

## MACIEJ KOZŁOWSKI

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### Degeneration and development of worker cooperatives – selected aspects

#### Abstract

*Problems of degeneration and planning horizon have been analysed very widely and attempted to be solved through numerous empirical investigations. The investigations in cooperatives and democracy in a workplace also tended to indicate circumstances that accelerate and precipitate degeneration or, alternatively, the internal and external conditions which can help sustain democracy as well as counteract processes transforming cooperatives into typical private enterprises.*

*There are many historical examples confirming that the possibility of sustaining genuinely democratic forms of cooperative organizations through their growth and pressure for greater efficiency is very limited and usually fails. This can be seen among other forms of employee ownership as well, though the post-socialist economies show high incidence of employee ownership. However, the available evidence suggests that the number of employee-owned firms (especially – cooperatives) is declining quite rapidly because of the degeneration process.*

*On the other hand, there are some examples evidencing that degeneration is not inevitable as cooperatives grow. In the economic reality we can observe that various cooperatives face different combinations of conditions and environments that they can interpret, as well as to react to in different ways. Therefore, economic growth and outstanding economic results of cooperatives do not have to be these parameters and factors that are perceived as causing degeneration. Different kinds of empirical investigations show that the opposite is possible, namely, emergence of the regeneration processes that open new possibilities of supporting democratic forms of management in cooperatives.*

## 1. Model assumptions of a self-managed enterprise and its capacity to expand

The fundamental assumption underpinning the self-managed enterprise's model is about workers' participation in exercising power in the workplace. In this model the workforce is the subject of power in the enterprise and either workers or their representatives issue all decisions about enterprise's operations. Following this assumption, labour is considered to be the factor of production by which the enterprise exists and operates. Besides, labour entitles to enjoy the financial surplus. This means that the subjectivity of workers is derived from the very fact of being an employee and not from assets held.

An assumption of a similar rank concerns the objective in operations of the self-managed enterprise. Most authors consider maximisation of income per employee to be such an objective. In their opinion it is valid both in short and long term<sup>1</sup>. One of the authors that advocate this thesis is B. Ward. He says that workers are interested in their pay and profit maximisation per one employee, and that this target dominates in the decisions they make<sup>2</sup>. What remains to be solved is how to attain the target. Income per employee as an objective in self-managed enterprise's operations is also referred to by E.D. Domar who has analysed operations of cooperative firms<sup>3</sup>. Many Polish authors share the opinion that the rate of income per employee is the economic category that determines the objectives of the self-managed enterprise. In the analysis of models of a self-managed enterprise and a cooperative can also be observed objectives other than maximisation of income per employee. Quite often the objectives mentioned are creation of new jobs, improving working conditions and interpersonal relations, increased entrepreneurship, better adjustment to oscillations of the market cycles and more efficient ways of overcoming them, satisfaction job etc<sup>4</sup>.

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<sup>1</sup> The material interests of workers incorporate both current and future wages, i.e. those covering costs and investments. Some problem is, of course, the time horizon of the interests and allocation of the surplus to consumption and development. See: J.E. Askildsen, *Essays on the theory labour-managed firm*, report No. 9/1987, Centre for Applied Research Norwegian School of Economics and Business Administration, Bergen 1987, p. 23.

<sup>2</sup> B. Ward, *The Firm in Illyria: Market Syndicalism*, "American Economic Review", Sept. 1958, Vol. 48, No. 4, p. 571.

<sup>3</sup> E.D. Domar, *The Soviet Collective Firm as a Producer Co-operative*, "American Economic Review", Sept. 1966, Vol. 56, No. 4, p. 736.

<sup>4</sup> J. Vanek, *Marktwirtschaft und Arbeiterselbstverwaltung*, Campus Verlag, Frankfurt, New York 1975, pp. 22–23.

Another assumption concerns the absence of uncertainty and risk in the environment of the enterprise. This translates, amongst others, into the belief that all output of the self-managed enterprise will be sold. This problem is frequently analysed in relation to the assumption on the capital which is treated in this model as hired and paid for factor of production. According to the labouristic principle the enterprise hires external capital and pays a rent for it<sup>5</sup>. It can be noticed that this situation differs from that in the capitalist enterprise. In the latter, capital is a factor of production that generates a surplus, as well as entitles to exercise power in the enterprise.

