in favour of stable long-term investment (the kind that actually does promote economic growth); secondly, providing the tools to fight recessions through the use of monetary policy (Krugman, 2009); and thirdly, improving financial stability and averting crises (Reinhart & Rogoff, 2009). This last issue is particularly important since the cost of financial crises can be enormous.\textsuperscript{154}

How can we weigh the economic costs versus the benefits? Unfortunately, few studies attempt to weigh both. One exception is the study by Epstein et al. (2003) in which they conclude from their evidence that the macroeconomic benefits of controls probably outweigh their microeconomic costs. Of particular significance is Rodrik’s well-known internationally comparative study, in which he finds no evidence that controls create significant costs. He does not mince his words: “There is no evidence in the data that countries without capital controls have grown faster, invested more, or experienced lower inflation” (1998, p. 8). Indeed, he finds that “capital controls are essentially uncorrelated with long-term economic performance once other determinants are controlled for” (1998, p. 9).

\textsuperscript{153} The economic literature on the costs and benefits of capital controls is large and I cannot do justice to all its nuances here. For a good survey see Epstein et al., (2003) and Palley (2009).
\textsuperscript{154} For instance, Indonesia after the Asian crisis, saw 20 million people join the ranks of the poor (Singh, 2000, p. 49). The costs of the 2008 financial-cum-economic crisis have yet to be calculated, but are sure to be astronomical. And now, just like then, the countries that are recovering best are ones that have used heterodox economic policy including capital controls, such as Iceland (Krugman, 2010b).
Even conservative economists who make strong theoretical predictions about the economic costs of capital controls have been unable to find strong empirical support for their position that controls damage economic growth. For example, an IMF staff paper in 1995 reviewed the evidence from 61 countries and was forced to conclude that “no robust correlation is found between our measures of controls and economic growth” (517). In 2003 the IMF published a particularly thorough analysis of the effects of controls, reviewing 17 recent studies. Their conclusion was that:

> theoretical models have identified a number of channels through which international financial integration can promote economic growth in developing countries. A systematic examination of the evidence, however, suggests that it is difficult to establish a strong causal relationship. In other words, if financial integration has a positive effect on growth, there is as yet no clear and robust empirical proof that the effect is quantitatively significant” (ix)

If even the IMF – the ideological apostles of free mobility of capital – cannot find clear empirical evidence about the cost of controls, it must indeed be hard to find. Consider as well the general fact that growth in Western Europe during the post-war period with capital controls was substantially higher (averaging 3.9% per year) than the same countries experienced in the subsequent neoliberal period without capital controls (averaging only 1.8% per year) (Baker, Epstein, & Pollin, 1998, p. 17). At the very least this suggests again that capital controls are not antithetical to growth. This means that while the debate about relative costs and benefits is an ongoing one, it seems reasonable to conclude that an average country would not find controls prohibitively costly. There is thus little reason to think that a country wishing to increase its sovereignty would only be able to do so by making enormous sacrifices in terms of economic prosperity.

### 2.3 Political costs and benefits

Those on the right have tended to argue that the main political cost associated with controls is that of rent-seeking (and the corruption it encourages) (Krueger, 1974). The idea here is that the machinery of capital controls requires an extensive bureaucracy to oversee it. There is thus a temptation for bureaucrats to manipulate the controls to their own personal advantages. For example, Johnson and Mitton (2003) have argued that Malaysian controls created a screen for cronyism. On the other hand, those on the left have tended to argue that controls, when implemented effectively, can bring one
overwhelming political benefit: that of increased democratic sovereignty (J. Crotty & Epstein, 1996). Indeed, there is substantial empirical evidence showing that capital controls can be effective in increasing a nation’s sovereignty by providing protection from capital flight and currency attack, as well as providing room for independent economic policy. Beyond the studies cited above, Ma and McCauley (2008) and Hutchison et al. (2010) show the efficacy of controls in this regard in China and India. Le Fort and Budevnich (1997), as well as the capital-controls pessimist Edwards (1999), concur in the case of Chile. Oatley (1999) in his study of 14 OECD countries between 1968-1994 found that capital controls were generally effective in allowing left governments to achieve increased policy autonomy. In general, it seems to me that these political benefits outweigh the costs. That is not to say that rent-seeking and corruption are not real problems – they are. But they are problems that can be mitigated by transparency and accountability, as well as a professionalized civil service. As Palley says, “the neo-liberal concern with regulatory capture is real, but the answer should be promotion of effective governance rather than abandonment of this important policy tool” (2009, p. 32). If government receded from every sphere of activity for which corruption was possible, there would be no government at all.

In order to demonstrate the feasibility of capital controls as a device for augmenting economic democracy (in the sense of protecting national sovereignty), it’s useful to highlight an example of successful controls in practice.

2.4 Malaysia

In May 1997, massive speculation against the Thai currency set off a financial crisis that quickly spread throughout Asia. In Malaysia, both domestic and international financiers quickly started selling their ringgits (the Malay currency) en masse, and sending money out of the county. This capital flight caused the currency to fall dramatically, domestic investment collapsed, the cost of credit skyrocketed, businesses started to falter, the economy slid into recession and millions of people lost their jobs. In addition, financiers started massively speculating against the currency: they did this by borrowing ringgit from offshore markets (mostly in Singapore) and using the money to purchase dollars,
hoping the currency would depreciate which would then allow them to buy back more ringgits than they started with, making money for nothing (even if the economy crashes in the process). This betting against the ringgit became a self-fulfilling prophecy as depreciation caused expectations of further depreciation, encouraging financial “herd behaviour” as more and more financiers rushed to join in and started selling their ringgit too, thus increasing even further the downward pressure on the currency (Kaplan & Rodrik, 2002).

The government, under Prime Minister Mahathir, sensibly wished to pursue expansionary policy to improve the economy, but found itself constrained by the free mobility of capital. Any attempt to expand the economy via the usual method of reducing interest rates to stimulate business investment was self-defeating, as reduced interest rates meant that even more capital would flee the country looking for higher rates elsewhere. The government thus found itself hamstrung, unable to pursue expansionary policies so long as financiers could freely move their money abroad and bet against the currency. The Malaysian government thus faced a stark choice: either to follow IMF advice and raise interest rates to try to stop the outflow of capital (which at the same time would cause the real economy to suffer even more), or break with the IMF and implement capital controls. And so, with fiery (and often bizarre) rhetoric155 Mahathir decided to forego the loans the IMF was offering and chose instead to implement capital controls.

Capital controls were implemented in September 1998 (Kaplan & Rodrik, 2002). The controls were broad and comprehensive, with two essential components. First, was the mandatory repatriation of all offshore ringgit, which meant that ringgit could only legally be bought and sold in Malaysia through official channels, and at the new government-set fixed exchange rate. This prevented speculation against the currency and slowed depreciation. Second, controls on outflows were implemented so that foreign investors were not allowed to remove their money for a period of one year (though in February this ban was replaced with a system of graduated exit taxes, that decreased the longer money stayed in the country) (Dornbusch, 2001). This measure effectively ended...

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155 Mahathir is infamous for his inflammatory anti-semitic rhetoric, blaming “the jews” for conspiring against the Malaysian economy.
capital flight and stopped short-term speculation, while exempting long-term foreign direct investment.

With controls in place, the financial chaos was quelled, and the government was able to engage in expansionary policies: lowering interest rates and introducing an expansionary budget. It’s noteworthy that despite the worry of technical impossibility, there is broad agreement that the country had little troubles with implementing the controls effectively (Edison & Reinhart, 2001; G Kaminsky & Schmukler, 2000). Interest rates were successfully lowered and the controls succeeded in stopping the outflow of capital, thus protecting the fixed exchange rate (without a black market flourishing). Even the IMF reported only occasional circumvention of the controls – indicating that the government was successful in preventing widespread evasion (Kochhar et al., 1998).

So what were the costs and benefits of the controls? Rodrik and Kaplan argue that in comparing Malaysia with other Asian countries at a similar point in crisis, the results are clear and impressive. The Malaysian economic recovery was faster, wages and employment did not suffer as much, the stock market did better, interest rates fell further, and inflation was lower (Kaplan & Rodrik, 2002, p. 7). The controls thus proved to be immensely successful (G. A. Epstein et al., 2005). One important caveat is, as mentioned before, the possibility that controls created a screen for cronyism (S Johnson & Mitton, 2003). Epstein et al. evaluate the controls in these words: “The most important cost of the 1998 controls was the political favoritism associated with their implementation. It is difficult, however, to estimate the economic costs of political favoritism... Moreover, these costs (if quantified) must be weighed against the significant evidence of the macroeconomic benefits of the 1998 controls” (2005, p. 29).

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156 Dornbusch (2001) argues that it was unclear if controls made a difference since the region was recovering anyway. But as Rodrik and Kaplan (2002) point out, this misses the point as the situations of countries like South Korea and Malaysia were very different at the time of Malaysian controls. A meaningful comparison needs to measure the countries’ respective performances from similar points of crisis.

157 In comparison with South Korea, Malaysia’s reduction in GDP was less severe (9.9% compared to 15.1%). Malaysia’s drop in manufacturing was 19.1% better; its drop in real wages was 10.8% better; and it had 18.5% less currency depreciation (Kaplan & Rodrik, 2002, p. 25). These results are particularly impressive given that by implementing controls, Malaysia missed the large capital injections from the IMF that countries like Korea and Thailand received.
This example shows that capital controls can be successful not simply from an economic perspective, but from a democratic one as well. They restored relative autonomy by allowing the country to follow an independent monetary and fiscal policy. They allowed Malaysia to follow its own path, despite the wishes of the world’s financiers and the IMF. The fact that a relatively small country like Malaysia can do so is thus powerful commentary on the efficacy and realism of controls. Of course it does not follow from this one example that controls can be implemented easily by every country, but it does show, I think, the importance of having capital controls as a well-established policy tool in the government’s toolbox should the need for them arise.

So considering the aforementioned evidence, what general conclusions can we state? The first is that capital controls are feasible to implement – which of course does not mean that such implementation is easy. They require state capacity to administer and to apply nimbly and dynamically. Furthermore, capital controls must be transparent and accountably supervised in order to minimize the risk of corruption (Singh, 2000). But given these prerequisites, we can conclude that, with sufficient state capacity and political will, capital controls are feasible to implement, not prohibitively costly, and ultimately an effective mechanism for increasing sovereignty.

3 Democratic Finance

In the last chapter the argument was made that democratizing finance requires (above and beyond protective measures like capital controls) institutions to extend popular say and accountability over the allocation of finance, as well as providing the financial wherewithal for co-ops to thrive. The central proposal was for particular kinds of Democratic Community Banks that would fulfill four features: they would be democratic (to provide accountability to the community); decentralized (so that the democracy operates on a meaningful scale); public (so as to be able to provide citizen sovereignty by

158 As well as allowing some mechanism for democratic representation of the internal workers.
having lending criteria that can react to market failures and so are broader than simple profit-maximization); and supportive of co-ops (in technical and financial ways).

Unfortunately, institutions meeting all these criteria do not presently exist. But there are close approximations that let us get a sense of their viability. There are state-owned public banks; there is Mondragon’s cooperative CLP, and there are decentralized democratic credit unions. So in what follows, we’ll briefly examine each of these types of institutions to try to gauge how successful they’ve actually been in democratizing finance. We will see that state banks hold the least potential for democratizing finance, while credit unions have the most.

3.1 State-owned Public Banks

State ownership of banks has been a common feature of many economies for many years. For our purposes, state banks are instructive in terms of the problems that might affect DCBs (which are public too) as well as in terms of the problems that might affect higher level investment structures (such as a National Investment Fund). La Porta et al. report that in 1970, 59 percent of the equity of the 10 largest banks in an average country was owned by the government, and still in 1995, 42 percent was state-owned (2002, p. 4).

There is, however, no clear evidence as to the economic advantages or disadvantages of publicly-owned banks. Some authors argue that private banks are more efficient (Berger, Clarke, Cull, Klapper, & Udell, 2005; J. Bonin, Hasan, & Wachtel, 2005; La Porta et al., 2002). Some argue the opposite (Altunbas, Evans, & Molyneux, 2001; Karas, Schoors, & Weill, 2010).

For our purpose the main question is whether state banks have been able to democratize the provision of finance in any meaningful way. There are two main views on this (Sapienza, 2004). The “social view” is that state banks, being public, are able to operate with broader lending criteria than profit maximization (Atkinson & Stiglitz, 1980). They provide direct financing to areas of market failure, particularly areas where social and developmental benefits are notable. Implicit in this view is that state banks have a degree of public accountability in terms of their main financing priorities. The “political view”
on the contrary, is a more pessimistic perspective, which sees state banks as sources of personal gain for politicians – favouring clients or firms for narrow political reasons (Shleifer, 1998).

In fact, there is evidence to back up both of these interpretations in various places. In terms of the “social view”, Stiglitz and Uy demonstrate how East Asian countries successfully used development banks in order to channel finance to socially desirable areas. Such governments targeted credit to priority firms and industries for developmental as well as for social reasons (1996, p. 270). Likewise in France, since World War II, a largely public banking system was instrumental in allowing credit allocation to become a central mechanism for the state’s industrial planning. Indeed, in many ways the developmental role played by the French Trésor is analogous to that played by Japan’s better-known MITI (R Pollin, 1993, p. 343).

Although there are prominent examples of state banks operating according to social objectives (such as development), rather than pure profit maximization, it’s much less clear that they can be called “democratic” in any meaningful sense. Of course, as public institutions they are formally accountable to the public, but in practice state banks seem to have very little actual accountability, or avenues for the public to get involved in influencing financing priorities (except the largely formal possibility of electing an entirely new government). State banks, even ones that pursue developmental goals, remain overwhelmingly technocratic and elite controlled.

The case of France is instructive in this regard. When Mitterrand was elected in 1981 promising a socialist rupture with capitalism, it would be natural to think that the state banks would radically change too, perhaps by focusing more on “social” criteria, and increasing their accountability to the public. Yet even though Mitterrand did further nationalize the industry, there was no change in how the banks operated. The banking bureaucracy was not altered, nor were there any deep changes in the structure or goals of the system (Lipietz, 1988). Perhaps the public banks had slightly broader lending criteria than their private counterparts, but no fundamental democratization occurred. There was

159 State control under Mitterrand went from 64 to 74% of all deposits and from 56 to 69% of credit advances (Singer, 1988, p. 114).
no ability for regular people to influence how finance was allocated – even though “the people” technically owned the banks. This is why nationalization by itself is an unpromising route towards democratization: large, centralized, state banks, which interact only with the highest echelons of government, are not a particularly promising avenue for increasing any kind of grassroots accountability, even if they are necessary for making large-scale investments.

On the other hand, there are clear cases of state banks operating as the “political” view would suspect. For instance, Sapienza, in an Italian study, concludes that “my results support the political view… and suggest that state-owned banks serve as a mechanism to supply political patronage” (2004, p. 4). Dinc (2005) and La Porta, et al. (2002) find additional evidence for this view. Although Stiglitz and Uy argue that state banks can play a social role, they too agree that the most common cause of development bank failures around the world is political pressure to finance bad projects and poor incentives for financial institutions to screen and monitor projects (1996, p. 267).

