

The long-term coherence of cooperatives is more a matter of principles than facts

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Abstract:

Cooperatives are organizations with, in principle, a democratic governance; but they can be legally organized in quite varied forms, which, in turn, condition the potential expression of short-termism. When the profits placed in a reserve fund cannot be “shared” (nor directly appropriated), a short-termism specific to cooperatives might arise. Although cooperatives are not always true to their principles, the latter serve, nonetheless, as a source of inspiration for their plans and eventually as a reference mark for evaluating the organization.

Cooperatives made a comeback after the collapse of Communism. In the first decade of this 21st century, the Lip experience in France was cited as an example, an antidote for “disposable jobs” and “stock market layoffs”. Against the short-termism of the markets, cooperatives were said to allow for virtuous economic relations and the creation of stable jobs thanks to sustainable business models. Like Lip, Manufrance and the Société Générale, consumer cooperatives have also, of course, filed for insolvency. If that left some pundits unmoved, the merger between Brandt and Fagor would bring to light other difficulties: the cooperative did no favors to the wage-earners of the financially troubled firm it was trying to absorb. Hard-core believers thus argued that Fagor was a bourgeois cooperative, while regretting the good old days when the [Communist] Party grew stronger by purging the weakest, accused Titoists of being snakes and shot them. The intellectually honest have contemplated the abyss of perplexity represented by this elusive topic before telling themselves that, if cooperatives actually had a sustainable business model, that would end up being known some day. Is it possible to advance the appointment of this last judgement and form, right now, an idea about the long-term potential of cooperatives?¹

¹ This article has been translated from French by Noal Mellott (Omaha Beach, France). The translation into English has, with the editor's approval, completed a few bibliographical references. All websites were consulted in June 2020.

The first reason cooperatives are known as being “long-term” has to do with jobs. But to offer steady jobs, a firm must, quite simply, last. How do cooperatives measure up in this regard? Some critics have accused them of dilapidating the heritage accumulated by the firm’s founders, while, on the contrary, other critics have embellished them with the virtues of production, since workers freed from the alienation of capitalism are evidently motivated. Political and ideological biases have made this topic poisonous, but let us hope that the recent enthusiasm of researchers for it will help us see more clearly.

What are cooperatives?

The idea of “cooperation” is vast. The International Cooperative Alliance’s “Statement on the cooperative identity” (1995) defines principles of autonomy and democracy. These principles are upheld by both cooperatives and many nonprofit organizations, excluding, of course, those nonprofits with, for example, an authoritarian management.² This statement does refer to property rights to make distinctions among cooperatives. So it concerns both socialist cooperatives (*e.g.*, self-managed firms in former Yugoslavia or the kibbutzim in Israel) and cooperatives under private law. The latter are not “capitalistic”, since production is not under the control of capital in proportion to the number of shares held and since shareholders do not choose top executives. In contrast with capitalism, the members of cooperatives make decisions following a democratic principle (one-person/one-vote).

The actual legal status of cooperatives under private law is variable. On the European continent, there is often one or more such statuses. In France, there are many such statuses: *société cooperative et participative* (SCOPs, worker cooperatives), *société cooperative agricole* (SCs, agriculture cooperatives), *société cooperative d’intérêt collectif* (SCICs, multistakeholder cooperatives with share capital), *société cooperative d’habitants* (housing cooperatives), *société cooperative européenne* (SCEs of which there are four types under European legislation), and banking cooperatives. Some cooperatives are similar to firms, for example: Mondragon Corporation in Spain (DURANCE 2011), Coop Italia, Crédit Agricole and Limagrain (one of the many agricultural cooperatives in France). In countries under common law, the legal existence of cooperatives might take the form of partnerships (in France: *sociétés en nom collectif*, SNCs). Such is the case of the cooperatives for producing plywood studied by Pencavel and Craig (1994). In the case of the John Lewis Partnership in the United Kingdom (STOREY *et al.* 2014), the firm’s assets have been placed in a trust (by its founder for wage-earners). But there are many examples of cooperatives that turn into benefit corporations with a cooperative sort of governance (STAMMER 2016). The legal forms of cooperatives are varied. To tell the truth, it is not even necessary to be a legal entity, evidence of this being the freeware projects in digital technology. As the creator of the GPL license, Richard Stallman (2001) explained, he drew on the ideas related to cooperatives to set up a legal framework for the freedom of association that prevailed at the start of the computer age and to keep collective work from being individually owned.