A question arises whether the above assumption on hiring capital and disbursing only a fixed rent is a realistic one, whether the creditors will accept making capital available (both in the form of money and material) incurring at the same time the risk related to its use without the possibility of influencing the decisions being made. There is a justified fear that no organisation making available loans or capital will approve of such conditions, and that it will expect at least some guarantees or a collateral, a share in the financial surplus and some control of the use of its resources. Yet, this situation is not allowed for in the model of the self-managed enterprise, also external shares in the assets of the enterprise managed by its workforce are ignored. Consequently, a conclusion can be drawn that self-managed enterprises wishing to adhere to the strictly labouristic principles face a definitely different economic reality.

The lack of external support may translate into the necessity to base enterprise's operations exclusively on its own resources. This situation may lead to many constraints, resulting mainly from the insufficient level of capital. Limited resources discourage workers to take chancy decisions, hence enterprises tend to operate in sectors of low capital intensity<sup>6</sup>. The same is indicated by the existing experiences both with the self-managed enterprises and cooperatives that are the worst at managing in the high risk sectors. The model of a labouristic enterprise allows external finance, but through non-commercial institutions specially designed for this purpose<sup>7</sup>.

Let us assume, however, that the enterprises base their operations on self-financing. Operational funds would be derived then from the surplus earned by the enterprise. Allocating a large part of them, or all, to investments would mean

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<sup>5</sup> J.E. Meade, *The Theory of Labour-Managed Firms and Profit Sharing*, "Economic Journal", March 1972, Vol. 82, pp. 402–428.

<sup>6</sup> E.G. Furubotn, *The Long-Run Analysis of the Labor-Managed Firm: An Alternative Interpretation*, "American Economic Review" 1976, No. 66, p. 108.

<sup>7</sup> J. Vanek, *The Participatory Economy. An Evolutionary Hypothesis and a Strategy for Development*, Cornell University Press, Ithaca, N. Y., 1971, p. 44.

a reduction of employees' personal income, which action might be confronted with some sort of their resistance. In such case investments with short return period would be preferred. The problem of self-financing business activities in the self-managed enterprises was already noticed by Ward and it has been valid since then. It seems that solving these issues requires departing from the model principle of labouristic legitimisation and introducing solutions that involve mixed ownership.

One of the commonly taken assumptions in the self-management model is the homogeneity of the enterprise's workforce and a harmony between its members. In practice, this condition is rarely met. It would happen in the past that because of the conflicts of interests decisions made in enterprises provoked quite many controversies. These concerned, amongst others, the volume of employment or investments planned<sup>8</sup>. That this assumption is frequently unmet results from the fact that other assumptions have not been met.

Under this model it is also assumed that the self-managed enterprise operates within a competitive market economy being a natural environment to this enterprise. This implies that the enterprise enjoys, amongst others, the freedom of business operations, freedom of recruiting and discharging employees, freedom of trading in commodities and services, setting prices and terms of transactions<sup>9</sup>. This also means the freedom to enter into and exit the market, and full mobility of the factors of production. State intervention is only possible by means of indirect instruments. The assumption of market economy as the actual surrounding of the self-managed enterprise is strongly accentuated, amongst others, by J. Vanek<sup>10</sup>. From the practice we know however, that in fact self-managed enterprises have functioned in a semi-market economy and in a different environment (limited mechanisms of the labour market, absence of the capital and money market), which may indicate that the enterprises are unable to survive in their model form in this type of economy.

The analysis of the assumptions presented above leads to the conclusion that they present a far-fetched simplification of the principles underlying the operation of the self-managed enterprise. The striking feature is the insufficiency of analyses as well as institutional forms of this enterprise. It is not enough to emphasise the primary differences from the capitalist enterprise, such as replacing capital with labour. The model lacks many facts concerning, for instance, the possible behaviour of the enterprise in the case of changing

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<sup>8</sup> E. Schlicht, Ch. von Weizsäcker, *Risk Financing in Labour-Managed Economies: The Commitment Problem*, in: *Zeitschrift für die gesamte Staatwissenschaft*, 1977, Vol. 133, p. 53.

<sup>9</sup> M. Dąbrowski, *No competition – No Efficiency*, "Życie Gospodarcze" 1984, No. 20, p. 7.

<sup>10</sup> J. Vanek, *Marktwirtschaft und...*, p. 20.

organisational rules, lacking analyses of the decision making process, of the motivation system, etc. This, however, is a problem to almost all theoretical works.