So it appears that public banks, by virtue of being public, are able to operate with broader lending criteria than profit maximization. Sometimes this allows for genuine social criteria to play a role in allocating finance, sometimes it merely opens the door for corruption and patronage. There is thus an interesting question about what conditions are necessary to prevent corruption in public banks. While answering this question fully would take us too far off-topic, it seems reasonable to suppose that the important factors are those that apply to other public offices – transparency, reviews and audits, access to information, clear lines of accountability, etc.

3.2 The Caja Laboral Popular

While we have mentioned the Caja Laboral Popular or CLP earlier, it is useful to examine it more closely here. The CLP is the co-operative bank of the Mondragon co-ops. It has been immensely successful in developing new co-ops and sustaining existing ones, to the point where the MCC is now the largest cooperative business in the world.
The CLP has two primary functions. First, it serves to provide finance to the co-ops at below market rates. It funds the co-ops in need, with the surplus attained from others, thus diversifying risk and putting the power of finance under the collective control of the co-ops. Second, its Empresarial division is dedicated to providing business and managerial advice, in particular with an eye to setting up new co-ops. For new co-ops to be set up, a group of workers approaches the CLP with their idea. Provided the workers’ vision is of a firm that is a cooperative with appropriately rigorous democratic structures, the CLP helps to carry out an in-depth feasibility study, which can take 1-2 years. If the project proves feasible, the CLP will bring in engineers to start planning construction of the new workplace, as well as to provide the bulk of the initial financing. The co-op workers are expected to put up roughly 20% of the initial start-up capital (without which projects tend to fail from lack of commitment). A further 20% is available from a state loan at 3% interest, while the remainder is supplied by the CLP. Beyond this, the CLP provides management skills, seminars in cooperativist ideals, and will even cover the new firm’s losses for the first couple of years (which are expected to be paid back once the firm becomes profitable) (Campbell et al., 1977).

The fundamental question for us is the whether the CLP enables the democratization of finance. Without a doubt it succeeds in terms of helping to spread new co-ops, as well as providing some accountability for the 40,000 or so worker-members of Mondragon in indicating the direction of financing that should take place for the complex as a whole. Furthermore, since the CLP is co-managed, it is partially internally democratic – the workforce has a say in governance, but not a complete say – which makes sense in order to balance the interests of the bank workers with the much larger group of other co-op workers. The major problem from a democratic perspective is that the community is not represented. Neither the town of Mondragon, nor the individual depositors of the CLP, have a voice in its governance, and therefore have no democratic say in how finance is allocated. Given that the MCC now represents 6% of total employment and 8.3% of the province’s GDP (Clamp, 2000, p. 565), its financial decisions significantly determine

\[160\] In fact, up until 1975, savers were represented in the CLP’s General Assembly, until such practice was banned by Spanish law (Campbell et al., 1977, p. 38).
the shape of future investment and thus the shape of the region itself. Genuine democracy requires that the community have some say in the direction this evolution takes.

However, if the CLP were to be made more accountable to the community it’s possible that the co-ops would then lose some influence, and perhaps might suffer as a result. In other words, there may well be a tradeoff between community accountability and co-op focus. So it may be that some kind of balance needs to be struck here, perhaps by dividing the bank’s management between associated co-ops, internal workers, and community representatives. Regardless, the most important and unique feature of the CLP from our perspective is its *empresarial* division – a division specifically tailored to helping co-ops develop – this is the feature that needs to be emulated by other democratic financial institutions.

### 3.3 Credit Unions

Credit unions emerged in Germany in the mid-19th century and slowly but surely spread across Europe and beyond. They were initially set up as a self-help response to the fact that poor people had no access to credit: banks would not lend to non-wealthy people, and money-lenders were notorious for their usury. Credit unions allowed poor people to pool their money in order to collectively access credit that would be unavailable to them as individuals. Over the years credit unions have developed as financial institutions that are collectively owned by their members and democratically controlled in a one-person one-vote manner. They are generally designed as not-for-profit organizations to serve a social purpose – that of providing the financing needs of their members in the local community – so commonly receive tax exemptions.\(^{161}\) For instance, credit unions in Saskatchewan initially focused on the stabilization of credit for low-income farmers. Over time they have come to focus mainly on small consumer loans and mortgages while continuing to support the community by investing in municipal bonds, sponsoring community events, funding various local anti-poverty initiatives, etc. (Purden, 1980).

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\(^{161}\) For instance, the original US legislation, which is standard for many countries, provides tax exemption to credit unions, which are defined as organizations with a central goal “to make more available to people of small means credit for provident purposes” (Ferguson & McKillop, 1997, p. 225).
Today credit unions exist all across the world, and although they are almost always smaller than the largest banks, they are far from negligible. Worldwide there are over 52,000 credit unions involving 188 million people, in 100 countries (WOCCU, 2010). In Germany, they compose 16% of the market, in Italy 29%, in the Netherlands 40%, in Denmark 15%, in Quebec 45%, and in the US about 85 million Americans (approximately 33% of the population) are members (McKillop, 2005).

Since credit unions are not public institutions, they must be able to survive in the marketplace. This means that they always have to walk a tightrope in balancing their social and economic objectives. Though designed for fundamentally social purposes, they nevertheless have to make enough money to continue their operations. And while the aforementioned statistics provide compelling evidence of the economic viability of credit unions, the crucial question for us is whether their democratic structures in fact make them into socially different kinds of organizations than banks. Indeed, in recent years many banks in the US and Canada, perhaps resentful of the competition, have increasingly argued that credit unions are not significantly distinct financial institutions, and so should not receive the tax benefits that they do (Mohanty, 2006).

Unfortunately there is a sparsity of studies directly comparing the lending practices of credit unions to banks, perhaps due to the inherent difficulty in clearly measuring “social” criteria. The studies that do exist, however, are interesting. They indicate that while there is some evidence that credit unions tend to dilute their social purpose as they get bigger and become less sheltered from market pressure (Ferguson & McKillop, 1997), the bulk of the evidence shows that they have largely maintained their social distinctiveness. Feinberg and Rahman find that credit unions do make it easier than banks for people to get small consumer loans (2006, p. 656). Ferguson and McKillop agree, arguing that “the overwhelming evidence still remains that US credit unions are wholly committed to their traditional credit union values” (1997, p. 225). In the same vein, Thomas et al.’s research finds that the vast majority of credit union workers are highly committed to the sense of social responsibility that underpins the credit union movement (2008, p. 113). Finally, Gunn and Gunn (1991) argue that credit unions are superior to banks in terms of community development, because being locally-controlled they are more likely to return
financing to the local savers as opposed to banks which tend to pump local savings out of communities (particularly small communities) into huge roving international pools of capital.

So how successful are credit unions at democratizing finance? The major success of credit unions is that they provide financial services in ways that are democratically accountable to their membership, which is the primary objective for any democratic banking system. The fact that credit unions are decentralized, uncontrolled by the state, and with a Board of Directors that is directly elected by the membership means that members are able to direct finance according to their collective priorities (balanced of course against market requirements). Unhappy members can leave and go to another credit union, or try to elect new Board members. This is the major advantage over the usual system of private banks: they provide members the equal formal power to decide their financing priorities, and thus give members a real tool of self-determination that is otherwise absent. Of course, these democratic benefits are not guaranteed; some credit unions clearly fail at making their democratic structure live up to their potential, for similar reasons that some co-ops fail (they get too big and bureaucratic, become overly profit-driven, allow democratic mechanisms of participation to atrophy, etc.) (Spear, 2004).

What about our other criteria? Credit unions do seem to operate with broader lending criteria that private banks, at least when they are somewhat sheltered from market competition via things like tax breaks. Additionally, some credit unions do support co-ops, though unfortunately this is not typically seen as a central goal.¹⁶² Moreover, the internal workers tend to be employees, not necessarily voting members.

Overall, credit unions have significant potential for democratizing the financial system. Although they are often quite small, they are also widespread and familiar to many. They are thus the most promising source of a new kind of system, and the most promising sprouts of future DCBs.

¹⁶² For instance, Vancity, the largest credit union in Canada, offer loans to small businesses as well as co-ops, purportedly according to broader criteria than simply profit maximization. Unfortunately to date there has been no empirical evaluation of their lending practices.
Let us take a step back now and review the conclusions we have reached. Democratizing finance has clearly not been an overwhelming priority of the left in recent years. The experiments that do exist are few and far between, often isolated and underdeveloped. This fact is all the more disconcerting giving the enormous and ever-expanding power of private finance. Indeed, the fact that the progressive movement has failed to develop viable and powerful alternatives to one of the most important sources of power in the world today speaks volumes about the left’s contemporary malaise.

None of the financial institutions that we have reviewed satisfy all the criteria necessary for genuinely democratic banks (democratic accountability to the community [as well as internal workers], public, decentralized, and supportive of co-ops). However, each and every one of these criteria is fulfilled in at least one of the institutions examined. Credit unions are decentralized and democratically accountable to their community membership. State banks are public, and, like credit unions, able to transcend narrow market criteria. The CLP is supportive of co-ops and (somewhat) internally democratic. All this is encouraging; it means that there is no obvious reason why the kind of DCBs advocated in chapter 7 cannot be possible. Each of the fundamental characteristics is feasible, and none is in irreconcilable tension with the others. The one potential conflict is in trying to be accountable to the community while simultaneously maintaining a focus on cooperatives. But this is not an impossible dilemma. A DCB could remain predominantly accountable to the community while possessing a separate division devoted to cooperative development.

While it is unlikely that DCBs will spring up fully developed, transition to them is conceivable by way of reforming any of the aforementioned institutions in the right direction. State banks could theoretically be decentralized and democratized by being less closely tied to politicians and instead elected by their constituent members. The CLP might be replicated elsewhere, while allowing greater community representation in its governance. But of the institutions analyzed here, credit unions have the most potential for developing into a democratic community banking system. They are already firmly
democratic, decentralized, and securely established in many places. To become DBCs they would need to be further sheltered from market pressure by the state, and encouraged to develop lending expertise to cooperatives. So in the short term, legislation to promote credit unions (perhaps by extending their tax benefits vis-à-vis private banks) would be extremely useful. As Stanford (1999) reminds us, credit unions are basically the only part of the contemporary financial system that is democratically organized. They are oases in the democratic desert of finance. Any movement to expand them is thus an important movement towards the expansion of financial democracy.

Of course, any such reforms would be heavily dependent on the political realities of their context, and would all require transparency, social audits, hard budgets, and anti-corruption measures to be successful. But successful they can be. And given the overwhelming importance of banks and the power of bankers, experiments in their democratization is likely to remain an ever-pressing requirement of a democratic society.

4 Democratic Investment

Democratizing finance is about rendering accountable the channels through which capital flows to people and businesses. The next step in the production process, of course, is that of putting such finance to use in terms of actual concrete investment – building, expanding, repairing, developing, hiring – in a word, producing. We saw last chapter that the current capitalistic system of investment is undemocratic in that it leaves the population dependent on private investment decisions. Investment strike (or “capital strike”) can be devastating for a country, and creates what I called the “paradox of investment dependence”: that workers and the population more generally find their own well-being dependent on the prospering of the employers, because the employers can sink the ship that they are all on.

In addition to this dependence, the population has no active say or accountability over how investment is made, which is deeply problematic given that investment is the sine qua non of societal development. To a degree, investment can be democratized through
the spread of co-ops, since this means that investment decisions are more broadly accountable to workers in their firms. But of course this would not enfranchise those who are not working, nor would it provide scope for investment decisions that extend beyond a particular workplace. So what are the real institutional possibilities for what we’ve called “citizen sovereignty”, i.e. public and democratic control of investment? For investment to be democratized, it first needs to be in public control. This can happen at different levels, and indeed needs to happen at different levels in order to be sensitive to the scale of different concerns. Public investment can, and already does, exist at the state level, especially for issues of broad societal concern. But additionally, public investment can exist at a local level, where the scope for actual democratic participation is greatest. So it’s useful to consider public investment at both of these levels.

4.1 State-level Public Investment

Market economies today are mixed economies. Every country in the West engages in substantial amounts of public spending. In 1870, government spending averaged only 10.7% of GDP, but by 1996 it averaged 45.6%. In OECD countries this is broken down as follows: on average, 17.3% of GDP is spent on public investment (which is sometimes called “real government expenditures”), 23.2% is spent on subsidies and transfers (such as health, education, pensions, and welfare), and about 4.5% is spent on servicing government debt (Tanzi & Schuknecht, 2000, pp. 6-7).

The standard concern is that public investment risks crowding out private investment, thereby undermining successful firms. On a theoretical level, however, there are widespread disagreements about how serious this is. On the one hand, increasing public spending requires raising taxes or borrowing more (which can raise interest rates), both of which can discourage private investment. On the other hand, public spending (especially on infrastructure), can increase the marginal productivity of private capital, and thus crowds in private investment (Aschauer, 1989, p. 171). For instance, the more that government helps with the provision of healthy, educated people, roads, telephone lines, water, sewage, social stability (perhaps through a welfare system), etc., the more private business will be able to profit from these investments.
Although a contentious area, there does not seem to be strong evidence for the crowding-out effect (Argimon, Gonzalez-Paramo, & Roldan, 1997). For instance, Aschauer finds both a real crowding-out and crowding-in effect of public spending, but concludes that “the net effect of a rise in public investment expenditure is likely to raise private investment” (1989, p. 186, my emphasis). This is particularly the case for government investment in infrastructure. Likewise, Lindert finds no evidence that countries with greater social spending have slower growth (1996, p. 4).

In previous chapters various reforms have been proposed that would require public spending. Workplace democracy requires public spending to foster new co-ops; market democracy in the sense of consumer sovereignty requires redistributive taxing and spending in order to reduce inequality; and citizen sovereignty requires public funding for DCBs as well as public investment (at the local and state level). How much public spending is required to make such policies practicable?

Social democratic countries already have significant levels of public spending. For example, Western European countries have public spending at average levels of about 50% of GDP. In 2011, Sweden’s spending was 55% and Denmark’s was the highest at 60%. A reasonable goal for economic democrats would be to strive to increase this spending by 10% or so (to 65-70% of GDP). Spending at this level would go a substantial ways towards fostering economic democracy in all its dimensions as well as marking a significant advance over social democracy.

Clearly there would be immense ideological opposition to spending at such levels, but for now the more relevant question is whether such spending is institutionally viable. The major institutional limit to high levels of public spending is that of disincentives to work. Everyone agrees that at very high levels of taxes – near 100% – there would be very little incentive to work, meaning that at a certain point higher tax rates actually result in less government revenue. In the economics literature, this question centers on the so-called

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163 This data comes from OECD Economic Outlook 87 database. These numbers represent total outlays and therefore are in most cases about ten percent higher than the countries’ tax take because they include borrowed funds as well as non-tax receipts (such as revenue from public enterprises, charges, fees, fines, etc.)
Laffer curve. Dylan Matthews (2010) surveys the wide disagreement among economists about the level at which strong disincentives would kick in. A recent review of the evidence suggests that in the US a reasonable estimate of the top rate for income tax would be 69% (Saez, Slemrod, & Giertz, 2009). This suggests that there is nothing institutionally impossible about public spending at the levels suggested even with the current cultural norms. Moreover, at the deepest level it’s important to remember that the limits to taxation are ultimately cultural ones – they depend on broad societal norms about the relative weight of moral and financial incentives to hard work (J. Cohen, 2001). During the Second World War, the US was able to implement income tax rates of 90% (Quiggin, 2010), precisely because the cultural norms about moral incentives and public versus private benefit had radically shifted (albeit temporarily). This is not at all to imply that reaching public spending levels of 65-70% would be easy (it will not be) but to remind ourselves that the disincentives that underlie the laffer curve, which are often treated as inviolable and given, are no more permanent or unmovable than any other cultural norm.