² Like the French Association for Research on Cancer, whose president was convicted of a breach of trust in 2000.

Can this diversity of legal forms be reduced to a few generic types? By using the criterion of membership, we can come up with a typology of cooperatives of physical persons, entities, firms, associations or administrations. Under French law for instance, the SCICs bring together at least three types of members: manufacturers (*e.g.*, the cooperative's wage-earners), beneficiaries (clients, users, neighbors, etc.), and other physical persons or legal entities that contribute to the cooperative's activities such as: local authorities (who can account for up to 50% of an SCIC's capital), firms, associations, volunteers, financiers, etc. This example with a diversity of members demonstrates the difficulty of establishing *ex ante* a typology on the basis of membership.

At the core of cooperatives seems to lie the idea of cooperation in production. English-speaking studies refer to worker- or labor-managed firms. In French, the term *autogestion*, often translated as codetermination or self-management, evokes the 1970s: the Yugoslav experiment, Lip and the PSU's political program. All of this seems historically outdated, even a myth beyond the pale of history. Nonetheless, self-management theory and empirical studies on it have been updated in the past few years, mainly because economists have started applying new analytic concepts to this hard-to-grasp topic.

Before examining these developments, let us inquire into the personal interests of a cooperative's members. Nowadays, the idea prevails that not everything can be bought and that it is better to keep control over the organization of work than to maximize profits to the detriment of working conditions, the environment and social relations. In contrast, the dominant idea during the 20th century was to gain the upper hand over capital. Let us take a look at the theory.

The theory and its problems

The first studies on self-management concentrated on "Illyrian" firms, the adjective referring to the ancient name of a region in Yugoslavia (WARD 1958). The guiding idea was that cooperative members receive wages but also have a right to a share of the profits. They will, therefore, try to maximize the value added per work unit. Though symbolically important since it proposed remunerating capital and not capitalists, this theoretical model led to paradoxical predictions (*e.g.*, the supply curve does not increase monotonically as a function of the price: its derivative has the same sign as the derivative of returns). Despite this model's questionable relevance for descriptive purposes, Jensen and Meckling's (1979) analysis of the Yugoslavian case formulated a critique listing the problems with this model:

- 1) the problem of sharing the firm's income (likened to the "tragedy of the commons");
- 2) the problem of the untransferable nature of rights to future income;
- 3) the problem of the control (the moral hazard of agency), which is also a question of
- 4) the origin of the firm's assets, in particular those that cannot be bought (in other words, most intangibles); and,
- 5) the problem of the time horizon.

Among these problems typical of socialist cooperatives (SAMUELSON 1957), the first three have been partly settled since the 1970s. Solutions to the tragedy of the commons earned a Nobel prize for Elinor Ostrom, and cooperative members have proposed applying them to their organizations (TORTIA 2018). The solution to the second problem is that, in market economies, cooperatives often allow their members to transfer their right to future income. Focusing on the income from selling share capital, Dow (2017) has shown that cooperatives can be considered to be firms that maximize their profits in the interests of their members. Accordingly, cooperatives are firms with share capital and voting rules (one-person/one-vote). Not all legal systems, however, allow for full transferability. Under French law, shares may be resold only at their nominal value; and in some countries, such as Italy or Finland, (but not in some common law countries) assets may not be shared among cooperative members in case of liquidation. Insofar as a firm's owners are also its managers, the third problem is also cleared up, at least in theory.

