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Comment on Ramon Flecha and Ignacio Santa Cruz. The Priority of Labor and Capital Accounts

Abstract: Two aspects of the fine Flecha-Cruz paper can be usefully elaborated. The Mondragon cooperatives differ not only from capitalist firms but also from most other cooperatives in the doctrine of the 'priority of labor over capital' which means that the people working in any sort of cooperative will be members and will not be rented as employees. Also the Mondragon system of internal capital accounts solves the equity-structure problem that has plagued many modern cooperatives structured as non-profits or traditional worker cooperatives with 'membership shares'.

1. Introduction

The fine paper by Ramon Flecha and Ignacio Santa Cruz gives an up-to-date summary of the status of the Mondragon Cooperative Corporation and the key strategic actions that have made the cooperative group so successful. There were at least two points mentioned in the summary that deserve some elaboration.

2. The Priority of Labor

The Mondragon cooperatives differ radically not only from the conventional capitalist corporations but also from the traditional cooperatives. Flecha and Cruz focus more on the contrast with capitalist firms but part of the reason for Mondragon's uniqueness and success is how they differ from traditional cooperatives, e.g., those in the International Co-operative Alliance.

A traditional cooperative has a certain set of members who 'cooperate together' in some activity which is interpreted as 'patronizing' the cooperative. Different types of cooperatives differ by how they define the patron-members and the patronage relationship. In a worker cooperative, the members are essentially the permanent workers in the company where 'patronage' is working in the company. In a producers marketing cooperative, the independent producers, which could be family farms or small conventional agricultural companies, 'cooperate together' by processing and marketing their outputs through the marketing cooperative. In a credit cooperative, i.e., a credit union or mutual bank, the members are the depositors who 'cooperate together' by using the bank or credit union for their banking services. In a mutual insurance company, the members are the policy-holders who 'cooperate together' by purchasing insurance services through the mutual company. In a housing cooperative, the cooperative activity is living in the dwellings owned by the cooperative.

The common feature in all these types of traditional cooperatives is the conception that the member-patrons are 'cooperating together' in some common activity which qualifies them as the members in the cooperative. The key difference between this traditional conception of a cooperative and the types of cooperatives in the Mondragon group is the role of the renting of people, i.e., the employment relation. With the exception of worker cooperatives, all the other forms of cooperatives are compatible with the renting of the people who work in the companies, e.g., in the processing and marketing activities of a producer-marketing cooperative, in the stores of a consumer cooperative, as the staff in a credit union, mutual bank, or mutual insurance company, and so forth. In all these other types of traditional cooperatives, the workers are rented, hired, or employed by the cooperative and are not members qua workers since 'patronage' is defined in some other manner.

The really distinctive feature of the Mondragon cooperatives qua cooperatives is the principled opposition to the renting of people that is usually expressed in the doctrine of the *priority of labor over capital*—even when the capital is that of member-patrons in a cooperative. Gregory Baum (1982) has given a summary of this theme in Catholic social thought—particularly in *Laborem Exercens* and the personalist school of Emmanuel Mounier. Race Mathews develops a similar Mondragon-related theme in the largely Catholic distributist thought (Mathews 1999). This priority-of-labor principle was the basic moral principle that informed Arizmendiarrieta in his work developing the structure of the various Mondragon cooperatives, not the traditional cooperative notion of 'cooperating together'. Hence in all the Mondragon cooperatives that are not straight worker cooperatives, the staff members are also members of the hybrid cooperatives.

In the large Mondragon 'consumer cooperative' of Eroski, the workers are also members and one might even say 'primary' members in terms of the actual management and operation of the company.[1] In the Caja Laboral, all the staff constitute a category of members (qua workers), unlike the case in traditional credit unions or mutual banks. In the Lagun Aro insurance cooperative, the staff are also members qua workers. In the farmer-marketing cooperatives of the Mondragon group, the workers in the processing plants are also members, not just the farmers. Similar considerations hold for the other cooperative institutions such as the Mondragon University and the research cooperatives.