Aforementioned assumptions we can transfer to worker's cooperatives which are firms controlled by their members, who are workers. The cooperatives operate with the following basic principles applied: first, membership is open and voluntary; second, there is democratic control at all levels of the enterprise based on one member, one vote; third, interest paid on share capital is limited; fourth, workers share in any profits, usually in proportion to their work contribution; fifth, some part of the cooperative's profits is devoted to worker education; sixth, cooperatives cooperate among themselves. If a worker cooperative is consistent with these principles, then its success depends on operating an economically viable and democratically-managed business in which workers have the knowledge and capacity to participate in the decision-making process and ultimate control of the cooperative<sup>11</sup>.

Taking into account the assumptions on the cooperatives as presented earlier, we need to state that their expansion capability cannot be viewed optimistically. The assumptions, or at least some of them, can be barriers and limitations in themselves and can obstruct the growth of the enterprises. The greatest difficulty cooperatives face is attracting and retaining talented entrepreneurs and managers. Shared control and limited rewards make cooperatives less desirable to most entrepreneurs unless they are committed ideologically to cooperatives. The issue of employment in the self-managed enterprises deserves more attention. The freedom of recruitment declared in the assumptions was rarely observed in practice as engagement of new employees was limited by the already employed driven by the fear of declining personal incomes. Apart from this, the actual workforce shared the attitude and belief that the newly employed will take advantage of the previously earned profits, which aroused reluctance and significantly obstructed the inflow of new workforce. On the other hand, the lack of capital did not allow in practice large redundancies of employment. Conventional financial institutions are commonly unwilling to lend to cooperatives either because of outright bias or because unfamiliarity with cooperative structures makes it difficult for them to underwrite loans. This phenomenon can be defined as „self-management anomaly”. This stance among the workers was also related to their anxiety that the recruitment of new persons will confine their influence on the decisions taken. Should the need to reduce employment arise, the problems might be similar, as

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<sup>11</sup> C. Dickstein, *Stimulation of economic development through workers cooperatives*, Community Economics Newsletter, Center for Community Economic Development, University of Wisconsin-Madison, August 1996, No. 238, p. 1.

such a decision would require the approval of all employees. Consequently, in the case of an unfavourable market cycle, one might expect stability of employment and a drop of income per employee. For an economy with a large number of self-managed enterprises this stability would mean a considerable reduction of the mobility of the labour force and of the opportunities to compete on the labour market.

The occurring problems might be soothed to some degree by a periodical recruitment of workers not holding membership rights. In this variant we can distinguish the group of permanent workers to be treated as the collective employer and the group of hired employees paid for their labour, which pay is accounted for as typical cost element. Yet, this variant bears some traits of discrimination of a part of the employees and it clashes with the self-management principles<sup>12</sup>.

Let us consider now when a self-managed enterprise may increase employment. It can be assumed that the enterprise would be willing to increase employment if the marginal income produced by the new employee surpasses the present average income per one employee. Given that, it would be extremely difficult for enterprises with high average income to increase it on the basis of the existing production capacity. In consequence, high efficiency and favourable market conditions hinder to some extent further development and obstruct enterprise's expansion<sup>13</sup>.

The reluctance to expand is, according to the model's builders, an advantage as it allows avoiding monopolistic tendencies, and thus reinforcing the mechanisms of competition in the market economy. This opinion is hardly acceptable as expansion does not always results in monopolisation, while almost in all cases it helps win a better competitive position on the market. Let us add that the lack of expansion opportunities may lead to the atrophy of grassroots initiatives and absence of motivation to increase production. It can be expected that an economy with a prevailing number of self-managed enterprises would be unable in the long run to meet consumers' demand or it would satisfy the demand at lower level<sup>14</sup>.

The aforementioned tendency in self-managed enterprises to maintain employment at a low level should conduce to choosing capital intensive

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<sup>12</sup> See: J. Robinson, *The Soviet Collective Farm as a Producer Co-operative: Comment*, American Economic Review, 1967, Vol. 57, No. 4.

<sup>13</sup> It has often been seen as the causes of degeneration.

<sup>14</sup> S. Kawalec, *What Can Be Hoped For in the Self-Management Market Reform*, a paper presented at the conference: Self-Management And Economy, organised at the Socio-Economic Faculty of SGPiS, Warsaw, 6-9 Oct. 1986.

investments at the cost of labour intensive ones<sup>15</sup>. Yet, a problem arises where to find funds for investments, which, as we have already mentioned, may not be easy for a self-managed enterprise strictly adhering to the labouristic principles. Our deliberations clearly indicate that the self-managed enterprise driven by these principles would face a significant resistance when investing into assets that are not held individually by employees. This would translate into the enterprise's low propensity to invest.