So, left hanging are the problems of the origin of assets (which I shall keep for the end) and of the time horizon. As these theoretical considerations show, cooperation raises open questions that call for research.

According to Pejovich (1992), if workers' rights are not transferable, then the time horizon of their decisions is their retirement age. When this horizon is shorter than that of financiers, cooperatives are going to make inefficient investments, since, instead of taking account of the current net value over the investment period, they will use the criterion of the number of years from retirement. In this case, they will distribute to their members profits even though they are unable to pay off their debts. Groups of ageing workers, who have the shortest decision-making horizons, are the most inclined toward this short-term bias. In the 1990s, the state of the Yugoslavian economy, along with the crisis of Israeli kibbutzim (RUSSELL *et al.* 2013), provided examples (relatively in line with Pejovich's comments) that were cited to condemn socialist cooperatives. These condemnations took the place of efforts to apply an econometric analysis to the model.

Although socialist cooperatives proved to be inefficient, cooperatives owned by their members could, on the contrary, be more efficient than capitalistic firms since this form of cooperation limits conflicts of interest related to the principal-agent problem and since members are better paid and oversee each other (PENCAVEL & CRAIG 1994). The purported effects needed to be measured empirically. As Dow (2018) has shown, they are not distributed homogeneously within labor-managed firms. Using the theory of property rights as applied to firms, he (p. 72) concluded that, if more investments are made in specialized physical capital than in human capital, such firms will be managed by capital, whereas they will be labor-managed if investments are the reverse. As he has pointed out, group offices of lawyers, doctors or consultants tend toward a cooperative form of organization. I would add the groups that develop freeware, the programming done completely by users (*e.g.*, Python or Linux, even though there are commercial versions of Linux). Dow's conjecture could explain the choice in favor of cooperation and settle the fourth problem raised by Jensen and Meckling about the origin of a firm's assets.

However the case of self-employed professionals raises a sensitive question about Dow's conjecture. Business partners, if they are part of a democratic work group, are also the owners of their firm's capital, unlike their secretaries, trainees and even young employees. It does not seem appropriate to talk about cooperation when *all* the workers in a firm do not have the same rights with regard to making decisions and having a share in the product of their labor. Furthermore, Dow's conjecture is ambiguous. We understand the basic idea: production processes necessitating human capital are more likely to be worker-managed. The stickler is to make sure that *all* workers have and keep the same rights. An appropriation ("hold-up") of production is always possible, subject to legal requirements about the modalities of this appropriation. In the United States, profits placed in a reserve account may be shared; and the question of short-termism thus arises as in conventional firms (even though few studies consider cooperatives to be normal firms). A few preliminary studies have been made about the cost of capital in cooperatives. For example, Royer (2019) has estimated it at 5-7% for electricity cooperatives and 14-20% for farm cooperatives. In Europe, regulations do not allow for dipping into "unshareable reserve" accounts, and the question of how cooperatives actually remain cooperatives calls for a different answer.

This theoretical examination of cooperatives turns up a paradox: to take account of the long term, cooperatives should be private firms with shares that may be traded without restriction. So, should the regulations adopted in continental Europe be dismantled since they limit the transferability of rights to future income? Before broaching this question, notice that, from this viewpoint, the particularity of cooperatives inheres only in the principle of one-person/one-vote — a principle jeopardized by differences in human capital within the firm. But do these considerations actually correspond the empirical reality of cooperatives?

Are cooperatives stylized facts subject to interpretation?

Given these discomfoting theoretical considerations, the supporters of cooperatives have tried to demonstrate the more positive aspects of cooperation with results from field surveys or quantitative studies. Recent research has been carried out about the motivation of cooperative members, their decision-making horizon and the comparative productivity of cooperatives.