4.2 Local-level Democratic Investment

Although it is rare to have investment funds allocated in a participatory manner, it is not utopian. Such practices do exist, and often work quite well. In this section we illustrate two examples of local-level democratic investment: participatory budgeting in Porto Alegre (which has been in operation for more than 20 years), and the more recent example of Communal Councils in Venezuela.

4.2.1 Participatory Budgeting

Participatory Budgeting (PB) was first implemented in Porto Alegre in 1989 after the leftist PT (Partido dos Trabalhadores) won the municipal elections. The process operates as follows: the city is divided into 16 districts, each of which deliberate on five key thematic areas: transport and traffic circulation; education, leisure and culture; health and social welfare; economic development and taxation; city organization and urban development (Souza, 2001). (Notice that it’s no accident that these areas correspond very
closely to the market failures that limit citizen sovereignty which we identified in chapter 5). Each district has two rounds of large assemblies, which explain the city’s finances from the previous year, and elect delegates to two bodies, the larger Fora of Delegates which represents the grassroots,\textsuperscript{164} and the smaller decision-making Participatory Budgeting Council. Between the assemblies, many more smaller neighborhood meetings are organized so as to facilitate widespread participation. The main purpose of these meetings is to prioritize the type of desired public investment, which then forms the basis of the Council’s plans. The Council (on the advice of delegates from the Fora) then meets every week to try to balance the investment priorities from the different parts of the city and develop an overall investment plan, which, when completed, is finally submitted to the municipal government for approval.\textsuperscript{165}

Over the years the importance of PB has increased. By 1999, 21\% of the city’s budget was allocated in this fashion, representing the bulk of the city’s public infrastructure investment, worth more than $80 million each year. One of the most encouraging signs regarding the success of PB is the consistently increasing participation. Participation grew from 1000 people in 1990 to over 40,000 per year by 1999. Indeed, if one includes those who attend the hundreds of intermediate meetings, the participation is closer to 100,000 (or about 8\% of the population). The participants are largely lower-income, less educated people, though the very poor tend not to participate. However, the middle-classes are starting to participate more as PB has become an increasing source of civic pride. The average age of the participants is 41. Women participate as much as men, though their participation drops at higher levels of the process. It is a testament to the success of PB that the level of interested participants has steadily grown. Indeed, PB has

\textsuperscript{164} There used to be one delegate for every ten participants. But since PB has grown so large over the years, the ratio of delegates to participants has evolved. If the assemblies have over 1000 people attending, one delegate is selected per 80 people (Souza, 2001). Delegates are elected for a one-year term, and can only be re-elected once.

\textsuperscript{165} Although the municipal legislature is not legally bound to accept the participatory budget, in practice since the budget arrives from such a democratic process, it is accepted as a fait accompli (de Sousa Santos, 1998).
now been instituted in 140 municipalities across Brazil (Bhatnagar et al., 2003; de Sousa Santos, 1998; Souza, 2001).\(^{166}\)

A significant advantage of locally-controlled democratic investment is that it allows ordinary people to influence the direction and kind of investment they think is required. Indeed the type of investment that has occurred is markedly different under PB than earlier eras. In terms of basic sanitation, in 1989, only 49% of the population was covered. By the end of 1996, 98% had water, 85% had sewage. De Sousa Santos reports that while all previous administrations combined had built 1100km of sewers, under PB, 900km were built (1998, p. 485). Other common investment projects include roads, houses, and schools. Between 1989-1996, the number of students in school doubled and the number of schools quadrupled. Not only is PB democratic, it is redistributively just, since the amount of revenue received by each district is weighted by its poverty and infrastructure needs – so poorer areas get more. Even the democratically-recalcitrant IMF admits that “The process of participatory budgeting has brought substantial changes in Porto Alegre” (Bhatnagar et al., 2003, p. 2).

Those who are critical of the expansion of democracy often raise the worry of “the rule of the mob” as indicating a lack of expertise. However, in the case of PB this has not been a real problem. The process has led to results (such as increased investment in basic public services) which are rational – indeed more rational than would be achieved by a market – in that they carry beneficial results in line with the preferences of the population. Additionally, the process allows for technical expertise to inform the deliberation (for instance by having expert input into the Council discussions), without subordinating such deliberation to the will of the technocrats. Of course, the existence of democratic structures such as PB does not guarantee that good decisions will be reached. Whereas increased democracy in Porto Alegre has led, sensibly, to increased local investment, it is entirely possible that increased local democracy in parts of North America – particularly in areas with a strong tea-party anti-tax ideology – would result in less public spending.

\(^{166}\) An interesting result of participatory budgeting is the flourishing of civic involvement that seems to accompany it. One commentator on Porto Alegre reports that “as participatory budgeting developed, the numbers of political, cultural, and neighborhood groups has doubled” (Lewit, 2002).
It’s entirely possible that the desire of many poor Brazilians to increase local spending versus the desire of many poor Americans to cut it simply reflects the different political and cultural backgrounds (there is no real economic difference since in both cases increasing progressive taxation to pay for social services is redistributive and economically beneficial for everyone except the richest). But it’s also possible that increasing PB actually breeds a kind of rationality, or at least mitigates the widespread delusion that all social spending is “gravy”, since the more one becomes intimately involved with specifying the priorities of social spending oneself, and the more one comes face to face with the demands of hundreds of one’s neighbors for various kinds of spending, the harder it is to simply dismiss local investment as waste and gravy.\(^{167}\)

This is not to say that the process has been flawless. Like all participatory structures, several kinds of problems have emerged. One problem is that of the “tyranny of the eloquent”. This is the problem brought to light in the excellent work by Jane Mansbridge (1980) in which she documents how democratic structures can still possess severe inequalities between members because of differences in the culture of participation. Since democracy is based on speech and deliberation, those who are skilled at these things will tend to dominate. Building on Mansbridge’s work, I would speculate that democracy tends to be biased towards the good persuaders: the powerful talkers (i.e., the articulate and charismatic); the knowledgeable (i.e. those who are educated, have been around for a long time, and have all the relevant information); the extrovert (i.e., those who are loud, have more energy, emotionally thick skin, are sociable and enjoy meetings); the resourced (i.e. those who have the time and money to participate, don’t have to look after children, etc.); and the authoritative (i.e., those who are seen as possessing authority by virtue of their identity). Indeed, the problem of the tyranny of the eloquent has been documented in regards to PB, where it is seen that educated and well-connected people tend to dominate, while the very poor are too busy struggling to survive to be able to participate.

\(^{167}\) I leave it as an open question for future researchers to investigate if there is in fact an empirical correlation between increased democratic participation in investment decisions and increased social spending.
While the tyranny of the eloquent is a ubiquitous problem, it is one that can be mitigated. In the short term, the most important protections are ones that make participation more accessible to all (particularly those who are poorer and less educated). For example, in Porto Alegre, participation in PB is encouraged through providing training on how to run meetings, by offering courses to delegates in law, management and public finances, and by offering transportation and childcare costs free of charge for all citizens attending meetings (Latendresse, 2005, p. 289). Over the long term, egalitarian participation requires greater social equality, particularly universal access to a good education system. There is thus the possibility of a virtuous cycle here: as PB increases investment in public services, over the long term we can expect those kind of investments to enrich PB.

An additional problem is that PB has no formal legal recognition, and thus no institutional guarantee of its continuation. However, probably the biggest constraint on PB is its financial limitations. Resources for PB are quite limited and dependent on higher-level government transfers.

This said, the successes of the system have been profound. The investments have concretely improved the lives of many citizens in Porto Alegre, as well as achieving two important democratic goals: lessening dependence on private investment, and empowering previously disenfranchised groups to influence the direction of future investment in their city. PB has produced better results than had been previously achieved by the reliance on the market for three reasons. First, PB allows the poor to articulate their investment preferences, which are ignored by the market because markets respond to dollars they don’t possess. Second, PB gives people a say in a much fairer fashion, on the basis of one-person one-vote, as opposed to market systems which distribute money-votes very unequally, particularly in Brazil, which is one of the most unequal countries in Latin America (Tornarolli, Cruces, & Gasparini, 2011). Third and finally, PB allows for investment decisions to be made through deliberation, and therefore allows for social values other than profit-maximization to be included (such as considering externalities, long-term goals, etc.). For all these reasons it seems advisable for Brazil (as well as other states) to increase their level of general public spending (as argued above), while increasingly allocating such funds to the local level for distribution via a participatory
process such as PB. Given the successes of PB at its present scale, its expansion and emulation elsewhere are justified.

4.2.2 Communal Councils

In April 2006, the Venezuelan government passed “The Special Law on Communal Councils”, which empowered local citizens to form neighborhood-based elected Councils. Article 1 of the Law reads as follows:

Within the framework of a participative and protagonist democracy, the Communal Councils represent the means through which the organized masses can take over the direct administration of the policies and projects which are created to respond to the needs and aspirations of the communities.168

The councils are thus an emerging parallel political system of government, which are directly linked to the central government. They are empowered to administer local projects and direct community development, through allocating investment funds that they democratically control. Neighborhoods are free to form Councils however they like, but the guideline for size is that they are composed of between 150-400 families (down to 20 families in rural areas, and 10 families in sparse indigenous areas). The Presidential Commission for Popular Power provides Councils with up to 30,000 bolivars (about $14,000) to invest in community projects as they see fit (Irazábal & Foley, 2010, p. 104). Decisions within the councils are passed by majority vote in a direct democratic fashion.

Since their launch in 2006, the Councils have proven to be extremely popular. They have been established in huge numbers of communities across the country, particularly in poorer neighborhoods. As of 2009, there were over 30,000 registered councils. Of course, many are small, but given that the registration process itself takes a lot of work, these numbers are very impressive (Pearson, 2009).

The Councils have invested in thousands of community projects, such as street paving, housing improvement, sports fields, medical centers, and sewage and water systems. In

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168 An English version of the law can be accessed online at http://www.globalexchange.org/countries/americas/venezuela/communalcouncils.html
In 2006 they received $1.5 billion dollars out of a total national budget of only $53 billion. In 2007, the received $5 billion (Kennis, 2010; J. Lerner, 2007).

As in Porto Alegre, the most important success of the Councils is that by extending democratic control over investment, local people have been able to influence decisions from which they were previously disenfranchised. They are thus able to direct funds according to their priorities, not those of the wealthy via the market, or far off politicians via their bureaucracies. The process has resulted in concrete material improvements as well as expanding control over their own lives.

Yet just as in Porto Alegre, the system has its share of problems. One issue is that funding for the Councils comes from the central government. The advantage of this is that it sidesteps municipal governments that in many cases have proven to be bureaucratic, corrupt, and hostile to the Councils, which they see as a threat to their own power. The risk, however, is that the central funding keeps the Councils dependent on the central government. Since the funding for Councils comes at the direct expense of funding for cities, they can be seen as a way of Chavez centralizing power, or at least retaining influence over the democratic expansions.

Additionally, the Councils have faced allegations of corruption. Like the tyranny of the eloquent, corruption is an endemic problem with democratic structures. Yet it is a problem that can be mitigated through the adoption of appropriate safeguards. For example, recent amendments to the law on Communal Councils have been developed to reduce corruption by making it easier to recall members for spending infractions out of line with the agreed development plan (Pearson, 2009). In Porto Alegre, corruption is combated by limiting the number of terms that one can be elected for, as well as enforcing rigorous transparency of its operations. To this end the government publishes a list of all approved works, including the names and addresses of every delegate (Souza, 2001).

Finally, and perhaps most significantly, the Councils suffer from limited resources. Amounts of $14,000 severely limit the kinds of investment project that can be undertaken.
Overall, the Councils have shown themselves to be successful at democratizing investment. Regular people are participating more and more, indicating that the Councils do indeed enable a kind of self-determination that is real and desirable. There also appears to be room for considerable expansion. The Councils have a solid legal foundation, and their funding could be increased. Since Venezuela’s government spends only 30% of GDP – far below that of most European countries (Weisbrot & Sandoval, 2007) – there is considerable scope for increasing taxes to supply councils with more funds.

A final point to make is that what PB and Communal Councils are really doing is extending opportunities for regular people to directly participate in decisions which affect themselves. As I’ve argued repeatedly, this kind of democratic participation is extremely important for one’s freedom (both in the sense of protection and self-determination), but beyond that, it is important for one’s quality of life. Evidence for this is presented by Frey and Stutzer, who find that the amount of direct democracy one experiences is positively and significantly correlated with one’s happiness: “The purpose of our estimate is to show that the extent of direct democratic participation possibilities exerts a statistically significant, robust and sizeable effect on happiness over and above the demographic and economic determinants so far taken into account in the literature” (Frey & Stutzer, 1999, p. 6).

So we have seen that democratizing investment requires public control over investment at different levels. Higher levels of public investment allow for greater scope, while lower levels allow for more meaningful participation. At the state level, public spending already exists in sizable amounts, though it could be increased in many places. However the real key to democratizing investment is not simply in increasing the amount of money that the central government controls, but in reconceptualizing what state investment looks like, by redirecting larger and larger amounts of this money to locally-controlled participatory bodies. This is where real participation can occur and where self-determination can be meaningful. The examples from Venezuela and Brazil make it clear that there is enormous potential for this kind of local-level democratic investment. This is not to say that these examples can be simply cut and paste into different contexts. Experimentation
is clearly vital (the Communal Councils went through two earlier manifestations, Bolivarian circles, then participatory budgeting, both of which failed, before a new structure was found that caught on). Above all, these experiments make it clear that it is these types of decentralized, participatory structures that are the crucial mechanisms for democratizing investment.

5 Transitions

This chapter has provided substantial evidence that democratizing banks and local investment is entirely feasible. We have reasonable theories of what to do, and various examples to concretely follow. But how do we get there? This is not the place to inquire about the political possibilities of specific transitions in various places – whether Canada will adopt participatory budgeting or whether the US will foster credit unions – but it’s nevertheless important to ask about the institutional possibilities for profound transition.

In this regard it’s useful to distinguish between short and long term reforms. The distinction is one of time, but also of depth. Short-term reforms are ones that are immediately plausible and start from the institutions and structures that exist today, while long term reforms, on the other hand, are ones that are more institutionally ambitious and actually challenge the very core structures. The aim is to show the continuity that bridges the short and long-term visions. This division is useful because, in Ungerian fashion, it allows us to think daringly without sacrificing realism, and to be realistic without abandoning imagination.