Still another problem that may arise in the self-managed enterprise concerns making decisions by employees who prefer maximisation of current wages to accumulation of resources in the enterprise. The employees' drive to have as high incomes as possible in a short period of time, to maximise day-to-day consumption, would question the growth capacity of the whole economy, with prevailing self-managed enterprises<sup>16</sup>.

When taking decisions about investing in enterprise's assets, a conflict of interests may appear between various groups of employees, especially between employees with different period of employment in the enterprise, employees of different age etc. It can be expected that the inclination to give up current income in favour of future profits will be different across these groups. It is unreasonable to expect a support to such decisions among older employees approaching retirement, that is, living their last days in the enterprise. Such decisions can be backed up by younger workers, associating their future with the growth of the enterprise. Beside, we face here the time horizon problem disregarded in the model assumptions and a conflict of interests between employees with different length of employment. As regards this issue, we have to share the opinions of those criticising solutions under the self-managed enterprise who emphasise the problem of the collective risk being incurred by the enterprise's workforce, the inability to diversify the risk, and a variety of risk acceptance degrees among individual workers. This in turn requires some compromising, which effectively narrows down the potential area of investment<sup>17</sup>.

Above mentioned deliberations show explicitly that self-managed enterprises are not adapted to market economy environment, or large problems can be expected in their adaptation to this environment. Because of the

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<sup>15</sup> S. Estrin, *The Effects of Self-Management on Yugoslav Industrial Growth*, Soviet Studies, 1982, Vol. 34, pp. 69–71.

<sup>16</sup> O. Gedymin, *Selected Issues in Intensive Social Reproduction*, Polish Scientific Conference: Model And the Practice of Economic Reform, ZOW PTE in Lublin, Lublin Technical University, Lublin, Nov. 1983, pp. 22–23.

<sup>17</sup> M. Dąbrowski, *Economic Consequences of Workers' Self-Management*, Ossolineum, PAN INE, Wrocław 1986, p. 82.

constraints inherent to the models, the enterprises in their pure form are doomed to conflict with the environment, and their survival depends on the introduction of a number of modifications, which means a departure from the labouristic principles. For the same reasons many authors share the view on the degeneration and self-destruction of the self-managed enterprises and cooperatives as they are in their model version<sup>18</sup>.

## 2. Theories of degeneration – examples

The concept of degeneration of worker cooperatives is used to explain their decline. This concept has been derived from the literature of worker cooperatives and labour self-management and applied to examine also ownership changes in the transition economies. The researchers of worker cooperatives are familiar with the argument of degeneration of self-managed enterprises. As early as the the 19<sup>th</sup> century and early 20<sup>th</sup> century some writers argued that worker cooperatives would inevitably degenerate. Interestingly, the authors were often supporters of the cooperative movement, disappointed about worker cooperatives' failure to outcompete their capitalist rivals<sup>19</sup>. Such claims might have affected negatively the way worker cooperatives were perceived<sup>20</sup>.

The use of the term 'degeneration' varies somewhat from author to author. B.Potter defines the term as an inevitable process of deterioration that leads all worker cooperatives either to economic failure or to the loss of their democratic characteristics<sup>21</sup>. This definition is very broad. It may refer to the ownership structures, to the decision-making structures, or both. Within the ownership structures the focus can be transformation of the cooperative form of

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<sup>18</sup> See: D.C. Jones, *The Economics and Industrial Relations of Producer Cooperatives in the US 1890 – 1940*, Monthly Labor Review, July 1978.

<sup>19</sup> Including Mill (J.S. Mill, *On the Probable Futurity of Labouring Classes*, Chapter 7 in Book 4 in: J.S.Mill, *The Principles of Political Economy With Some of Their Applications to Social Philosophy*, 1871), Potter (B. Potter, *The Cooperative Movement in Great Britain*, Swan Sonnenschein & Co., London 1891), Webb (S.Webb and B.Webb, *A Constitution for the Socialist Commonwealth of Great Britain*, with an introduction by Samuel H. Beer, Cambridge University Press, Cambridge 1975).

<sup>20</sup> P. Kalmi, *Does employee ownership survive the transition? Case study evidence from Estonia*, 2nd version, presented in the 2nd International Conference "Transition and Enterprise Restructuring in Eastern Europe", HILLERØD, Aug. 17–19, 2000, p. 3.