Empirical studies have referred to cooperatives' objectives in order to determine their members' motivations and assess the difference with the maximized profit-seeking of capitalistic firms. The cooperatives thus studied tended to respond to the business cycle by adjusting wages rather than the size of the workforce or the quantities produced (BURDIN & DEAN 2009). This is evidence that the previously mentioned theoretical models (maximization of profits or of the value added per work unit) very imperfectly reflect the rationality specific to cooperatives. We could deduce that cooperatives prefer long-term jobs rather than profits; but it would be illusory to think that they forget about profit-seeking. In France, for example, the Confédération Générale des Coopératives has

recently conducted a study on nonprofit organizations that have become cooperatives:³ there was no other motivation for this change than sharing in the profits. Qualitative studies confirm this finding. In a sample of French worker cooperatives (SCOPs), members were attracted (DUPORT 2009) by the increase in pay and, too, job security. This is consistent with the previously mentioned quantitative studies. So, we could say that the members' objective is to maximize profits in relation to their risk aversion of dismissal. However this explanation does not seem to have been tested. After all, some cooperatives have wage-earning employees who are not members and are not protected from unemployment (a point to which I shall return).

What about the problem of the time horizon in countries where the law limits the transferability of members' rights? Using a French database of firms, Fakhfakh *et al.* (2012) have shown that the rate of capital growth was at least as high in cooperatives as in other firms. Nonetheless, the capital/labor rate was higher in the firms that were not cooperatives; they had, on the average, more capital (controlling for the size). Since this observation is consistent with Dow's conjecture (according to which the production processes that mainly require human capital are more likely to be labor-managed), the time horizon seems to depend on circumstances. Tortia (2018) drew up a list of the reasons (*e.g.*, involving younger members in decision-making) that might counterbalance short-term biases. The legal and fiscal frameworks might also play a role, since members in some Italian cooperatives are, as pointed out, forced to reinvest part of the profits, whereas worker cooperatives in France are exonerated from corporate real estate taxes and from corporate income taxes on reinvested profits. Since it is hard to generalize the findings of Fakhfakh *et al.* to other legal and fiscal environments, we might imagine that the right conditions can eliminate short-termist bias. But what are the right conditions? Research on this topic has barely been undertaken.

A third set of empirical findings has to do with the life cycle of cooperatives, a question directly or indirectly approached by trying to measure their productivity. As Craig and Pencavel (1994) have shown, the cooperatives that produced plywood in the United States had a higher productivity than their capitalistic competitors. However this study was limited to 34 firms. The survey by Fakhfakh *et al.* (2012), which focused on 10,000 conventional firms and nearly 1200 SCOPs, is much broader. The productivity of the cooperatives in this sample was at least as high as in capitalistic firms: *"In several cases, no significant difference appears between the outputs a given type of firm would produce with the technology used by the cooperatives and with the conventional firms' technology. In almost all cases in which a significant difference occurs, the SCOPs would produce more with their own technology [...] In contrast, in a number of industries, conventional firms would produce more using the cooperatives' technology with their current input levels"* (FAKHFAKH *et al.* 2012: 867). What is surprising is that these authors have not pointed out that their method shows, first and foremost, that the conventional firms would have usually been more productive than the cooperatives had they used the latter's methods! These puzzling conclusions are evidence that quantitative research has barely started on this topic and that work must still be done to understand how the cooperative alchemy (co)operates.

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http://www.les-scop.coop/export/sites/default/fr/media/docs-presse/CP_CG_Scop_Transformations_dxassociation_en_coopxative_VF.pdf

Burdin (2014) has tried to compare the average survival rate (and thus average life span) of cooperatives and capitalistic firms. While showing that the former lived longer (when controlled for statistical biases but not for the sector's exposure to international competition), he has offered little explanation, no more than Parkin-Kelly (2019) in her statistical presentation of cooperatives in the United Kingdom.

While these quantitative studies are conditioned by the fiscal and legal frameworks in effect, they point to a superiority of cooperatives on the dimension of time (in matters of jobs, investments, productivity and survival), whence a question: why do cooperatives not dominate the world economy?