In the short term, several kinds of reform would be very useful. In terms of democratizing investment, private investment could be regulated through a series of deterrents and incentives. In Pontusson’s classic study of investment politics in Sweden, he argues that,

[i]t is at least conceivable that a reformist government committed to radical reforms could sustain an adequate rate of investment through a combination of carrots to stimulate private investment, sticks to discourage capital flight and hoarding of wealth, and perhaps a partial replacement of private investment by public investment (J. Pontusson, 1992, p. 19).
We’ve already mentioned the “sticks to discourage capital flight”, as well as the use of public investment, but the other main tool at a government’s disposal to maintain an adequate investment rate is the tax system. One possibility is the shifting of taxation to consumption away from corporate income so as not to discourage investment – e.g. through a progressive Kaldor tax (A. Przeworski & Wallerstein, 1988; Unger, 2000).169 Additionally, there could be tax penalties to companies for paying out large dividends, thus encouraging them to invest more. Furthermore, communities could raise the cost of investment strike by introducing plant-closing legislation: requiring notice, compensation and severance pay (Schweickart, 1996). Complementary incentives could easily be envisioned, including tax breaks or subsidized credit to encourage investment.

In terms of democratizing finance, the most obvious place to start is reforming the banking sector. The current financial crisis has made this obvious to practically everyone (Quiggin, 2010). Banks that are too big to fail should be seen as too big to exist. Governments should be more interventionist in their oversight of the financial sector – ensuring transparency and highly regulating, if not outlawing, excessively risky practices such as credit default swaps (James Crotty, 2009; Simon Johnson, 2009). Beyond the banks, the idea of a “Tobin Tax”, initially suggested in 1972, is finally gaining ground. The Tobin Tax is a small tax on financial transactions. While it would be too small to discourage long-term investment, it would discourage very short-term speculative movements of capital, thereby reducing the danger that such movements of capital hold for autonomous monetary policy (Eichengreen, Tobin, & Wyplosz, 1995).170 Indeed, there have been promising recent developments in this direction; as of 2011 there appears to be real possibility of implementing a European-wide financial transaction tax (colloquially called a “Robin Hood tax”), as the measure is supported by Germany, France, Spain and the European Commission.

169 When consumption taxes are flat (i.e. everyone pays the same amount), which they usually are, they are regressive, because poorer people spend a higher portion of their income, so are taxed proportionally more. However, consumption taxes can be made to be just as progressive as income taxes – like Kaldor suggested – by taxing more expensive items at a higher rate.

170 As the authors point out, the chief obstacle to implementing a Tobin Tax is the international coordination it would require. It would have to apply in all jurisdictions, since it if were imposed unilaterally in one country, the foreign exchange market would simply move offshore (Eichengreen et al., 1995, p. 165).
However, the short-term measure with the most far-reaching potential is that of democratizing pension funds. Pension funds currently control gigantic amounts of wealth: US pension funds, for instance, held $7 trillion in assets in 2000, and owned about 24% of total equity – meaning that workers (understood broadly) essentially own a quarter of the entire economy through their funds (Blackburn, 2002, p. 102). So if pension fund legislation were relaxed to enable workers increased democratic say over how the funds are used, the possibilities would be enormous.171 However, pension funds are currently controlled by trustees who are legally bound by “fiduciary responsibility”, which means that they are obligated to aim for maximum returns and diversify the funds as much as possible. These legal requirements effectively prevent pension funds from being used for progressive purposes (maximizing returns prevents social or ethical investing, and extreme diversification prevents obtaining sufficient equity to influence a company’s policies or facilitate worker ownership).172 If this legislation were relaxed, however, workers could gain a more active say in weighing and balancing the criteria by which they invest. Since their pensions represent the funds for their retirement, profitability will undoubtedly remain a key criterion, but there’s no reason to think that it’s the only criteria that workers care about – they may also value various social projects even if they have slightly lower rates of return, e.g., financing affordable housing, local infrastructure, etc.

The tremendous size of pension funds make them a source of enormous potential for furthering economic democracy. One possibility is that pension funds could be required to invest a portion of their funds into municipal bonds, which cities then use for long-term investment in infrastructure, thus reducing the danger of capital strike. Another possibility is that pension funds could be required to deposit a portion of their funds into credit unions or even newly created DCBs, to capitalize them and help them grow, thus encouraging the growth of financial democracy.

171 It is these possibilities which have stimulated debate around so-called “pension fund socialism” (Drucker, 1976; Simon, 1993).
172 It may be the case that this mainstream interpretation is actually more rigid than the actual case law. For example, in the British case, it has been argued that trustees are in fact legally permitted to consider a much broader range of issues that their beneficiaries may consider in their “best interest” than solely financial ones (Berry, 2011).
What about the possibilities for long-term transition? The closest a country has come to fundamentally democratizing its system of finance and investment is the Meidner Plan, proposed by Swedish government in the 1970s. Rudolf Meidner, Chief Economist of the largest Swedish union the LO, proposed that all firms with more than 50 workers should be obliged to create new shares worth 20% of their gross annual profit to be controlled in so-called “wage-earner funds” (Meidner, 1978). These funds would be controlled by the firm’s internal workers until they reached a size of 20% of the firm’s equity, at which point control rights would shift outside of the firm to be governed by regional public bodies controlled by the trade unions. These wage-earner funds would over time acquire more and more control over capital to direct towards public investment. It was estimated that firms making 10% profit per year would become majority worker-owned within 35 years. Thus the economy would slowly and irresistibly become socialized.

The plan had a number of important strengths. The funds would not have expropriated any present wealth, but only diluted future control, thus somewhat calming the inevitable opposition to them. This is justifiable because while large amounts of private wealth may be justifiable, large amounts of private power that derive from such wealth is not. From a democratic perspective, the funds would have slowly reduced the power of unaccountable investors and slowly increased democratic control over societal investment. Additionally, since the funds would not remove any capital from the firms, thus not subtracting from internal cash flow, in fact by maintaining equity within the firm (as opposed to siphoning it off through dividend payments as usually happens) the plan would actually have improved the firm’s internal financing (Blackburn, 2002; J Pontusson, 1987). Most importantly, the cumulative nature of the plan allows for the gradual socialization of the economy. Bit by bit, private productive property would have become public, and able to be directed according to popular criteria. Unfortunately, the Meidner plan was ferociously attacked by business groups and ultimately abandoned by the socialist party.173

173 While this defeat was unfortunate it was in no way inevitable. In this particular case the socialists did a bad job of convincing the population of the benefits of the plan. Additionally, the fact that the proposal was for wage-earner funds to be controlled by the unions, instead of broader community representatives, made them unpopular (J Pontusson & Kuruvilla, 1992).
Although the Meidner plan was developed for a specific Swedish context (J Pontusson & Kuruvilla, 1992), the basic idea remains very powerful and replicable. Indeed, it doesn’t require much of a stretch to imagine a Meidner-type plan, what we earlier called an “Incremental Democratization Plan”, to be adapted to the goals of economic democracy. Imagine for instance an IDP with two distinct streams – one banking stream whereby profits from private banks are cumulatively placed under the control of newly established democratic community banks. And a second business stream, whereby profits from private firms are cumulatively placed under the control of a workers’ trust, which could then serve as a basis for buying-out the firms and transforming them into cooperatives. Thus over time, such a plan would gradually and fundamentally alter the economy, replacing private banks with public DCBs, and private firms with worker-owned co-ops. This would achieve at one stroke two fundamental goals of economic democracy: democratizing finance and democratizing workplaces. And such changes would be mutually reinforcing as the democratic banks would prove vital for helping the increasingly worker-owned workplaces to transform into co-ops. Although such changes would be gradual, their cumulative effect would be massive, indeed, revolutionary.

While the specific details of this Swedish battle over the Meidner plan need not concern us here, there is a more general problem that any attempted transition by a government to significantly socialize investment runs the risk of immediate capital flight and strike. This is why the short-term reforms identified above are so important: they provide the initial breathing room for a country to lay the groundwork for more major changes, without being threatening enough that they are likely to provoke hugely serious reactions from the holders of capital. It’s also useful to remember that while there is always an immediate risk of capital flight and strike, over the medium-term if financiers and investors think that conditions are stable enough for them to make a profit, they will likely return home to continue investing, even if conditions are not as favourable to them as they once were. This is an important lesson of the Chavez regime in Venezuela. While elites were clearly unhappy with the new capital controls, government spending, nationalization of oil, etc., once they felt assured that they would not be expropriated and

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174 Robin Blackburn (2010) proposes something similar to this.
that economic conditions were stable enough to operate in profitably, even if less profitably than before, business more-or-less went back to normal (Weisbrot & Sandoval, 2007).

6 Conclusion

The proposals explored in this chapter – for capital controls, democratic community banks, and local participatory investment – are the most radical proposals of this book. Although we can see examples of most of these things in action to a certain degree (with democratic finance being the least common), they remain exceptional and underdeveloped, though not entirely invisible. Venezuela and Malaysia show us the practicality of capital controls. The CLP and particularly credit unions, present us with potential forerunners to DCBs. Participatory budgeting and Communal Councils show us the possibility of local democratic investment. These examples not only illustrate the feasibility of increasing democratic control over finance and investment, they also show how such institutions provide real and concrete improvements over the status quo. Economic democracy can improve people’s lives. Of course, for these changes to become robust the components need to grow, and become connected and integrated with one another. But even in their present nascent form, they allow us to glimpse a new world in the womb of the old.

We have now examined all the main elements of economic democracy, and so it’s useful to take a step back in order to appreciate how the constituent parts are integrated and sustain each other.

We have seen that workplace democracy could be increased by legislation to facilitate start-ups and buy-outs, as well as by creating institutions to provide financial help and guidance, such as through Democratic Community Banks. The expansion of worker co-ops would not only increase workplace democracy but would also increase investment
democracy, as more workers acquire a say over investment decisions. It would also increase financial democracy to the extent that co-ops keep their savings in democratic banks or credit unions.

The market system could be democratized in the sense of increasing consumer sovereignty by reducing inequality and price distortions so that the market becomes a more democratic voting-machine. Consumer accountability can also be increased through consumer or preferably multi-stakeholder co-ops, the latter of which also advance workplace democracy. Reducing inequality not only is useful for making the market function in a more democratic way, but it also promotes workplace democracy since reducing poverty means that more people can afford to buy out their firms or start co-ops of their own. Additionally, shaping the market system through tax systems that benefit democratic businesses and tariffs that prevent odious competition is not only useful for consolidating national democracy from global pressures, but it also promotes workplace democracy (through the spread of co-ops) and financial democracy (through the spread of credit unions).

Democratizing market system in terms of citizen sovereignty requires financial and investment democracy. Financial democracy could be increased by capital controls and the spread of democratic financial institutions such as credit unions or better yet, DCBs. DCBs would be useful not only for providing democratic accountability over the allocation of finance, but they would also promote worker co-ops (as the CLP does for Mondragon).

Finally, Investment democracy could be increased by the spread of co-ops as well as by increased public investment, particularly at the local level via participatory structures. Democratizing investment through increased public spending reduces the risk of investment strike, which means that taxes can be raised higher than in social democracies, which in turn allows for a greater reduction of inequality and thereby an increase in the democratic functioning of the market.

Ultimately, economic democracy is both a goal and a direction of transition. It is a bridge that must be built brick by brick, pillar by pillar, to carry us from here to there. Yet even
though the main pillars – workplace democracy, market democracy, finance and investment democracy – are important goals in their own right, we can see that they are also deeply interconnected and mutually sustaining. Democratic institutions in one place feed and foster those in another. This means that even though economic democracy is doubtless an ambitious project, it’s also true that diverse actors and variegated movements, contributing to democratization in their own particular spheres, are likely supporting those of others they do not even know. As such, the grounds for comprehensive change in a democratic direction may not be quite as infertile as they often appear.
Part Five: Conclusion
Chapter 9

Towards A Feasible 21\textsuperscript{st} Century Socialism

1 Introduction

Although economic democracy is primarily a direction of reform, it also embodies a vision of a future socialist society. This chapter, by way of conclusion, attempts to illustrate the main contours of what such a society might look like. Yet this kind of speculative work requires careful vigilance in order to prevent it from falling into fantasy; it’s crucial that imagination be tempered by the feasible. One way to ensure this is to ask what might be possible within the lifetime of a young person considering these issues today – i.e. in the next 50 or so years. The point is not to build castles in the sand, but to try to paint a picture of society that is at once plausible enough to seem worth talking about, yet inspiring enough to warrant the risk, energy, and commitment that building such a society would require.

One of the oldest debates on the left is about whether models of future society are actually useful. On the one hand, it’s clearly important to have enough humility to recognize that we cannot possibly envision the infinite complexities and hidden aspects of a future society.\textsuperscript{175} The future falls inevitably within the penumbra of the present. Not to mention the obvious fact that different countries, with their particular histories and cultures, will unavoidably develop different types of institutions, even if they aim at similar broad purposes. This means that any speculation must necessarily be of a high degree of generality and abstractness. But that doesn’t make the attempt meaningless. Far from it. The most important reason to engage in this speculation is to concretize our

\textsuperscript{175} Consider that even a thinker of the stature of Murray Bookchin was able to start an essay on future “forms of freedom” by saying that “the problem of what social forms will replace existing ones is basically a problem of the relations free men will establish between themselves” (Bookchin, [1968] 2005, p. 199, my emphasis). The fact that a thinker of Bookchin’s intellect and sensitivity to hierarchy could be blind to the sexism in his language, as were most writers of the time, reminds us of the necessity for having humility ourselves in thinking about the future since we can never entirely escape the hidden hierarchies and blind spots of our age.
vision of what exactly we’re aiming for, so as to have a better idea of how we should direct our energy here and now. Having a vision to work towards is like having a north point on a compass – it orients our plans, projects, and strategies for reform. It gives coherence to our organizing and direction to our activism.

This chapter begins by presenting a simple model of developed economic democracy in the form of market socialism. I describe the basic components of such a society in order to demonstrate its viability as well as its desirability. The next section, and the core of the chapter, deals with several important socialistic objections to the idea of market socialism, including the question of whether superior alternatives exist. I make the case that those sympathetic to socialism should not be implacably hostile to markets, since the most viable path for feasible socialism today is based on finding ways to embrace the virtues of markets while minimizing their defects.

2 Economic Democracy as Market Socialism

In the present context it is difficult to imagine a radical break from that which currently exists. Yet imagining that nothing will radically change is even harder. As neoliberalism generates ever greater inequality in the form of riches for some and powerlessness for others, and as global warming makes current economic arrangements seem ever more impossible to continue, it’s not unlikely that a number of governments around the world will start moving left. Although we’ve been talking about economic democracy as a set of reforms, it’s more accurate to see it as a direction of reform, rather than any necessary package of reforms themselves. But if economic democracy is about a direction of reform, where exactly does it point? It points towards the building up of possibilities for popular self-government of economic relations: building workplace democracy, democratizing the market, and increasing local control over finance and investment. Ultimately, if we carry the argument of the previous chapters to their logical conclusion it points to a system of market socialism. Of course such a system has nothing in common with the current Chinese regime, which is sometimes described in this way, rather it
belongs to the school of thought that attempt to carve out a third way between capitalism and communism.\textsuperscript{176} Theories of market socialism tend to fall into two camps – \textit{public} market socialism, where firms are managed by a democratic state, which equally redistributes the profits to the population, and \textit{self-managed} market socialism, where workers control their own firms and distribute the profits themselves (Weisskopf, 1993). Economic democracy falls into the second camp.

