**Econ 426**

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I have taught this course 14 times. This is the last time. I'm retiring in April 2022.

I became an assistant prof in 1981, which was 40 years ago. Retirement seems appropriate.

This is an overview of how I became interested in LMFs, what I contributed to the study of LMFs, and what we have learned about LMFs since "Governing the Firm" was written.

When I was an undergraduate (I got my BA in 1975), I was a sociology major. I had taken the equivalent of Econ 103 but not 201. I didn't know much about economics.

I first heard about LMFs in a sociology class in my fourth year as an undergrad. My prof said some people in Europe thought that workers should control their own firms.

I thought this was an exciting idea, but not for economic reasons. I had worked in factories to make money for school, and I saw people working for low wages, in poor working conditions, with supervisors who sometimes abused their authority. I liked the concept of LMFs because I thought democracy was a necessary restraint on authority (see chapter 2 of GTF).

Next, I did a Master's in Public Policy at the University of Michigan. I took more econ courses and decided I liked it. Eventually I switched over to the PhD program in economics and got my PhD in 1981. Then I became an assistant professor.

My career can be divided into two equal parts:

1981 - 2001 (I finished writing GTF in Dec 2001, although it wasn't published until early 2003).

2002 - 2021 (after writing GTF).

During the 1980s, I spent a lot of time criticizing other people's theories (for example the Illyrian model and ideas about LMFs based on transaction cost economics).

My main positive contribution was to show that with competitive membership markets, all of the strange behavior of the Illyrian firm goes away. The horizon and degeneration problems also go away. In fact, KMFs and LMFs behave identically (they both maximize profit).

The same idea was developed independently by another economist named Murat Sertel.

During the 1990s, I started to think about two things:

(a) I needed my own theory about LMFs (especially why they are rare).
(b) My theory needed to include imperfections in membership markets.

I worked on repeated game models, adverse selection models, public goods models, etc.

Originally, the plan was to write a big book on LMFs that would have lots of math.

But I thought the book needed an introduction that provided some case studies, a review of the existing economic literature on LMFs, a verbal description of my own theory, and so on.

The introduction turned into a 300-page manuscript and became "Governing the Firm".

End of part one.

After 2001, I started teaching courses based on GTF. But I also became department chair. This kept me busy, and I didn't have time to finish the earlier project.

I was also burned out on LMFs and wanted to work on other things. This led to two decades of research on economic prehistory (several journal articles plus a book coming out in 2022).

But around 2014, I thought I needed to pull together my theoretical work on LMFs and turn it into a second book. This led to "The Labor-Managed Firm: Theoretical Foundations" in 2018.

In the process of writing the new book, I returned to the LMF literature to see what people had learned since 2001.

There was a lot of new empirical work, some using good data sets and good econometrics.

Here are the highlights. For details you can read chapters 6 and 7 in LMFTF, 2018. You can also read chapter 8, which updates my views about why LMFs are rare.

<u>Industry Distribution</u>

Depending on the country, LMFs tend to be concentrated in services, retailing, construction, transport, and some manufacturing activities.

<u>Comparative Statics</u>

Several studies in multiple countries have compared how KMFs and LMFs respond to shocks (changes in market prices). Everyone finds that LMFs have less elastic output supply and input demand functions than KMFs, and more variation in labor income. Sometimes these results are statistically significant and sometimes not.

## Objective Functions

A couple of studies have tested the hypothesis that LMFs maximize profit. Think of a spectrum from max income per worker (Illyrian), to max profit, to max employment. LMFs deviate from profit max by giving additional weight to employment (the opposite of the Illyrian prediction).

## Productivity

When people assume identical production functions except for an intercept term for total factor productivity, usually they find no statistically significant difference. But a good study based on French data allowed KMFs and LMFs to have different production functions and it found that in most industries LMFs were at least as productive as KMFs, conditional on input levels. In some industries the LMFs had a statistically significant advantage.

## Wage Structure

There has been evidence for a long time that LMF wage distributions are more compressed than KMF wage distributions. The best data is from Uruguay, where researchers observed the entire wage distribution within each firm. Wage inequality was systematically lower in LMFs.

## Entry Rates

LMF entry is higher when unemployment is high, and lower when GDP growth is high (data from France). This is the opposite of what we see for KMF entry. At the industry level, LMF entry is lower for industries with higher capital intensity and higher variance in industry profit (data from the UK).

## Exit Rates

The best study is from Uruguay. The author finds that LMFs have failure rates 29% lower than KMFs. There is no significant difference for manufacturing or transport, but a large difference for services. Maybe an LMF advantage in industries with high labor intensity? The difference in survival seems to be related in some way to greater employment stability in LMFs.

## Membership Markets

Not much new research on this topic. Outside of the US, such markets are rare. Some countries have legal rules against them while in other countries individual firms are organized in ways that prevent buying and selling membership rights. When allowed, transactions must be approved by other members of the firm.

## Degeneration

No evidence of degeneration in LMFs from France, Italy, or Uruguay. Often there are legal rules limiting the use of non-member labor that prevent this. But the issue is still a little controversial.

Underinvestment

Data from France indicate that when firm size is measured by assets, LMFs tend to be smaller than KMFs in the same industry. In a minority of industries, the capital/labor ratio is lower for LMFs (no difference in other industries). But the growth rates of LMFs were at least as high as KMFs in all industries. This may be due to institutional rules about minimum reinvestment of net income.

Agglomeration

A good study for Spain found that in any given county and industry, the number of LMF entrants responded positively to the number of LMFs already there. The results were highly significant.

Some Puzzles

1. How can LMFs survive in competitive markets in the long run, given that they deviate from profit maximization?

2. If LMFs really do have higher productivity than KMFs, at least in some industries, why don't they outcompete the KMFs and dominate those industries?

3. If LMFs really do have higher productivity than KMFs, at least in some industries, why can't the KMFs replicate what the LMFs are doing?

4. What explains the very low rate of LMF entry even in highly labor-intensive industries?

5. What explains the low rate of conversion from KMFs to LMFs, if there are industries in which LMFs would have no systematic productivity disadvantage?

Conclusion

Today I have clearer ideas about why LMFs are rare, compared to my understanding in 1981.

But it turned out to be a complicated question, and there are still plenty of problems to explore.

My early interest was motivated by a belief that democracy in firms would be desirable. I still think this.

A key question is whether public policies can be used to promote democracy in firms with little or no loss in economic efficiency (maybe even with efficiency gains).

I think LMFs are limited mainly by market imperfections that could be overcome, not inherent organizational flaws. Given well-designed institutions and policies, I am optimistic.

Thanks for taking the course!