<sup>21</sup> Y. Stryjan, *Understanding Cooperatives: The Reproduction Perspective*, Annals of Public and Cooperative Economics, 1994, No. 65(1), p. 61.

ownership to capitalist ownership structures (conversion of worker cooperatives to profit-maximising firms) or exclusion of some employees from ownership.

The ability of cooperatives to survive or the tendency to degenerate has been introduced to the neoclassical economic theory of a labour-managed firm by Ben-Ner and Miyazaki<sup>22</sup>. It has also inspired a great number of empirical researches, that typically investigated the propensity of employee-owned organisations (cooperatives) to survive compared with more conventional organisations, or the evolution of “participation (membership) ratios” (the ratio of owner-employees (members) to the total number of employees)). This term ‘degeneration’ also refers to the attrition of the ownership base in employee-owned firms caused by the incumbent owners’ insufficient incentives to increase the number of owners<sup>23</sup>. The idea behind this argument is the following: the higher number of owners sharing the residual revenue of the firm, the smaller share of each owner. Therefore, when employee-owners retire the incumbent owners do not extend ownership rights to new employees. In this process, ownership shifts gradually outside the enterprise and the number of employee-owners tends (degenerates) to zero. They bar new members from entering and hire non-member labor in order to hoard profits. One would expect that the complementarity of ownership and participation, or the need to attract new finance, would encourage firms to offer shares to new employees. On the other hand, the expected increase in decision-making costs would discourage firms offer shares to new employees.

The degeneration thesis also states that in order to survive worker cooperatives have to adopt the same organizational forms and priorities as capitalist businesses. As a result, it is argued, cooperatives will gradually become dominated by a managerial elite that will effectively take decisions in the cooperative and thus undermine the democracy of management and the influence other workers can exert. In other words, control is relinquished in favor of managerial elites with specialist technical knowledge, expertise and leadership skills. The authors consider this to be a direct reason for the failure

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<sup>22</sup> A. Ben-Ner, *On the Stability of Cooperative Type of Organization*, Journal of Comparative Economics, 1984, No. 8, pp. 247–260; H. Miyazaki, *On Success and Dissolution of the Labor-managed Firm in the Capitalist Economy*, “Journal of Political Economy” 1984, No. 92, pp. 909–931.

<sup>23</sup>P. Kalmi, *Employee ownership and degeneration, evidence from Estonian case studies*, 11th Conference of the International Association For the Economics of Participation (IAFEP), Participation World-Wide, Catholic University of Brussels, Brussels, 4–6 July 2002, p. 4.

(collapse) of worker cooperatives<sup>24</sup>. The issue of skills stems from three main sources. Firstly, people forming cooperatives often have no previous experience in running or managing a business. Secondly, the cooperative sector is so small that a labour market for cooperative managers has not yet developed. Thirdly, because of their size and commitment to low wage differentials, many cooperatives cannot offer the same incentives to those with management skills as private firms.

Cooperatives experience also the degeneration-related problems typical of new small businesses, for example difficulties in locating premises and low or fluctuating demand. In addition, they have to learn how to work cooperatively. This may lead to high commitment and flexibility, but it can also mean, particularly in the short term, some organizational inefficiency and conflict<sup>25</sup>.

First hypotheses of self-destruction and degeneration were already presented by J. Vanek<sup>26</sup>. They referred to cooperatives whose shares were sold to non-members. The incumbent members would sell shares for financial gain. This led to the cooperatives' increased dependence on external entities or financial organizations whose business profiles were not always convergent with the workers' interests<sup>27</sup>. The problem of obtaining finance was very important in cooperatives' development. Cooperatives' equity was too small to assure fast growth; in addition, many cooperators had little to invest and few assets that could be used to secure a bank loan. In consequence, a slowly transforming cooperative turned into a capitalistic enterprise; as a result the external shareholders can be admitted – this undermines the cooperative principles and brings the risk that the accumulated cooperatives' reserves will be claimed by the shareholders as an equity.

The degeneration thesis originates from Marxist and socialist critiques of worker cooperatives as the means of transforming capitalist relations of production. Writers in the Marxist tradition identify the cause of degeneration in worker cooperatives with external forces, which stem from the capitalist relations of production. Marx himself had mixed views on cooperatives. While acknowledging that cooperatives demonstrated the feasibility of certain aspects

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<sup>24</sup> See: E. Mandel, *Self-management. Dangers and Possibilities*, International, 1975, 2–3, p. 3–9; A. Meister, *Participation, Asociacion, Development and Change*, New Brunswick, N.J: Transaction Books, 1984.