It is far from inconceivable that within the next 50 years a number of countries will move substantially towards economic democracy. Countries in South America may move in this direction substantially sooner, with Venezuela, perhaps, already leading the way.\textsuperscript{177} It’s likely that the best chances for the success of market socialism will be in countries which experience a gradual accumulation of economic democracy over the years – expanding co-ops and credit unions, and regulating the market in a democratic direction. Incrementalism is crucial because it builds up the democratic resources of a country, so that if and when the storm of opposition comes, the democratic institutions have a better chance of weathering it.\textsuperscript{178}

Transition is impossible to predict with any accuracy, but in broad strokes one can imagine a variety of countries slowly building up various democratic components of their economies, perhaps propelled by legislation akin to the original Meidner plan, involving the slow but cumulative passing of control of business to workers, and private banks to DCBs. Over time, things like a Meidner plan or a shaping of the market system so that co-ops (and credit unions) outcompete private firms could lead to a peaceful transition to economic democracy. Recall, for instance, the transition that occurred in Swedish society from the 1930s to the 1970s in the building of the welfare state, which was just as deep and profound as it was peaceful and piecemeal.

\textsuperscript{176} Although Proudhon sometimes gestured in the direction of market socialism, it is usually historically associated more with Lange and Taylor (1938) from the period of the socialist calculation debates. The fall of the Soviet Union spurred a renewal of interest in market socialism, led by such theorists as Carens (1981), Miller (1989), Bardhan (1993), Roemer (1994), Schweickart (1996) and others.

\textsuperscript{177} Venezuela is a complex story. There is definite evidence of a move towards economic democracy – with expanding co-ops, communal councils controlling local investment, and a government at least formally committed to expanding workers’ control and building socialism. However, there are also countervailing tendencies, such as Chavez’s authoritarian personality, the decline of co-management, and the ambiguity of the main political parties and the unions towards workplace democracy (Malleson, 2010).

\textsuperscript{178} For a good discussion of the possibilities of transformation to a socialist system, see Wright (2010).
Of course, it’s possible, and perhaps more likely, that things will not be so orderly. Recall the more recent case of Venezuela, where several years of democratic reforms transpired peacefully before finally reaching a tipping point where the opposition revolted, leading to massive capital flight, investment strike, and a coup. Not only did Chavez survive the coup (with massive popular support) but it led to the deepening and radicalizing of reforms, as the government initiated the Communal Councils and started explicitly calling for “21st century socialism”. In a broadly similar way, it’s possible to imagine a country peacefully moving towards economic democracy reaching a tipping point: perhaps welfare rates are increased, or a legislative proposal is put forward to increase the scope of the Meidner plan. Capitalists react en masse. Capital flight takes off; owners lock out workers; banks refuse to lend. Unemployment skyrockets, the economy starts to collapse, yet instead of capitulating the bulk of the citizens push back – riots break out, factories get occupied, elections get called and a more radical left is elected. Meidner-type reforms are sped up, the remaining privately-owned small and medium-size firms pass into the hands of their workers, large firms are taken over by the state for co-management, large-scale capital flight is outlawed, private banks are put under public control, and the stock market is abolished. The wealthy are removed of their empires (but not of their homes), as the old order is swept away. In addition to popular support, the depth of the previous reforms are crucial in providing a solid foundation for transition. The basic idea here is that given widespread co-ops and partial democratic investment, the capital flight and strike that leads to what Przeworski calls the “transition trough” is likely to be shallower and less destructive than otherwise (Wright, 2010, chapter 9).

In either case, once the dust settles it is possible to ask what a society determined to enact full-blown economic democracy might actually look like. Imagine a society where the economy is based on the following basic components.

(i) *Democratic workplaces*. All firms are run as worker cooperatives (except for those run by a single individual, or those of large capital-intensity or national importance, which are co-managed between worker representatives and state representatives). The

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179 Strategic firms as well as workplaces with broad social importance, such as schools, might experiment with extending co-management by including different proportions of internal workers, state representatives,
majority of the workforce of each co-op must be full members with equal rights to participate in the governance of the firm, elect managers, and receive a share of the profits. Temporary workers could be permitted, but after a probationary period they must enjoy full rights to become members should they wish to do so. Each firm is free to remunerate as it sees fit. While some firms may opt for strict equality, past experience with co-ops suggests that most firms would allow some inequality of wages to foster motivation, but not usually exceeding a of 3:1 (compared to common rates of 200:1 in the US, and 12:1 in Sweden). Since all firms are run as co-ops, the society has effectively abolished the segment of the capitalist class who are business owners. In other words, there is no longer a group of people who have the power to control workplaces based solely on the ownership of property. It’s a guiding principle of a society like this that control rights are distinct from ownership rights and instead derive from working, and are thus vested equally among working members.

(ii) A democratized market system. Co-ops and consumers interact with each other and are coordinated by way of the market system. This is the second component of the economy – a cooperative market system regulated by an interventionist state. The market system is regulated to improve consumer sovereignty by reducing inequality (as well as reducing the price distortions that arise from the market failures of externalities and monopolies). In addition, the market system as a whole is shaped to allow for public deliberation on economic scale and to promote the flourishing of democratic businesses.

(iii) Democratic finance and investment. Citizen sovereignty over economic development is protected by capital controls and promoted through public institutions that are both accountable and well-equipped to deal with market failures (such as externalities, public goods, etc.). These public institutions exist at different levels: accountable investment at the highest level is achieved through a National Investment Fund, while meaningful involvement occurs at the local level through Democratic Community Banks (ideal for dealing with local externalities) and participatory budgeting (ideal for dealing with local public goods). Finance is controlled by DCBs who receive funds from the state, in
proportion to their membership, which they then disperse as loans to co-ops (and individuals) on the basis of criteria decided by the elected and revocable bank managers. Each DCB has a department devoted to co-ops – offering not just finance, but business advice, support, strategizing, etc. Since investment is democratized and all the banks are run as democratic institutions there is no longer a group of people who have the power to make investment decisions, to direct capital and develop society, solely on the basis of their ownership of property – this segment of the capitalist class has likewise been abolished. The power to direct the economic development of society has evolved into a basic right of all citizens.  

So how would these components function in a day-to-day manner? The basic functioning of the economy would be straightforward and familiar: co-op firms would produce various goods and services to sell on the market. Firms would compete with other to make more profit, and consumers would buy what they desire in response to price signals. There would be substantial progressive taxation on income or consumption or some mix (up to say, 70% or so of GDP), as well as extremely high taxes on inheritance (such as 99% for funds above a certain threshold). These taxes would fund the various public programs, such as high quality universal education, like Nordic countries do now, in addition to funding an extended welfare system, or, preferably, a basic income. The size of the basic income would of course be dependent on what the society could afford, but hopefully it would constitute a living wage (which is within the reach of many developed countries today (P. Harvey, 2006)). In addition, these taxes would fund public investment at different levels. Funds for public investment would be divided between the national level, perhaps a regional level, with the bulk being reserved for the local level – split between DCBs and participatory budgeting. DCBs would loan their funds out to local co-ops, individuals, and community groups, thus recycling the nation’s capital through democratic bodies, so that the flow of capital is allocated on the basis of a variety


\[180\] In terms of theories of market socialism, this model is probably closest to that of Schweickart (1996, 2002) from whom it takes considerable inspiration. I differ from Schweickart in three main aspects: I think that democratizing finance requires decentralized and democratic (not just public) banks; second, I have argued that investment requires local participatory investment structures (not just state investment); thirdly, I emphasize more than Schweickart does the importance of democratizing the market system – not only in terms of ensuring that people have relatively equal “votes”, but in shaping the key parameters of a cooperative market system.
of criteria accountable to affected people. The practice of recycling investment up from
genral taxation then back down through democratic participatory structures is the
mechanism by which the wealth that is the social heritage of the past becomes the social
inheritance of the present.

Workers wishing to join an existing co-op apply in the usual fashion. Alternatively
workers can start a new co-op. There would be substantial support to do this. A group of
workers can approach the co-op department of their local DCB with their idea. The DCB
would perform a feasibility study and require a down payment from the workers (as the
CLP does today), and if the project is seen as feasible, financing and business advice will
be provided. Clearly in a competitive market system like this certain firms will prosper
and certain will fail. When co-ops go bankrupt the workers can live off the basic income
or try to find work elsewhere. Of course there may well be structural unemployment in
the economy (i.e. mismatch between the demand for labour and the skills and location of
workers looking for employment). In this case, economic democracy could follow the
same strategy as Sweden does today, i.e. providing Active Labour Market Policies, which
provide workers with opportunities to retrain and/or give subsidies for people to relocate
to different areas. Economic democracy would be able to invest more into such programs
than Sweden currently does because of the higher tax take.

In general, people will search for the jobs that appeal to them, or choose to live off the
basic income and devote themselves to other activities – art, music, activism, caregiving,
parenting, etc. Since the basic income is unlikely to be very high, most people will
likely choose to work. The incentives to work, to move to a different job, or start a
business will come from two sources. People will retain an element of the material
incentives that exist today, since hard work and innovation will provide some individuals
with a marginally greater income than others (though only marginal, since taxes and co-

181 The most common objection to a basic income is that it means that some people will simply spend their
time surfing, or some other such activity, on the income that other people have generated. This objection is
dealt with at length in Van Parijs (1995). The basic response is that most of society’s wealth today is
inherited wealth, i.e., from the labour of past generations, and so a basic income gives every individual a
claim to a portion of that wealth to use as they see fit. While it’s unlikely that a basic income (at the living
wage level that it’s currently envisioned) would lead to mass exodus from work, it is likely that various
unpleasant jobs (such as trash collecting) would have to offer higher wages to attract workers – but this is
hardly an undesirable result.
op business structures will prevent massive inequalities). Additionally, people will have moral incentives to work hard – e.g. the desire to excel, have high self-esteem, be respected by co-workers, obtain community status, etc. Moral incentives are often sneered at and derided as ineffective, but they can provide enormous levels of motivation. Even in contemporary society – which champions self-interest above all else – we see that huge amounts of effort is galvanized by sources other than narrow profit-maximization. Parents look after children out of an ethic of care; academics publish less for the money than the peer recognition; health practitioners study hard to be good at their job and perform a function that they see as valuable, and so on. A market socialist society based on democratic principles would almost certainly develop stronger cultural norms than exist presently about the importance of contributing to the community, and working out of solidarity with the consumers (who are ultimately our neighbors and ourselves). This is not to say that such norms would entirely replace material incentives, but they could well complement them.

Taking a step back to visualize the interaction of the parts, we can be fairly confident that such a society would be able to function smoothly. Price signals would provide everyone in the economy with information about supply and demand. Workers would have incentives to find jobs. And businesses would have incentives to respond to consumer demand. Furthermore the system would be stable since there would be no inherent group or class of people with a vested interest in overthrowing it. Imagine, for instance, that a smart, self-interested individual does not wish to work in a co-op, because he doesn’t want to share his ideas or his profits. Imagine he wants to be a capitalist. There is no problem. He is perfectly free to start his own company, where he is king and hierarch, make all the decisions and keep all the money for himself (except for taxes). The only thing he is unable to do is to hire employees who are forever denied equal say, since the employees, after a probationary period, have a fundamental right to buy their employers out (with financial support from local DCBs); he is able to remain king only over himself. Such a person would have little reason to destabilize the system, and even less ability to do so.
It’s worth pointing out that economic democracy is fully compatible with large-scale business and complex economic activities. While it’s true that direct democratic participation (and feelings of empowerment through self-determination) can only occur effectively on a small scale, a central strength of economic democracy is the organizing of institutions in ways that operate at different levels and different scales simultaneously. Participation can happen to a certain degree in co-ops through decentralization of various tasks and delegation of various responsibilities. Yet nothing about the co-op structure requires them to be small or simple. Although co-ops are better able to retain their democratic character with less than 500 workers, they can grow to be much larger than this, and incredibly complex, through spinning off departments as new co-ops and expanding through networking. Mondragon is a powerful example of this kind of network that is huge, complex, and yet allows for direct democracy at the base with representative democracy at the broadest level. Moreover, a economic democracy would likely retain some huge firms, such as oil or telecommunications companies, which make economic sense to keep large (for instance, because of natural monopolies). Such firms would ideally be co-managed. Additionally, direct participation can happen to a certain degree in local participatory investment meetings. Yet here too this system can very easily sit within broader systems of public investment occurring at the regional or national level. Though again, at this higher level the accountability comes from elected representatives not direct participation. So nothing about economic democracy requires smallness or the lack of complexity; the system combines democracy with large-scale effectiveness by nesting mechanisms for direct participation within larger structures of representative democracy.

It seems to me that such a society would constitute a substantial advance over contemporary capitalism – both the neoliberal and the social democratic variants. Let’s consider the harder case: how exactly is economic democracy better than social democracy?

Perhaps most importantly, this society would be significantly freer. Firstly, there would be important increases in social freedom flowing from the institutionalization of democracy in those areas of society that exert major economic power. In particular,
widespread workplace democracy constitutes a major advance from social democracy. For the first time in industrial history, workers would acquire formal equality at work – the right to elect their managers and influence the direction of their organization with others who are peers and of equal status. There would no longer be structural inequality or institutionalized inferiority. Since co-ops tend to be freer, less demoralizing, and more pleasant places to work than capitalist firms, the fact that work occupies such a significant portion of people’s time and energy means that we can expect the spread of co-ops to lead to substantial improvements in people’s lives. Of course, this is not to say that worker co-ops are perfect institutions; we’ve seen that they can easily be marred by informal hierarchy stemming from the tyranny of the eloquent as well as the pressures of scale and complexity. But this should not depress us because we are not searching for perfection, we’re searching for improvement. Workplace democracy constitutes a wave of enfranchisement, similar in certain respects to the wave of female suffrage that occurred in many countries in the early 20th century. While acquiring the vote didn’t abolish all inequities between men and women, the formal equality that resulted nevertheless represented a fundamental improvement in women’s freedom. Likewise, acquiring the vote at work won’t abolish all inequities between workers and managers, but it represents fundamental progress all the same.

In addition, a society of this sort would have increased social freedom from the increased accountability and self-determination that comes from being able to vote at one’s DCB, as well as at local participatory investment meetings. DCBs and participatory investment are important mechanisms for enhancing the capacity of regular people to direct the development of their communities. Those who choose to engage and participate are able to, while those who choose not to are still afforded the democratic protections stemming from accountability.

Secondly, beyond the social freedom that democracy brings, this society would have much more individual freedom. The combination of a robust public education system and a basic income substantially increases the scope of real choices individuals have. Since economic democracy has public systems of investment, it is able to have taxes that are significantly higher than present social democracies. Clearly there are limits to taxation,
but there is no reason why economic democracy couldn’t have taxes a good ten percent higher than the Nordic countries have ever achieved. This means that everything that social democracy does well, economic democracy could do slightly better. More material equality and investment in education means that people’s futures are more open and less constrained by the fluke of birth than in social democracies. Likewise, a stronger social safety net and increased investment in ALMPs means that individuals would face less compulsion to accept bad jobs, while enjoying more ability to find good ones. The existence of capital controls gives governments the tools to pursue full employment – thus allowing individuals to benefit from the increasing living standards and material security that this brings – which social democratic states are unable to achieve.