Cooperation, a driving force

If cooperative work were universally desirable (for labor-intensive semiskilled or skilled jobs at least), we would reasonably expect it to attract talents. However cooperatives represented only 0.1% of the labor force according to the International Labor Organization in 2013 with maxima of 2% in Venezuela and 5% in Cuba, countries that hardly make anyone dream.⁴ In other words, it is very low. Other statistics⁵ report much higher figures, but they include other sorts of cooperatives (in finance or business) whereas the ILO only covered worker cooperatives. Beyond any bickering about statistics, what is important is to understand the reasons for this low figure.

For activists, the reasons have nothing to do with the cooperative movement. Doucouliagos (1990) has stigmatized the ideological bias of bourgeois analyses and blamed discrimination against workers. Quijoux and Ruggieri (2019) have exposed a neoliberal capitalistic plot against cooperatives. Unfortunately, this sort of demonstration has changed the subject. Even though governments, businesses and banks obviously put little effort into supporting cooperatives, this does not suffice to prove that worker cooperatives are viable and long-term.

When cooperatives actually turn a profit not by consuming their initial (capital) endowment but by sustainably creating value, the models (DOW 2017, WARD 1958) have predicted that their members will try to appropriate the gains. This process, called "degeneration", can occur in various ways.

In "demutualization", members resell their shares to nonmembers with the goal of immediately reaping the profits of their undervalued shares. This might have happened in the North American plywood cooperatives (CRAIG & PENCAVEL 1994), at Norwich Union (which became Aviva) and in other cases. In some countries, legal provisions block any appropriation of the profits on a reserve account, the objective being to avoid demutualization. In Italy, the proceeds from liquidating a cooperative can only be

⁴ ILO statistics on cooperatives can be found on https://www.ilo.org/global/statistics-and-databases/meetings-and-events/international-conference-of-labour-statisticians/WCMS_222036/lang-en/index.htm.

⁵ From wikipedia or Coop.fr: "Panorama des entreprises coopératives. Édition 2020", 24p., available via https://www.entreprises.coop/system/files/inline-files/panorama-entreprises-coop-2020_5.pdf.

transferred to another cooperative. Besides, demutualization does not concern cooperatives alone.⁶ Unfortunately, it is not the only path to degeneration.

A second path is taken by cooperatives that employ, directly or indirectly, wage labor following a merger-acquisition. In this respect, Mondragon has been amply studied: its external growth led this overstretched cooperative to acquire capitalistic firms and hire wage-earners to cope with variations in its business activities. Obviously this can be said to be a betrayal of the principles underlying cooperation, but Durance (2011) has shown that Mondragon's intent was sincere even though it took time for it to be realized. Storey *et al.* (2014) have studied how two cooperatives (John Lewis Partnership and Eroski) trained new members. These qualitative studies seem more conclusive than econometric analyses. Dean (2019) has tried to show that such cooperatives do not degenerate since their relative demand for wage labor does not depend on their profit rate. It is a fact, however, that this demand increases significantly over time! To conclude, degeneration exists but does not suffice to account for the weak showing of cooperatives in statistics.

For Dow (2018), the cooperative movement's point of vulnerability is undeniably the low rate of creation of new cooperatives. In effect, we can count the number of new cooperatives on our fingers. In a presentation of statistics on European cooperatives (BARSAN 2018), the number created per country is consistent with the existing stock of cooperatives in the country — in other words: (much) less than 1% of newly created companies are cooperatives. Furthermore, more than half (of the jobs, of capital) come from capitalistic firms that are being converted into cooperatives: family companies that the owners bequeath to wage-earners (BARBOT-GRIZZO *et al.* 2013, BARGUES *et al.* 2017) or "firms recuperated" against the wishes of their owners (who refused to fund them). After Lip, there were many examples of this in Latin America, in particular Argentina. However this topic is so controversial that objective information is hard to come by. In any case, we can state that turning a firm into a cooperative settles the problem of the origin of the assets mentioned by Jensen and Meckling (1979). Nonetheless, actual creations of cooperatives are very scarce.