<sup>25</sup> Ch. Cornforth, *Creating successful cooperative businesses*, Cooperative Research Unit, Open University, 1987, p. 6.

<sup>26</sup> J. Vanek, *Marktwirtschaft und...*, p. 28.

<sup>27</sup> Classic examples were operations led by cotton cooperative – Rochdale (see: M. Mellor, J. Hannah, J. Stirling, *Worker Cooperatives in Theory and Practice*, Open University Press, Milton Keynes, Philadelphia 1988, pp. 15, 29–30).

of a socialist mode of production, he also felt that being operated in a capitalist environment they were doomed to reflect that system. This has been a recurring theme in subsequent Marxist analysis of worker cooperatives. For example, Mandel argues “Not only is self-management limited to the level of the factory, workshop or assembly line, an illusion from an economic point of view, in that the workers cannot implement decisions against the operations of market laws, but, worse still, the decisions taken by the workers became more and more restricted to decisions about profits. There have been many examples of workers' cooperatives that went wrong; there have been some that “succeeded” – in capitalist terms that is. All they have succeeded in, however, has been to transform themselves into profitable capitalist enterprises, operating in the same way as other capitalist firms”<sup>28</sup>.

The main point of this Marxist analysis is that isolated worker cooperatives cannot change the wider forces and relations of production that have developed under capitalism, and are controlled by them. In particular, the need to survive in a competitive market forces them to seek profit maximization in the same way as other capitalist businesses and to adopt the same forms of organization<sup>29</sup>.

The most sustained critique of worker cooperatives came from B. Potter and S. Webb. They did not believe worker cooperatives to be a viable form of an enterprise. Based on their observations of producers' associations in Britain and Europe they concluded: “The most enthusiastic believer in this form of democracy would be hard put to it to find, in all the range of industry and commerce, a single lasting success. In the relatively few cases in which such enterprises have not eventually succumbed as business concerns they have ceased to be democracies of producers themselves managing their own work; and have become, in effect, associations of capitalists or a small scale”<sup>30</sup>.

In contrast to Marxist explanations, the Webbs argued that the main source of degeneration was the internal characteristics of worker cooperatives. They believed that associations of producers would suffer from indiscipline, lack of knowledge of the market and unwillingness to adopt technical innovations, because they were democratically controlled by workers. As a result, they would either fail or be forced to adopt more conventional forms of ownership and

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<sup>28</sup> E. Mandel, *Self-management...*

<sup>29</sup> Ch. Cornforth, *Patterns of Cooperative Management: Beyond the Degeneration Thesis, Economic and Industrial Democracy*, SAGE, Thousand Oaks and New Delhi, London 1995, Vol. 16, p. 489.

<sup>30</sup> S. Webb and B. Webb, *Consumers' Cooperative Movement*, published by the authors, 1921, pp. 463–464.

management, and hence degenerate. Even if cooperatives begin their activity with appropriate and competitive resources of knowledge and techniques, this does not mean that they will keep their competitive position for ever. This can be connected with their lower readiness to bear the expenses and risks connected with introducing new technologies in a situation, when the beneficiaries of such an action are not known. While Webbs realized the marginal position that many associations of producers had in the economy, they argued that this was not the main source of their failure as businesses or cooperatives, because in similar circumstances consumer cooperatives had been able to grow and prosper<sup>31</sup>.

Another theory of degeneration is presented by R. Michels and it is known as the "iron law of oligarchy". He suggests that both psychological and organisational factors will lead to the emergence of a dominant elite in democratic associations. At a psychological level, he indicates, the members of an organisation need a leader, but once elected, the leaders tend to see the position as their own, and the skills they possess become a powerful centralizing force. The formation of elites is also necessitated by various organisational factors, which make direct democracy inefficient, e.g. large size which makes meetings and other forms of communication difficult; the difficulty in resolving disputes in collectives; the degree of technical specialization which requires experts who acquire greater power because of their expertise; the difficulty of large collectives in making quick decisions; and the need for a stable leader in order to preserve the continuity of direction<sup>32</sup>.

More recently, A. Meister has presented a more detailed description of the process of degeneration. Based on his empirical studies of various democratic associations, he suggests that they have a life cycle of four distinct phases. The first phase is characterised by high idealism and commitment, which enables the association to get off the ground. However, over time there are clashes between direct democracy and its prerogatives and an economic activity and reality. The need for greater efficiency leads to the establishment of full-time administrators or coordinators who come to be seen as directors. The second phase is a period of transition in which, if the enterprise has survived, further economic consolidation takes place and conventional principles of organization are increasingly adopted. These changes are not always accepted and conflicts continue between idealists and managers who are more rational. In the third phase, cooperatives lose their radical ideals and market values are accepted. Democracy becomes restricted to the board of representatives, and the

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<sup>31</sup> S. Webb and B. Webb, *Cooperative Production and Profit Sharing*, New Statesman, 1914, p. 20.