Given the difficulties that any cooperatives have in the capitalist environment, there is some reluctance to focus on this fundamental difference of princi-

[1] As the Eroski cooperatives have expanded out of the Basque country across Spain, there has been some lapse in this principled approach to membership, but we are discussing how they differ in principle from the traditional cooperatives.

ple that runs through the cooperative movement as a whole. Only the traditional worker cooperatives tried to abolish the employment relation, i.e., the renting, hiring, or employing of people, in favor of a structure where working in the company qualified one for membership rights in the cooperative. Labor always rents or already owns capital and other things, instead of the owners of capital and other things renting the people who work with those means of production and distribution. But in the other traditional cooperatives, the idea was not to abolish the employment relation but to redefine the employer as the collective body of patrons—the customers in a consumer cooperative, the suppliers in a marketing cooperative, the depositors in a credit cooperative, the policy-holders in an insurance cooperative, the residents in a housing cooperative, and so forth.

3. Internal Capital Accounts

Another basic feature of the Mondragon cooperatives that deserves more emphasis is the system of internal capital accounts, the portion of the net worth in each cooperative that is eventually due back to the members as they leave, age, or retire. Almost all of the previous worker cooperatives or similar worker-owned companies had confused and distorted structures of rights that also had detrimental practical consequences. In theory, the worker-member's membership rights in a worker cooperative are personal rights, not property rights. The worker qualifies for these 'citizenship' rights by working in the company on a long-term basis; they are not property rights that can be bought or sold. Yet the net income earned by the workers is a form of private property, and is always seen that way once distributed as pay to the members. But the problem arises when, for a variety of reasons, the workers need to retain some of their net income in the company to help, together with loans, finance some investment. How is that retained worker income to be treated?

Many traditional worker cooperatives were organized as what are misleadingly called 'non-profit' companies. The 'non-profit' name means essentially that there is no recoupable claim on the retained earnings. This creates an unnecessary bias in favor of distributing all earnings as current pay and then financing all reinvestment in the company with 100% borrowings. Since lenders are understandably reluctant to lend to a company with little or no net worth, such 'non-profit' or 'social property' cooperatives tended to be rather under-capitalized and service-oriented. Part of the success of the Mondragon cooperatives was developing the system of internal capital accounts to avoid that 'non-profit' structure so that they could compete in industries with non-trivial capital requirements.

There is an opposite mistake in many worker-owned companies which use a more traditional 'share' system to try to recoup the retained earnings. In some traditional worker cooperatives, like the plywood cooperatives of the northwest United States, they have a 'membership share' which tries to play both roles of carrying the membership rights (so each member has to buy one) but also carrying the value of the retained earnings (so an entering worker in effect has to be able to finance the payout to an exiting worker). If the company enjoys any economic success, the membership shares, of course, become prohibitively expensive for entering workers. Then either the exiting workers are morally pressured to reduce their retirement income to something the young worker can afford as payroll deductions, or the entering worker is rented as an employee and then the cohort of founding members eventually 'open up the market' for their shares by offering them to outside investors or other firms.

Both these deeply flawed structures of rights for a democratic firm can be avoided by recording each member's share of the retained earnings in a separate internal capital account that represents a property right eventually owed back to the member. Then the rights of membership (share of net income rights and voting rights) can be treated as personal rights attached to the functional role of long-term work in the firm, and are not attached to having to finance the retirement of an exiting member.

Unfortunately, some worker-owned companies, such as the SAL firms that are literally 'across the street' from the Mondragon cooperatives, still use the membership-share system (with all the attendant problems) and do not understand the importance of that Mondragon innovation. One might even say that the Mondragon cooperatives themselves—as well as many Mondragon researchers—see it simply as 'the way they do things' and do not appreciate the contribution made to resolving the difficult equity structure questions in worker cooperatives of either the non-profit/social-property variety or the membership-share variety.[2]

Bibliography

Baum, G. (1982), *The Priority of Labor: A Commentary on Laborem Exercens Encyclical Letter of Pope John Paul II*, New York

Mathews, R. (1999), *Jobs of Our Own: Building a Stakeholder Society*, Sydney–London

[2] The underlying principles and the analysis of the legal structure of democratic firms are developed at length in my books, *The Democratic Worker-Owned Firm* (1990) and *Property & Contract in Economics: The Case for Economic Democracy* (1992), both of which are out-of-print and can now be downloaded from my website: http://www.ellerman.org.