For Dow (2017), this scarcity is to be set down to the conditions for a return on entrepreneurial investment. To borrow and adapt a euphemism from Voltaire, entrepreneurs do not work for the king of Prussia. So, in the case of cooperatives, entrepreneurship creates a public good... that will have to be subsidized. Even if, as suggested by Groot and Van der Linde (2017), the subsidy from public authorities were limited to an initial endowment (to, of course, be protected from private appropriation), the relentless demands voiced down through the centuries for subsidies would lead us to believe that the voices arising out of cooperatives represent their members' private interests. This would be evidence of retrieving an advantage for which all of society has to pay. Talk about a long-term vision!

⁶The GNU general public license (GPL) for software was created to avert the individual appropriation of collectively developed software. It has served as the basis for several remarkable projects.

Since cooperative members seek their own profit just like shareholders in publicly traded firms, and since they are willing to recruit wage-earners who will not be members, or to resell their shares, or consume the assets invested by others, examples of short-termism are never lacking among cooperatives. Notwithstanding this, the idea of cooperation conveys long-term values: the inclusion of wage-earners as members, the investment of savings in production based on a sustainable business model. It has also prolonged the life of companies that shareholders no longer wanted to fund or that the owners wanted to convey to wage-earners as a commonwealth. For these reasons, the idea of cooperation is an eternal recurrence despite the failures in 1848 or in the 1970s, and despite Mondragon's problems. Even if a cooperative were but a phase in a company's life cycle, cooperation would still be important because it serves to mobilize workers around a cause (BARGUES *et al.* 2017), as in the development of freeware. Even when a cooperative (*e.g.*, Essilor) seeks to pursue international development, traces of this idea are found in its shareholding and inclusive managerial practices (PALLEZ & PAVÉ 2006). For this reason, research should focus not on cooperatives as entities opposed to the market economy but as essential components of the economy that can potentially provide a response to concrete problems (and enable us to advance in building theories).

Does the behavior of cooperatives tend to be coherent in the long term? The answer has turned out to be as complicated as the question appears to be simple. Cooperation can lead to short-term biases, particularly when members' rights terminate with their labor contract. For this reason, socialist cooperatives are spontaneously short-termist, whereas private cooperatives can barely be distinguished from capitalistic firms. At first sight, private cooperatives seek to maximize profits; but legal provisions might temper the appropriation of these profits, and members might accept to trade their pecuniary expectations for job security. For all that, it would be exaggerated to conclude that cooperatives favor long-term employment, since big cooperatives have a "spare" source of labor that they adjust to the business cycle. In fact, most of the general studies on cooperatives (investment, competitiveness and life span) are too closely linked to the country's legal system or are too vague to provide us with universally valid information for building a theory of cooperatives. This difficulty is not specific to cooperatives: it simply reflects the problems encountered in the theory of the firm (VANEK 1970).

Paradoxically, cooperatives sometimes forget cooperation. All the same, cooperation represents an important ideal, even if worker participation is not the privilege of cooperatives. No study has yet shown that this participation is stronger in cooperatives, a point that calls for tact to be assessed (DUPORT 2009). Besides, cooperation is not restricted to the legal definition of cooperatives (as illustrated with the example of freeware); nor (even though this might seem paradoxical) is it tied to the permanence of this legal status. Legal restrictions related to the status of cooperatives — a counterpart to tax advantages — hinder the deployment of ambitious projects (as at Essilor). The point to be made is that cooperation signals a direction, as companies come into being, change form and, many of them perish. This direction — democracy in the realm of production, the absence of alienation — is important both for citizens who are workers and for the theory of the firm. Cooperation raises significant questions for this theory. The long-term virtue of cooperation inheres, for sure, more in the assertion of a universal possibility than in the perfection of each existing cooperative.

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