In addition, such a society would have rid itself of massive *inequality*. Incomes would be compressed by co-op remuneration standards as well as by high levels of taxation. Large inheritances would be taxed away. And wealth from capital ownership – such as dividends and interest payments which today transform the rich into the superrich – would no longer exist since the financial markets have been abolished. And just as the social democracies benefit more than neoliberal countries from the range of advantages that come from having increased equality – lower mental illness, homicides, obesity, and imprisonment rates, as well as higher life expectancy, children’s educational performance, and social mobility (Wilkinson & Pickett, 2010) – we can expect these benefits to accrue even more substantially in economic democracy. Beyond material equality, the democratization of finance and investment means that there is no longer a business class occupying a “privileged position” in society, which means that in this society citizens have roughly equal political freedom. This society therefore meets Rawls’s criterion of being a just society, much more than social democracy, because it possesses “fair value” of political freedom, in other words, all citizens have “roughly an equal chance of influencing the government’s policy and of attaining positions of authority irrespective of their economic and social class” (Rawls, 2001, p. 46).

This society would also have the potential to be significantly better for the *environment*. Since co-op workers tend to live close to where they work, they are far less likely than absent capital owners to pursue economic goals which are detrimental to their local
environment. But the main difference from social democracy is that economic democracy has more established mechanisms for setting limits on scale and dealing with large-scale environmental externalities. Economic democracy is thus in a better position to limit the scale of the economy by taxing the extraction of basic materials and by setting caps on the use of various non-renewable resources, since it wouldn’t face the same ferocious opposition from private energy companies that exists today. Using a rigorous system of caps and limits would allow the economy to continue growing in the sense of developing, without growing in the sense of increasing throughput. Of course, whether this potential is actualized depends on whether the majority of the population actually votes to restrain throughput growth in this way. There is nothing inevitable about that one way or the other. Clearly environmental sustainability requires a cultural shift just as much as an institutional one.

In contemporary capitalism rich countries are subject to the Huxleyesque paradox that in order to keep the economy functioning, citizens need to consume ever more (hence the inherent tension between the green movement and the labour movement). In the US, for example, the average worker’s productivity has more than doubled since 1950, and yet this 100% of these gains have been taken as increased wages/consumption and 0% has been taken as increased leisure (in fact Americans work more hours now than they did 50 years ago (Schor, 1991)). To encourage this a relentless barrage of advertising and promotion of materialism is needed in order to inculcate the population with a desire for constant shopping. It is practically impossible, under capitalism, to make the sensible tradeoff of having less consumption for more leisure because capitalist firms prefer to hire fewer workers for more hours rather than more workers for fewer hours (since they usually have fixed overhead costs per worker from things like formal training, tacit knowledge of the workplace, etc. (Wright, 2010, p. 67)). In market socialism, however, the sensible choice for a rich society – to work less, produce and consume less (so being more environmentally sustainable), while having more leisure – is much more structurally accessible because there is more democracy in workplaces, meaning individuals have broader options about personal work-leisure tradeoffs. Instead of the typical position in both neoliberal and social democratic countries where worker productivity is rewarded every year or so with increased wages, in economic democracy
workers would have the free choice to take productivity gains as more wages or as more time off. A democratic society is more able to adjust the tempo of its economy in line with the desired rhythms of people’s lives, instead of working ever harder, like a mouse in a running wheel, for things no one really needs. “The trouble with the rat race” after all, “is that even if you win, you’re still a rat”\(^\text{182}\).

Notwithstanding all these advances, a market socialist society would likely retain similar levels of economic efficiency as social democracies do, since, broadly speaking, the basic source of efficiency in contemporary capitalist societies has very little to do with the existence of “capitalists” – i.e. the presence of a rich minority with power to control workplaces, finance and investment – but rather stems from having markets which provide information and incentives for actors to respond. It is markets, not capitalism per se, that provide the grounds for allocational and innovative efficiency. And since market socialism maintains the market for allocation, while democratizing the sources of economic power, it retains the same bases of efficiency. Any loss of efficiency that workplaces might suffer from the absence of strict hierarchy are more than compensated for by the reduction of alienation and increased motivation that comes from being one’s own boss. Likewise, any incentive losses that might come from high societal taxes or the security of a basic income are likely to be more-or-less balanced by the increased productive capabilities that workers acquire from a society that invests heavily in them and in public infrastructure more generally\(^\text{183}\).

That said, all of these advantages should not blind us from the fact that this society would be far from utopian. There would still be scarcity; people would not have the total freedom to “hunt in the morning, fish in the afternoon, rear cattle in the evening” (Marx & Engels, [1845] 1960), but would still need to work. Additionally, there would likely remain a range of troubles and injustices. For starters, the institutional changes we’ve talked about do nothing to address systemic issues of sexism, racism, or ableism. The

\(^{182}\) Attributed to Lily Tomlin in *People Magazine*, December 26, 1977.

\(^{183}\) Economic growth requires not just incentives but also capabilities (Chang, 2007). For instance, a child can be presented with maximal incentives (a $10 million gift or threatened with a gun), but regardless she is not going to be productive because she has such limited capabilities. Productivity growth requires not simply incentives but the fostering of capabilities.
new democratic structures would disproportionately benefit the most educated and articulate who can best take advantage of opportunities for democratic participation. Similarly, such structures are clearly not immune from informal hierarchy, meaning that without constant vigilance and experimentation, it is easy for informal practices of inequality (person A starting to monopolize this information, or person B staring to monopolize access to those relationships, etc.) to sediment into rigid hierarchy. Additionally, a society of this sort would still retain a certain level of inequality, and business relationships would still be driven predominantly by market motives of fear and greed – which we discuss below. Finally, this society would face a range of similar external problems that social democracies face today, particularly those of global justice. If economic democracy occurs in a rich society, there are important questions to ask as to how this society should engage with an incredibly unequal world – what kind of obligations does it have towards helping alleviate the poverty and debt of the global south? For instance Schweickart suggests that countries embracing economic democracy should also develop fair trade schemes to help alleviate global poverty.\footnote{He proposes a system of “socialist protectionism” with the goals of protecting domestic workers from damaging low-wage competition while contributing positively to alleviating global poverty. To these ends he advocates that a “social tariff” be imposed on the imports of all goods coming from poor countries. This tariff would protect domestic workers from low-wage and/or environmentally unfriendly competition. At the same time all of the tariff proceeds would be rebated to the country of origin of the goods, particularly to those agencies most likely to help alleviate poverty – state agencies (where effective), unions, environmental groups, NGOs, etc. (Schweickart, 2002, p. 82).}

Yet for all this, economic democracy would nevertheless be a vastly improved society. A place where the values of liberté, égalité, solidarité, proudly articulated in France in 1789, would finally become more than simple decorations on European monuments, and actually serve for the first time as a more-or-less (or rather, more-than-less) realistic descriptions of the institutional basis of society.

Although economic democracy aims towards a socialist society that is also a market society, it’s noteworthy that the conventional leftwing objections to market societies don’t have much force here. There is, admittedly, still competition and greed, but these sentiments provide motivation to respond to economic information, and are drained of their most pernicious consequences. There is no fear of extreme poverty or deprivation.
No one suffers horribly from losing in the competition, and no one wins abundantly; there are no beggars nor billionaires. Instead of a life-or-death struggle, competition in this society resembles more an athletic race: serious, and with winners and losers, but hardly terrifying, since the winners gain no power, and the losers lose no dignity. In this society some people work hard out of noble goals (just as some do today), while some people work hard out of ugly goals, such as the desire to earn bit more than the person beside them to prove their superiority (just like today). But who cares? Earning more doesn’t translate into more power or privilege. The crucial point is that in this society money has been depoliticized because it has been stripped of its ability to transform into power over people; it represents only consumption-potential. The wealthiest person in society is able to consume more, but is unable therefore to acquire any power over anyone else. The rich man can spend his time endlessly shining his coins in glee and self-aggrandizement, like the Businessman in Le Petit Prince, but his wealth grants him no power over his neighbors. So greed, under market socialism, is rendered a petty vice, instead of a social cancer.

What label should we attach to this society? Although I have been arguing that the logical outcome of economic democracy is “market socialism”, it might be objected that this is an inappropriate use of the word “socialism”. Classically, socialism has been defined as having two central components: instead of private ownership of the means of production, socialism implies social ownership – i.e., ownership by the state, presumably oriented towards the public good; secondly, instead of using a market (with its corollaries of competition and profit-seeking), socialism organizes the economy by means of system-wide economic planning (supposedly based on the values of cooperation and solidarity). Economic democracy, however, meets neither of these criteria, and so within the dominant vocabulary of the 19th and 20th centuries, it would not be called “socialist”.

This is a mistake. We should be faithful to linguistic traditions only insofar as they usefully reflect the reality they are meant to represent. Our experiences with “actually-existing socialism” throughout the 20th century should encourage us to re-examine our definitions. David Ellerman (1992), and Erik Olin Wright (2010) more recently, have argued persuasively that capitalism should be defined less as a system of private
ownership, than as a system based on unequal power stemming from the employer-employee distinction.\textsuperscript{185} In the USSR, ownership shifted from private to public hands – yet although one could therefore formally call it a “socialist” state, it makes little sense to do so, since the mass of workers were still powerless and disenfranchised. Bosses still made all the important decisions about workplace organization, finance, investment, etc. The same dislocation continued between workers and the means of wealth creation. The only difference was that the new “bosses” were party bureaucrats instead of capitalists. This is obvious in the western world too, where nationalizations have not altered in any fundamental way the daily hierarchies of work. So Ellerman’s point is that public ownership per se should not be the fundamental basis of socialism.

I agree, although I think we need to broaden Ellerman’s focus from power in the workplace to economic decision-making power in general. Society, I would argue, is shaped around economic decision-making power – particularly, power over work, investment and finance. The defining feature of capitalist society is that major economic power is controlled by a small group of unaccountable people on the basis of their property.\textsuperscript{186} By this definition, the USSR, or China today, are better characterized as “state-capitalist”, since major economic power is likewise controlled by a small group of unaccountable people on the basis of their position within the state (though even this term is imperfect implying as it does that there could be a “capitalism” which was not dependent on the state); and economic democracy is indeed a kind of socialism, since there are no longer any capitalists. In the place of capitalist owners and investors, there are democratic structures whereby economic decision-making is controlled by and accountable to the population at large.

\textsuperscript{185} Ellerman (1992) gives a striking analogy to the old capitalism-communism debate. He reminds us that in ancient Greece, there were two schools of thought about slavery. In Athens slaves were privately owned, whereas in Sparta they were state-owned. His point, of course, is that both sides in this ancient debate miss the crucial issue: humans shouldn’t be slaves! By analogy, he insists that the debate today shouldn’t be about whether it’s better to work for a private capitalist or for a public state, but about challenging workplace hierarchy itself.

\textsuperscript{186} In a similar vein, the influential authors of Socialisme ou Barbarie argued that the fundamental division of society was between order-givers and order-takers (Castoriadis, 1974).
Of course, economic democracy still relies on markets, and so for some this immediately disqualifies it of the moniker of socialism. The rest of the chapter deals with objections of this sort in more detail.

3 Objections from the left

The bulk of this book has been concerned with mainstream liberal and social democratic objections to economic democracy in an attempt to avoid preaching to the converted. However, in this chapter since we’re assuming the existence of a market socialist society, it makes sense to consider objections from the other side – those who are already committed to socialism of some sort (cf. G. A. Cohen, 1995; Devine, 1988; Hahnel, 2005). Although it is far beyond the scope of this chapter to present a comprehensive detailing of left critiques of market socialism, there are four central objections that deserve mention: the ignoring of consumers under economic democracy, the inequality of market systems, the injustice of market systems, and the degradation of human beings under market systems – arranged here from what I take to be the least persuasive to the most persuasive. Discussing these objections gives us a more nuanced understanding of the relative strengths of market socialism.

3.1 Objection 1: Economic democracy ignores consumers

Economic democracy is a form of market socialism that could be called “socialism of production” (R. J. Arneson, 1992). It is thus open to the following critique: economic democracy does little to remedy the biggest problem of contemporary capitalism: people’s poverty, i.e., their inability to consume. It is too focused on production and producers and largely ignores the freedom of the consumers. So things like Van Parijs’ (1995) basic income or Ackerman and Alstott’s (2003) stakeholder grant or Roemer’s (1994) coupon socialism – i.e., “socialism of consumption” – are, so the critique goes, more important goals than broader economic democracy.
I have no disagreement with the point that a basic income would be a fundamental improvement to contemporary society. I have largely avoided discussing it not because I think it unimportant but because to do so would require a book in itself. Economic democracy is not a panacea, solving all society’s ills, nor is it meant to be one. Its focus on democratizing work is not meant to imply that empowering consumers is therefore unimportant. Yet while I agree that a basic income (or stakeholder grant or equivalent) would be a vital component of any socialist society by boosting people’s power to consume, I disagree that such is entirely separate from economic democracy.

Democratizing the market requires, first and foremost, a way to provide dollar-votes to the poorest people, as a method of enfranchising them. In other words, a democratic market requires something like a basic income in order to guarantee all citizens a standard amount of “votes” in the marketplace. Thus a basic income should be seen as a well-fitting complement to economic democracy, rather than something that is antagonistic to it.

A related objection is that even if people have a basic income, the market doesn’t provide consumers with any kind of direct say over production. It might be argued that since a firm’s practices often affect the community it is in (through prices, employment decisions, pollution, decisions about relocation, etc.), above and beyond the immediate workers, the community should have some influence in the firm’s decision-making structure. It’s undeniably true that the decisions of firms directly affect workers, as well as more ambiguously indirectly affecting the larger community in a variety of complex ways. So the question becomes: where should democratic boundaries be drawn? What kind of “effects” do we consider serious enough or consistent enough to warrant direct democratic involvement? Archer (1995) provides a sensible response. He argues that workers are directly affected, and subject to the authority of the firm – and so should have a direct democratic voice therein, whereas consumers and the larger community are indirectly affected, so should be entitled to indirect influence. The rationale for this is the democratic principle of affected interest, whereby people should have a say, presumably in rough proportion, to the degree to which they are affected (Arrhenius, 2004; Hahnel, 2005; Shapiro, 2003). Workers are subject to a firm’s decision every day, in serious, consistent, ways, whereas consumers are usually affected to a lesser degree, often in
vague and unpredictable ways. The market is a good mechanism for providing indirect influence for consumers over the firm’s prices and products – allowing consumers to vote with their dollars for things they like, and to vote with their feet against things that they don’t. Additionally, in economic democracy (as well as social democracy) citizens have some indirect say over things like over things like corporate pollution through pressuring their elected representatives to enact regulations. So this mixture of institutions seems to me an appropriate solution to the differing degrees of affectedness that a democratic system must try to accommodate: workplace democracy for workers subject to the firm, the market for consumers indirectly affected, and representative government for citizens indirectly affected.\(^\text{187}\)

### 3.2 Objection 2: Markets generate inequality

The system of market socialism that is proposed here would obviously not result in a perfectly egalitarian society. There would be inequality of income within co-ops between higher and lower skilled workers, as well as market pressure for co-ops to hire more and more non-members (or contract out non-essential work to non-members) who could be paid a lower rate. There would also be inequality between co-ops, as some would prosper more than others. Indeed, some co-ops would become very successful and hence become much larger, and their workers substantially richer than others. Is this system therefore an abandonment of the socialist goal of equality?