<sup>32</sup> R. Michels, *Political Parties: A Sociological Study of Oligarchical Tendencies of Modern Democracy*, New York: Free Press, 1949.

gap between managers and workers increases as the business develops and production is rationalised. During the fourth phase, members and their representatives lose all effective power as control is taken over by managers, because of their superior expertise and ability to control information<sup>33</sup>.

Constraints in cooperative's development can result also from the inability to make optimal decision in enterprises with group ownership, in which individual shares have not been distinguished<sup>34</sup>. Then the investment decisions are often connected with admitting so-called mandatory reinvestment provisions that lead to overinvestment and too large capital per worker. In this case creation of new jobs is smaller than it could or should be.

What contributes to the degeneration of cooperatives is financing of their development and growth. This problem arises, among others, from the position of workers – owners who prefer immediate payment of rewards (income from the capital) and shares in profits instead of pooling part of the profits into the reserve fund which serves to pay for investments and possible losses in the future. Such an attitude has led to liquidation or the so-called “capitalistic degeneration” of many cooperatives and enterprises managed by workers in Great Britain<sup>35</sup>. It is also argued that in this situation a cooperative must seek some finance outside and fund its development through external debt. But some doubts can appear about the ease of finding suitable sources of capital. It seems, that the presented proposals are impossible to be realised also for another reason, namely, when a cooperative is going through a difficult period and the employees – owners do not bear financial responsibility, they can cause its fall and bankruptcy.

Let us add, that a lack of financial responsibility may discourage banks to make available a credit facility for a cooperative. Even if a loan is granted there is always the danger that lender will behave as owner and interfere into current matters of cooperative.

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<sup>33</sup> See: A. Meister, *Participation, Associacions...*

<sup>34</sup> See: E. Bader, *From profit sharing to common ownership*, Journal of Current Social Issues, 1971, Vol. 10, pp. 4–15

<sup>35</sup> These cases and weaknesses of cooperatives became described in details in: P. Abell, *The Viability of Producer Cooperation*, International Yearbook of Organizational Democracy, New York: Wiley, 1983; R.A. McCain, *Empirical Implications of Worker Participation in Management*, 1982, in: D.C. Jones and J. Svejnar (eds), *Participatory and Self-Managed Firms: Evaluating Economic Performance*, Lexington, Mass.: Heath, 1982, pp. 17–43; M. Uvalič, *The Investment Behavior of a Labor – Managed Firm*, Annals of Public and Cooperative Economy, 1986, 57(1); C.M. Fanning, T. McCarthy, *A Survey of the Economic Hypotheses Concerning the Non-Viability of Labor – Directed Firms in Capitalist Economies*, in: S. Jansson, A. Hellmark (eds), *Labor-Owned Firms and Workers' Cooperatives*, Aldershot, Hants, UK: Gower, 1986.

### 3. How to stop the process of degeneration – final remarks

Though an empirical investigation has confirmed some theories of degeneration of cooperatives, not all of them have to be so dismal. It can be argued that while both external and internal factors can severely constrain what is possible within cooperatives, they do not completely determine cooperatives' behaviour. As a result, cooperators have some choice over the organization and management of their cooperative. Nevertheless, it is recognized that cooperatives do face particular problems in developing management structures and a division of labour that does not undermine democracy, and in maintaining an active and committed membership. Different cooperatives are likely to face different combinations of conditions and may interpret and react to them in different ways<sup>36</sup>. It can be assumed that cooperatives need to pay careful attention to the way they maintain an active and committed membership through such things as recruitment and socialization, and to the importance of continually reviewing and adapting structures to give new expression to cooperative democracy and participation as circumstances change. One way to maintain active participation is rotation of workers among particular departments. Such rotation becomes very important when the number of workers in enterprise increases. It should be remembered, however, that too frequent rotation diminishes competences of workers and which negatively affects the quality of work. This shows the need to adequately recognise assignments that require different skills. Consequently, it becomes necessary to share assignments among workers and to select a group of persons responsible for quality assurance, distribution of work, specialization as well as co-ordination and integration of every activity.