This objection is not hugely persuasive. The system’s progressive taxation rectifies the largest inequalities of wealth, while the inheritance tax prevents the remaining inequality from solidifying into cross-generational class privilege. Again, in capitalist society it is generally impossible to raise taxes high enough to substantially reduce inequality, but in

\(^{187}\) Some socialists have proposed that firms should have municipal representatives on their boards in order to give the community more of a say over production (Devine, 1988). While this is an interesting idea, two issues immediately arise. First, who would pay the salary of these officials (since if they’re on boards of every medium-size to large firm, there would be thousands and thousands of them across the country)? If the firm pays, they are unlikely to be independent; if the government pays, we are talking about a massive public expense. Second, since the officials are to represent outsiders who have no knowledge of the internal workings of the firm, their active involvement may well constitute unwarranted interference. It’s unclear why outsiders need an active say in the firm’s internal workings. All they really need is a “veto” over the rare firm practice that might seriously adversely affect them (such as the practice of dumping poisonous materials into a nearby river). But providing this kind of broad veto is exactly what regulation does.
market socialism this is not a problem since the democratization of investment means that society can raise taxes much higher since it need not worry about investment strike (since co-op workers could only go on investment strike by firing themselves!) The major limit to taxation is the point at which the increased disincentives to work more make such a tax uneconomical (and even this limit is likely to be softer if the taxes come from consumption as opposed to income (A. Przeworski & Wallerstein, 1988)). Neither is there an insurmountable problem about the amount of non-members in firms, since it can be easily legislated that members have to represent a majority or supermajority of workers. It is true that market competition leads some firms to be much larger than others. But this is hardly objectionable. The dynamism of certain firms shows that they are responding effectively to growing consumer demand. Largeness is only a problem if it turns into monopoly, in which case, anti-trust legislation would be necessary to maintain competition so that firms remain accountable to consumers (such practices are common already).

A thornier problem, that we see in some co-ops today, is that a highly-skilled co-op may try to contract out a lot of the firm’s peripheral functions (such as cleaners) in order to keep control concentrated and increase their wages. This is hard to prevent since markets function by allowing firms to freely contract with other firms, so it’s hard to see how a highly-skilled co-op could be prevented from contracting with a low-skilled cleaning firm (or be forced to internally hire their own cleaners). While this kind of contracting out is an issue today (commonly used to try to reduce the scope of a union’s bargaining committee), it would also likely be an issue under market socialism. But the situation would be better in several respects. First, whereas cleaning firms today are often particularly exploitative businesses, in economic democracy such firms would be organized as co-ops. So the cleaners would have more freedom at work at well as increased pay (since there is no employer or outside shareholder appropriating the bulk of the profit). These workers would also have more opportunities to retrain or go back to school than currently, and so would be less confined to low-paying work over the long term.
Yet it’s true that this system would not bring about strict equality of income. On the one hand, inequality is generated by external competition between different co-ops, as some firms prosper more than others (we discuss the justice of this below). On the other hand, co-ops may internally decide to adopt a certain level of inequality amongst their workers. But this is not hugely problematic either. Allowing for a degree of difference in wages within firms is useful for providing motivation for all those people – who likely constitute the large majority – for whom complete equality would be de-motivating, and for whom material incentives to work hard are required. Not only do firms need to be able to offer different wages in order to signal where workers are needed, but Alec Nove makes the important point that pay differentials are essential if workers are to be free to move and not directed by some bureaucratic body. The alternative to market inducement is bureaucratic compulsion (Nove, 1991). This means that any socialist who, on principle, refuses the use of material inducements by insisting on absolute income equality, can only do so by spelling out how workers would be motivated to move to different jobs without overt coercion.

Overall, we can expect that the levels of inequality that would exist in market socialism would be limited and not unacceptable. They would be far less severe than the inequality that exists in even the most egalitarian welfare state today. Moreover, the deeper point is that we should be more concerned with inequality of power than of inequality of money (Miller, 1993). The goal should not be a society where everyone has exactly the same amount of dollars (such a society would struggle to function) but rather a society where everyone has similar amounts of power to self-determine and live their lives as they choose. As long as the poorest in society have enough wealth (from a basic income) and educational opportunities so that their life opportunities are not seriously mitigated, as long as they are not powerless and without voice, it’s not really an ethical concern how much money the richest have, since money is only consumption-potential, and who really cares if the rich are able to overly stuff themselves? We need not be Buddhists to doubt that happiness and wellbeing comes simply from massive consumption. As long as inequalities of power and basic opportunities are minimized, we need not be so concerned about the inequality of money. And in this sense market socialism is an incredibly egalitarian society. Market socialism would be a much more structurally equal society.
than societies today, since the major levers of the economy (workplaces, participatory budgets, local banks, etc.) would be controlled by people on a one-person one-vote basis – by the poor just as much as the rich. The bottom line is that the marginal inequality of wealth that market socialism permits is not a major ethical problem, while on the contrary it plays a useful social function of providing motivation and coordination without coercion. Insisting on strict economic equality would do more harm than good (G. A. Cohen, 1995; Schweickart, 1996).

3.3 Objection 3: Market systems are unjust

The next major objection to market distributions, particularly vis-à-vis labour markets, is that they are unfair and unjust. With markets for labour, you get situations where, for instance, basketball players will make millions more than, say, slaughterhouse workers. This is not because they need the money more, nor because the work is harder or they have put in more effort or made greater sacrifice, but largely because they were genetically lucky, blessed with height and agility. Another way to say this is that market systems reward those with more human capital, and such is obviously distributed somewhat randomly, often unequally, and not according to any ethical criteria. Likewise, the amount of money that different firms make is, to a degree, the product of luck. Two restaurants could serve similar food, of the same quality and price, yet if one is located by a train station it might boom, until the train station shuts down, making it go bankrupt, through no responsibility of its own. For these reasons socialists have traditionally argued that market remunerations are unjust – including those that would occur under market socialism. Maurice Dobb put it this way: “to speak of a market for labour… would be to invite strong disagreement from many, who would expect income differences to be determined by other considerations than market scarcities and transitory conditions of demand and would deem it incongruous if a socialist society failed to give ethical considerations a place in its incomes-policy” (qtd. in B Jossa & Cuomo, 1997, p. 125). The main critique is thus that markets don’t remunerate ethically (e.g. according to need, or effort). A correlative critique is that even if firms or co-ops wanted to remunerate

\[188\] The classic socialist maxim for ethical remuneration is Louis Blanc’s (appropriated by Marx): from each according to his ability to each according to his need. However, there is much contemporary debate about
ethically (e.g. pay their engineers only as much as their cleaners), the market would undermine the attempt to do so since the highly-skilled could always leave for better pay elsewhere (Hahnel, 2005).

It’s true that under market socialism, remuneration would be partially driven by market competition, so that those with more education, training, and ability, are able to command higher wages. I accept that this is not ideal, especially so for those who have limited human capital through no fault of their own, such as disabled people. But the situation would be much better than at present. In market socialism remuneration is democratically controlled, so although competition provides certain limits that can’t be completely ignored, the workers can collectively decide the distribution of wages within these limits. Indeed, since firms are co-ops, i.e. governed by the collectivity of workers with heterogeneous preferences, we can expect to see a much greater range of remuneration schemes than under capitalism. For instance, some firms will likely pay equal wages to all, some may set up balanced job complexes and remunerate according to effort as evaluated by one’s co-workers, some will use alternative schemes – just like we see today even with the small number of co-ops. The point is that wages are not automatically set by the market – they’re always filtered through firms which, if structured democratically, have significant power to adapt according to the members discretion.

The problem of unjust remuneration is particularly exacerbated by having a society that is incredibly unequal in terms of human capital. Market socialism significantly reduces the injustice here by reducing such inequality. Market socialism would provide high levels of public education, training and retraining programs (such as Active Labour Market Programs) so as to provide high levels of human capital to all job seekers, as well as providing additional protections for those less able to work – for instance by providing generous disability support, parental leave, injury insurance, etc.

So it’s true that remuneration under market socialism is not perfectly just (whatever that might mean). But the worst aspects of such injustice (such as poor families remaining

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whether this maxim provides a satisfactory ethical basis for remuneration. For instance, other contemporary socialists have argued that instead of “need”, remuneration should occur to each according to their effort (or personal sacrifice), since it is only this that an individual can be held responsible for (Hahnel, 2005).
poor for generations) are substantively diluted. Everyone has an equal opportunity to go
to school throughout their lives to increase their human capital above and beyond what
nature endowed them with, and all workers can vote to change their remuneration
practices in their co-ops. Furthermore it is not particularly persuasive to say that a system
is unjust in the abstract. No system is perfect, except of course in the imagination. So this
critique of market socialism has teeth only to the extent that there is a better practicable
alternative. Yet for reasons that I’ll discuss below, I think it doubtful that there is a better
alternative for allocating wages than a (regulated and democratized) labour market.

3.4 Objection 4: Markets degrade human relationships

Market systems are immense machines able to achieve stupendous results of coordination
(bringing coffee from a bean in Guatemala to a cup in Toronto for less than a dollar), but
the basic fuel on which they run are the unattractive incentives of greed and fear. Of
course, most people work for a variety of additional motivations (self-esteem, enjoyment
of working with others, etc.), but nevertheless, fear and greed are often predominant.
Since market societies operate on the basis of fear and greed they inevitably inculcate
everyone with a certain degree of anti-social values: competitiveness, individualism,
egotism, selfishness, etc. If, as Bowles (1991) says, the market is a gigantic school, it is
one that teaches terrible values. Since markets are based on sentiments of selfishness and
individualism they likely play an important role in generating a rightwing politics of
resentment: hatred of immigrants, of welfare recipients and the “gravy train” – indeed
resentment towards anyone who is seen to be getting unfair help in what is perceived as
the “natural” competition of life. So economic democracy, in maintaining a market, can
be criticized for taking humans as they are, and not attempting to mould them into
something new and better. In Schumpeter’s words:

Constructing a ‘market’ of consumers’ goods and of orienting production according to the indications
derived from it will come nearer than any other, for instance the method of decision by majority vote,
to giving each individual comrade what he wants – there exists no more democratic institution than a
market – and that in this sense it will result in a ‘maximum of satisfaction’. But this maximum is only a
short-run one and, moreover, is relative to the actual desires of the comrades as they are felt at the
moment. Only outright beefsteak socialism can be content with a goal such as this. I cannot blame any
socialist for despising it and dreaming of new cultural forms for human clay, perhaps of a new clay
withal; the real promise of socialism, if any, lies that way (qtd. in B Jossa & Cuomo, 1997, p. 120).
This is probably the deepest critique of markets: that they degrade human relations (G. A. Cohen, 1995; Miller, 1989). Miller argues that markets encourage people to see each other as competitors, their neighbors as rivals and the world as hostile. “They transmute all human intercourse into exchanges in which each party seeks to use the other for his own private ends” (Miller, 1989, p. 200). For this reason various socialists and anarchists have rejected market socialism, trying to think of ways to replace the economics of greed with the economics of solidarity and mutual aid (Hahnel, 2005).

It is hard to deny the force of these objections. It’s true that the fuel that provides the motive force behind markets is a mixture of greed and fear. These provide the basic incentives which push and pull actors to respond to price signals. Yet no one can deny that they are ugly motivations, which, when permeated through society, tend to make it ugly too. That said, the key question, ultimately, is the one posed by Keynes. It’s one thing to think a system ugly, it’s entirely another to know how to replace it. Capitalism, Keynes said, “is not intelligent, it is not beautiful, it is not just, it is not virtuous – and it doesn't deliver the goods. In short, we dislike it, and we are beginning to despise it. But when we wonder what to put in its place, we are extremely perplexed” (J.M. Keynes, 1933).

Every economic system requires coordination which in turn requires clear incentives. To put the issue bluntly, capitalism works primarily through the incentives of fear and greed, Communism through fear and force, and economic democracy through self-interest as well as the solidarity inherent in cooperative work. In principle, how could one ever object to an alternative to the market that seeks to coordinate economic activities through entirely different incentives, such as altruism and solidarity? My objection is simply pragmatic. At this stage of human history, it is difficult to imagine. Is it possible for a society to transcend individualistic values? Will the bulk of people study, sweat, work late, go to the office day-in day-out for 30 years or so if doing so wasn’t connected to any concrete material rewards? Is it possible to sustain moral motivations to work hard over the long term in the absence of material motivations? I don’t know. Perhaps it’s not
impossible, but without any examples, at least on a small scale, healthy skepticism seems entirely appropriate.

At present, competition and the desire for material reward do seem like necessary incentives to achieve coordination and innovation in massively complex economies. So the chief advantage of market socialism is that it’s designed to gain the practical advantages of market competition while diluting the ills that come with it. Yet while market socialism does still rely on competition to achieve coordination, it doesn’t follow from this that human relations are therefore just as degraded as they are under current capitalism.

For example, in *Back to Socialist Basics*, GA Cohen reiterates the socialist critique that a basic problem of the market is that it induces people to see each other in terms of fear and greed – which he condemns as “horrible ways of seeing other people” (1997, p. 35). Yet we can expect human relationships under market socialism to be markedly improved, since the majority of people would spend the bulk of their time in cooperative institutions. It may be true that the broader level of impersonal market relationships – the buying and selling that occurs in a store or online between people who don’t know each other and are not likely to meet again – are ultimately based on fear and greed. But because these are such impersonal and fleeting interactions, such sentiments are significantly watered down; whatever bitterness exists is of a mild variety. When I buy my fruit and milk from my grocer, even if I think his prices are too high, I don’t feel much of anything towards him, and he, likewise, reciprocates this ambivalence. Where market incentives of greed and fear are more likely to contribute to deeper problems, lasting conflicts, and psychological stress is in long-term, personal relationships, such as the ones that are experienced at work, precisely because they are personal and long-term. So whereas Cohen thinks that markets *in toto* are afflicted by the corrosive sentiments of fear and greed, I think that such problems are particularly acute in workplaces. Yet in market socialism, workplace democracy would hopefully alleviate a good portion of this antagonism since the internal social relations are organized on egalitarian and cooperative principles. It’s generally (though not universally) true that the feelings of competition, suspicion, and animosity that are so prevalent in hierarchical firms are somewhat
diminished in co-ops (though it would be unrealistic to expect them ever to be abolished altogether). More broadly, just as capitalism is a fundamentally competitive society, economic democracy is a fundamentally democratic society — so it seems undeniable that the values of democracy (such as equality and solidarity), institutionalized in all the main institutions of society, would leave their definite imprint on social relations.

4 Are There Better Alternatives to Market Socialism?

As I’ve said before, it’s not enough to critique economic democracy for being imperfect — every system is. The only real critique is to say that something better is possible. Yet with our current level of knowledge and experience I don’t think we can say that with any confidence. What are the alternatives to a market system? This is obviously not the place for an exhaustive account, but it’s useful to register the main points.

4.1 Central Planning

The only alternative to markets that we’ve actually seen in practice is that of centralized state planning. Although the USSR largely discredited this idea, some Marxists still argue for centralized state planning (though with a democratic state instead of a dictatorship).\(^{189}\) There are, however, five deep problems with central planning (Roemer, 1994; Schweickart, 1998). Firstly, complex economies produce such massive amounts of fast-changing information, that planning is incredibly difficult if not outright impossible. Secondly, centrally planned economies lack the incentives for people to respond to information, thus becoming severely inefficient. The USSR suffered from three fundamental principle-agent problems in this regard. Workers had no incentive to listen to managers, since they couldn’t get fired for slacking off nor get more money by working hard. Moral incentives of solidarity and the common good were able to provide some

\(^{189}\) On the possibilities of (democratic) central planning, see the fascinating debate between Mandel (1986) and Nove (1987).
motivation, particularly in times of national crisis, but were unable to sustain motivation over long periods. Likewise, managers had no incentives to listen to the state planners, since they knew they would be bailed out if they lost money (leading to soft-budgets), as well as knowing that they wouldn’t be permitted to keep any excess profits if they did well. In fact, managers had huge incentives to *mislead* the planners – to overestimate their costs and underestimate their capacity, to make their lives that much easier. Finally, planners had no incentive to listen to the public, since the public had no way of articulating their demands – without a market they simply consumed what they were given.

Thirdly, centrally planned systems proved deficient in their ability to innovate, since there was no negative threat of bankruptcy nor positive lure of riches. Fourthly, centrally planned systems are not easy to create. Planning the economy requires a revolution, with massive prospects of large-scale violence, to socialize all property, which makes any such scheme highly risky and unlikely at least in the medium term. Finally, and perhaps most importantly, centralized planning systems are inherently, deeply authoritarian. They concentrate huge powers into the hands of the planners, who must direct the economy like a general directs the army, providing clear potential for tyranny since all power – political and economic – is concentrated in the same hands.

In economic democracy, however, these problems are substantially reduced. The market transmits information in the form of price signals, while simultaneously providing incentives to respond to them in a rational way. There is less conflict between workers and managers since workers *choose* their management (and get rid of those they grow to dislike); workers have incentives (material and moral) to work hard, though it’s true that the incentives that come from fear may be reduced since co-op employment is more secure; and firms have incentives to produce what the public wants in order to not go bankrupt, as well as having the usual market incentives to innovate in order to get rich. Skeptics have often worried that co-ops might prefer to secure market niches rather than innovate, since if they grow and hire more people, the newcomers will get most of the benefits of the growth (B. Ward, 1958). Yet as we saw in chapter 4, the empirical evidence shows that this is not the case: co-ops grow just as fast as capitalist firms. In
practice co-ops often build a drive to innovate into the structure of the firm by mandating a large portion of profits to be reinvested each year. This maintains a constant drive towards innovation, compared to capitalist firms where profits tend to be siphoned out of the firm into dividend payments.

So in thinking about alternatives to the market system we need to be honest about the trade-offs. The competition and competitiveness that market systems bring also bring innovation, accountability to consumers, and a safeguard against centralized power. The market socialist perspective is thus that these goods of the market outweigh the bads, especially since the bads that still exist under market socialism are so diluted (recall that no one goes hungry if their firm goes under).

4.2 Participatory Planning

A more optimistic alternative to a market system is participatory planning where matters of production and allocation are decided in a participatory democratic manner. Classical anarchism gestured in this direction, though it shied away from fully worked-out schemes (e.g. Berkman, 1929); Guild Socialism belongs to this tradition too (Cole, 1920). Today, participatory economics or Parecon is probably the most well-known and sophisticated version of such models (Albert, 2003; Albert & Hahnel, 1991a, 1991b). The basic idea of all such models is that producers organize themselves into self-managing bodies, representing the workers (sometimes called workers’ councils or syndicates), while simultaneously citizens organize themselves into community bodies representing the consumers (sometimes called community councils or communes). These two sets of organizations are then supposed to communicate between each other in order to coordinate production and distribution. But of course, figuring out how this “coordination” will actually proceed is enormously complex. Contemporary models of participatory planning – such as Parecon – make extensive use of computers to help with the gigantic tasks of trying to coordinate supply and demand across the economy, but

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¹⁹⁰ For good debates about the feasibility of Parecon see Albert’s debates with Schweickart (2006) and Monbiot (2004).
even so, there are good reasons to be skeptical about the possibility of participatory planning.

The biggest problem with participatory planning is that of feasibility. It is doubtful that the economic activities of millions of people could be coordinated without a market. This is because planning requires comprehensive foresight, yet it is extremely hard for consumers to predict exactly what they wish to consume (how many kilometers will I drive this year? How many bananas will I eat? What style of shirt will I want to buy?), and even harder for workers to predict how much they’ll produce (given changes in technology, work organization, etc). The basic problem is that for workers to produce what is desired, consumers have to be incredibly precise about what they want (not just the number of shirts, but size, colour, style, etc.).

Yet even granting that this kind of planning and foresight is possible, how would coordination and adjustment work? Even with powerful computers, it’s difficult to imagine how a complex economy could ever be planned in advance. For instance, if consumers start demanding a new product, a new sound system for example, and a number of firms want to start producing this new product, they will clearly require new inputs from other firms, meaning that upstream firms will have to change their production practices too, which will mean they too need new inputs from others, and on and on – causing ripples of change cascading out through the economy. Since every change in the economy cascades out in incredibly complex ways, and since small changes in some places can create large changes in others, it’s very difficult to imagine a fixed plan that wouldn’t be incredibly rigid or unresponsive (like indeed, the Communist plans were, constantly resulting in shortages, gluts and bottlenecks). Since economies are clearly not simple linear systems – but experience non-linear behaviour (e.g. Panas & Ninni, 2000), positive feedbacks (David, 1985), and sensitivity to initial conditions – they are inherently unsuited for planning. Just as the flutter of a butterfly’s wings can cause a storm half a world away, so a purchase of a newspaper in one area could conceivably lead to the closure of a car factory in another. Even the most powerful computers are of limited use in predicting and planning complex systems such as this.
In any society, a complex economy can only work if it provides ways for decentralized information (what Hayek called “tacit information” from local agents) to circulate rapidly, as well as motivation for people to respond to such information. Yet even if information could be effectively disseminated in a planned economy (perhaps with workers and consumers constantly at their computers updating their production and consumption plans), which is already extremely doubtful, it is even harder to believe that there would be sufficient motivation to respond to this changing information. To return to our example, if consumers start demanding a new sound system, who decides which firms will shift their production practices? How many firms should shift? What if firms don’t want to shift? Why wouldn’t they just stick with what they know? Since in most visions of participatory planning, there is no central state to threaten violence, nor any possibility of great riches, such systems must rely entirely on the goodwill of socialist citizens to work for the common good. Will such motivations be sufficient to keep the economy running? Such is an empirical question, and can only be guessed at until there are actual examples. Definitely we have examples of countries in wars and revolutions that manage to galvanize massive efforts for “the common good” – but I know of no examples of this motivation providing the main force for economic effort over a number of years. That doesn’t mean it’s impossible, it just means we should be skeptical until we can see at least partial evidence (for instance, a small town or village operating with participatory planning). In general terms, we can say that while participatory planning is perhaps superior to centralized planning in that it is much less authoritarian and perhaps more likely to acquire decentralized knowledge, it suffers from even greater incentive problems.

A final issue of feasibility is that participatory planning, like central planning, would require a full-blown revolution in order to make all property social – thus making the prospect of such a system remote (though not impossible).

Connected to this is the second major issue with models of participatory planning – the problem of transition. Anarchistic societies envisioned by participatory planners are nothing like contemporary societies. Our current institutions have been completely uprooted and replaced with things entirely new. So such schemes are utopian in the sense
that they involve wiping the slate clean to start again. They require not just new institutions but new kinds of people, “a new clay withal”, as Schumpeter would say. Such utopianism has a great pragmatic difficulty: how will we ever get from here to there? What are the intervening steps? If one cannot show how the institutions of the future are to be built slowly from what really exists today, then one is forced to lean heavily on the theoretical crutch of revolution whereby society is somehow magically transformed “after the revolution” to the theorist’s required specifications. Models of participatory planning like Parecon have long been criticized for this (Monbiot & Albert, 2004). In ignoring questions of transition, the ideal opens itself up to criticism that it is unpersuasive and utopian. Even more than this, there’s always a worry that utopian thinking – i.e. imagining a society radically divorced from the contemporary world – contains within it a dangerous will to suppression. If society is to be changed rapidly in some kind of radical rupture, what is to happen to those who dislike the new society? Will they be culturally re-educated? Banished? Jailed? Drawing visions of utopia requires wiping the canvas clean, but what does it mean to clean the canvass of an existing population? André Gide’s warning is well taken: “Let us beware of those who want to apply communism [or anarchism] coldly, of those who want, at whatever cost, to plow straight furrows on a curving field, of those who prefer to each man the idea they have formed of humanity” (2000, p. 377).

In contrast, one of the major strengths of economic democracy is that it is not a blueprint for a perfect order, but a direction of radical reform. Throughout this work a lot of attention has been focused on outlining possibilities for transition. The central motivation for this is the conviction that a vision of a better society is infinitely more persuasive when one can see how the institutions of today could, slowly but surely, develop towards institutions of the future. We don’t need to be able to map each and every step of transition, but we do need to be able to conceive of a plausible trajectory of institutional change. Economic democracy doesn’t require a revolutionary break in history to come into being, it grows slowly and messily from the real institutions existing today. Recall that of its four constitutive components – co-ops, democratic banks, participatory

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191 Robin Hahnel, to his credit, has in recent years increasingly focused on practical questions of transition (Hahnel, 2005).
investment, and a regulated market – *we already have real practical familiarity with all of them*. We have familiarity with worker co-ops; extensive knowledge of the market; a fair amount of experience with participatory investment in the form of participatory budgeting and communal councils. Democratic banks like DCBs are the least well explored, but even here we have real world familiarity with close siblings, such as credit unions and Mondragon’s CLP. Economic democracy thus requires only the building up of the democratic tendencies *already present* in society, not a complete destruction and recreation of society. Such a society, it seems to me, is different enough to be worth fighting for, yet similar enough to what we know to be conceivably built from where we are today. It is concrete enough to be compelling, yet flexible enough to be adopted by activists in largely different circumstances, since there is no canonical program, only an insistence that economic power be recognized – in workplaces, financial and investment structures – and democratized where possible. The best methods for doing so are open for debate and experimentation.

### 4.3 Summary

Let us sum up. The strongest critique of the kind of market socialism envisioned here is that markets depend on competition fueled by ugly motivations, such as fear and greed, which fundamentally poison human relationships. But I’ve argued that at least in regards to economic democracy, this is only partially true. It’s true that market socialism requires competition, and material incentives would play a role, but it’s not true that human relations are therefore poisoned. The worst effects of competition have been substantially diluted. The social safety net means there is no risk of extreme deprivation, hunger or homelessness, from losing in the competition. There is still competition between firms (i.e., between people who don’t know and won’t likely meet each other), but internally, where there are long-term face-to-face relationships, these are based on cooperation and formal equality. Moreover, I’ve argued that this critique is only valid to the extent that it can offer a superior non-market alternative. But, as we’ve seen, such a possibility seems unlikely. State planning is possible but undesirable; participatory planning is more desirable, but at the very least we should be agnostic about its possibility. We should have healthy skepticism to any system so far removed from actual practice.
This means that there is no obvious alternative to a market system. Indeed, the analysis here suggests that those who are interested in feasible socialism should not be implacably hostile to markets. While markets have their defects, they also have their virtues. Markets provide incentives to engage in destructive behaviour (such as consumer manipulation and disregard of the environment), but they also provide incentives for producers to be accountable to what consumers want. Market competition makes winners and losers, but it also brings innovation. Market coordination via pricing makes society care a lot about money, but it also provides information and motivation to coordinate a hugely complex, constantly changing system. Markets generate inequality, but they also allow for workers to choose where to work without bureaucratic compulsion. So Schweickart is right: “neither market fundamentalism nor market rejectionism is an appropriate response to the reality of economic complexity” (2006). The most viable path for feasible socialism today is to seek institutional ways to embrace the virtues of the market while minimizing its defects.

Ultimately, there is no contradiction between, on the one hand, looking forward to a day when human development allows for the possibility of a non-market society – where the bulk of people are motivated solely by generosity, mutual aid and solidarity – while, on the other hand, feeling doubtful than such a society will exist within the span of our lives, and hence concluding that economic democracy as a form of market socialism is a much more viable goal to strive towards. Of course, nothing about market socialism precludes the establishment of utopian alternatives (indeed, in many ways, it gets us much closer by establishing a lot of the groundwork), but it doesn’t require it. Those who hope for a utopian future can see market socialism as realistic half-way-house, while those unmoved by utopia need not be bothered by its absence.

5 Conclusion

A decade into the 21st century the current neoliberal system seems strangely both invincible and doomed. The system has no clear competitors, and the world’s elite (as
well as a sizable portion of regular citizens) seem united in their conviction of the superiority of free markets and liberal politics bound together by the string of shallow political democracy. Yet the extreme inequalities that exist in and between countries, and the increasing likelihood of environmental catastrophe from global warming, both undermine the apparent stability. The system seems at once unlikely to continue but unable to change course.

It’s increasingly looking as though our societies have three broad possible futures. The first is to stay on the same path, driven by the inertia of the status quo, and the liberal faith in unregulated markets and avaricious people to regulate themselves, combined with the conservatism of those in power to hold onto their way of life, the blind indulgence of the middle-classes, and the powerlessness of the poor to do anything about it. Unregulated global markets, mobile capital, and de-unionization create a race to the bottom destroying local safety nets and undermining social security. In the south, massive inequality and environmental destruction (from desertification in Africa to the sinking of large parts of Bangladesh) cause increased poverty and mass migration. In the north, the undermining of the welfare states combined with competition from the south causes islands of prosperity in seas of poverty. Both the first and third world develop gated communities and fenced off slums. Liberal values of freedom and equality continue to be preached while their material manifestations disintegrate more and more.

The second possibility is that environmental and social breakdown – combined with welfare state disintegration and mass immigration – leads to increasing xenophobia and social conflict, which expresses itself in a popular backlash against the status quo. The backlash is channeled by demagogues into anger at migrants and minorities and contempt for liberalism’s individualism and free markets, thus bringing a desire for strong leadership and state security, culminating in authoritarianism and perhaps even fascism. The rise of the extreme right across Europe is a particularly foreboding omen of this.

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In a worldwide poll, the majority of respondents in every country, except France, agreed with the statement that “the free market economy is the best system on which to base the future of the world” (WorldPublicOpinion.Org, 2006).
The third and most hopeful possibility is that environmental and social breakdown lead to a backlash which instead is channeled towards a radical deepening of democracy. The masses of people intimately affected by economic power demand increasing control over their own lives. Instead of directing anger at each other, the backlash is directed at unaccountable power – multinational corporations, corrupt governments, bankers and billionaires – demanding restitution in the form of enfranchisement: self-government in politics, self-management in economics, self-determination in general. Organs of self-management are thus developed throughout the economy so that the people are able to shape the market to serve the interests of the population at large: strict limits are put on the economy’s size, mass redistribution of wealth occurs, alongside transformation of firms from hierarchical corporations to democratic co-ops, with the democratization of the banks, and decentralization of investment – all serving to empower those who have been previously excluded.

Of course there is no way of knowing which of these possibilities is the most likely. All that we can do is start working towards the option that we would like to see. All we can do is start laying the groundwork for economic democracy so that people become better able to experiment with institutions they direct in order to further their own capacities and extend the means of controlling their own lives. All that we can do is struggle to bring this age-old aspiration of democracy – of equality and people power – a little closer to reality.
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