Relationships between the division of labor and the survival of democracy are very complicated. They can be maintained by an unobstructed access to information and exchange of experiences among workers. Such an approach is possible inside appropriate organizational structures, which combine direct and indirect forms of democracy that reinforce each other. This prevents processes of degeneracy of cooperatives.

Some important criticisms can be also levelled at Michels' argument. His analysis assumes that direct democracy is the standard against which other forms of organisation are judged. As a result, any form of representative democracy or delegation is regarded as a sign of oligarchy. Because beyond

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<sup>36</sup> G. Hunt, *Division of Labour, Life Cycle and Democracy in Worker Cooperatives*, Economic and Industrial Democracy, 1992, 13(1), pp. 19–43.

a certain size every organisation will need some form of delegation for reasons of efficiency, then all large organizations must be oligarchic. Michels argues that leaders, by virtue of their position, will move in a different “social world” to those they lead. As they become socialised in this New World they lose touch with the ordinary membership and their interests diverge from those of the members that elected them. It is possible that leaders in organizations can maintain good contact with the wider membership and try to act in their interests, particularly in organisations such as cooperatives. Finally, Michels’ work largely ignores the historical processes that gave rise to the organizations he studied. As a consequence, he does not discuss the extent to which the processes that he observed might be influenced by wider economic, technological, social or political factors<sup>37</sup>. Thus, Michels’ theories of degeneration can be said to be too deterministic and denying the possibility that cooperators have some choice in structuring and managing their organisation. They also embody an idealized view of democracy which is unrealistic in all but the smallest organizations. However, this is not to deny, as a variety of empirical studies have shown, that factors such as growth, the creation of specialist roles and pressures for greater efficiency can undermine democracy<sup>38</sup>.

Other authors of empirical studies also question the determinism of the degeneration thesis. For example, J.Rothschild-Whitt suggested that under certain conditions cooperatives can retain direct democracy of organization and pursue alternative goals. As well as factors such as a small size and appropriate technology, Rothschild stresses the importance of a variety of conditions that can help maintain the alternative values and culture of these organizations, such as links to wider social movements, economic marginality and an oppositional and transitory orientation<sup>39</sup>. A theoretical framework which no longer accepts degeneration as inevitable is given by Y.Stryjan, that he called a “reproduction perspective”. He emphasises the way in which cooperators, through their everyday actions both draw upon and reproduce the structural features of their organisation. As Stryjan sees it, the primary feature of cooperatives is that they are membership organizations. Hence the core process of a self-managed organization is the reproduction of an active membership. Within this perspective, degeneration is just one pathway that a cooperative may go down

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<sup>37</sup> B. Abrahamsson, *Bureaucracy or Participation: The Logic of Organization*, Beverly Hills, CA and London: Sage, 1977, pp. 78–79, quoted by Ch.Cornforth, *Patterns of Cooperative...*, p. 492.

<sup>38</sup> A. Shirom, *The Industrial Relations System of Industrial Cooperatives in the United States: 1890–1985*, Labour History, Fall 1972, pp. 533–551.

<sup>39</sup> J. Rothschild-Whitt, *Conditions Facilitating Participatory Democratic Organization*, “Sociological Inquiry” 1976, No. 46, pp. 75–86.

and is due to a failure of reproduction, which may result from things like member turnover or mismanagement of the member involvement<sup>40</sup>.

Another conclusion is that to restrain the degeneration of a cooperative a regular review of its accomplishments is extremely important, both regarding the effectiveness and quality of working in order to maintain economic growth of enterprise and evaluation of the degree to which cooperative rules and values have been complied with. Such equilibrium should be kept despite changing external environments in which enterprises function, which demands refining of existing organizational structures or searching for new solutions in order to maintain cooperative ideas as well as ensure further development.

A large role is played by the aforementioned relationships between cooperatives and cooperative movement. Cooperatives help strengthen ideas and cooperative values in moderately favorable external conditions. Also individual attitudes of the future workers and their motivation for taking a job in cooperative are essential. Workers should be characterized by the determination and desire to actively participate in organs of cooperative. Permanent socialization of the members should be stressed, e.g. through training, discussions, consultations and meetings, that help them understand the values and aims of working in a cooperative.

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<sup>40</sup> See: Y. Stryjan, *Impossible Organizations: On Self-Management and Organizational Reproduction*, Ph.D. thesis, Department of Sociology, University of Uppsala, Sweden 1987; Y. Stryjan, *Understanding Cooperatives...*, pp. 59–79.

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