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Employment protection regimes and dismissal of members in worker co-operatives

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Abstract

This paper discusses the possibility of strong employment protection regimes (EPRs) in worker cooperatives (WCs), a unique organizational form in which employees coincide with members who hold control rights. Worker control is reported by several theoretical and empirical contributions to stabilize employment better than other proprietary forms. We leverage key theoretical insights from evolutionary theory and systems to discuss the possibility (benefits and critical elements) of constraining the dismissal of WC members to further strengthen employment stabilization and enforce member rights. Strong EPRs would be functional to meeting workers' needs for a decent life and job security. While stricter constraints on layoffs can cause short-term inefficiencies (e.g. preventing the dismissal of shirking workers), they also perform an insurance function against unemployment, favor the accumulation and conservation of firm specific human, relational and social capital and improve the equity of distributive patterns. It is also hypothesized that performance would increase in the medium to long run. Voluntary resignation, not involuntary dismissal would be the dominant mechanism allowing for the allocation of work to the most productive occupations.

Key words: worker cooperatives; membership rights; dismissal; minimum wage; rules and routines; systems theory

JEL codes: J31, J41; J54; J83

1. Introduction

This paper starts from the premise that the very concept of dismissal of redundant workers is problematic in worker cooperatives (WCs), since it may be incompatible with their associative nature. If members are worker-owners with equal duties and rights, dismissal implies the expulsion of part of the owners by other owners, and may not be accepted on the ground of procedural fairness, ethical norms of cooperation and stability of the governance rules (it may be difficult or impossible for the whole collectivity of members to identify on procedural grounds those sub-groups of members that are to be laid-off).

Several arguments have been put forward, which show the difficulties that a collection of members in WCs would encounter in trying and dismiss their own fellow-members (Jossa & Cuomo, 1997; Ellerman, 2016, 2020). These arguments discuss the possible criteria used to dismiss redundant worker (e.g. seniority or last in first out; contractual position; subjective evaluation by managers etc...). When dismissals are discretionarily decided by managers, the decision about who is to be laid off is again problematic since the criteria used may be controversial, cause internal contrasts and find limited consensus among members. The very existence of a non-negligible risk of dismissal can engender contrasts between individual and groups of members, this way inflating organizational costs, which are considered to be potentially high and damaging in worker co-ops (Hansmann, 1996). In the absence of centralized hierarchical control and external (investor) ownership, these contrasts can be especially dangerous since each individual member perceives layoffs as a serious threat. Positive reciprocity and pre-emptive behaviors may induce members to select directors and appoint managers that are willing to minimize layoffs (Jossa & Cuomo 1997).

Strong employment protection regimes (EPR) in terms of limiting redundancies make work a not perfectly flexible or even fixed factor of production in the short term. The consequences should be compelling as limiting layoffs can force WCs to substantially reduce wages and make them float, or deplete parts of capital reserves (Navarra, 2016; Navarra & Tortia, 2014; Albanese, Navarra &

Tortia, 2015). They would also exclude the assumptions of Ward's (1958) neoclassical model of the labor-managed firm regarding labor as a perfectly flexible factor of production in the short run (Ellerman, 1986, 1989).

Both theory and several empirical tests have clarified the importance of job stability and protection among the main objectives of WCs, sharply differentiating them from investor owned firms (IOFs). The theoretical literature emphasizes that employment insurance, not only income insurance enters the objective function of WCs (Myhazaki & Neary, 1983; Navarra & Tortia, 2014; Albanese et al., 2015, 2019). While IOFs would ensure workers against the risk of income fluctuation by stabilizing wages, WCs would be able to proceed one step further by guaranteeing also employment stabilization (Wong, 1983; Kahana & Nitzan, 1989; Craig & Pencavel, 1993, Burdin & Dean, 2012). Empirical evidence shows that employment stabilization is achieved in WCs mainly through stronger fluctuation in labor income and hours worked (Bartlett et al., 1992; Craig & Pencavel 1992; Pencavel, Pistaferri & Schivardi, 2006; Burdin & Dean, 2009; Delbono & Reggiani, 2013; cfr. the reviews Bonin, Jones & Putterman, 1993; Pérotin, 2013). The important implication of this body of work for this paper is that the study of the rules supporting employment stabilization and protection in this kind of organization is of crucial importance. The tendency of WCs to minimize layoffs is interpreted as pathway to a possible process of institutionalization of spontaneous organizational behaviors leading to strong EPRs that emphasize needs' fulfilment, accumulation and preservation of human capital and improved performance in the medium to long run.

We resort to the theory of collective rationality and evolution of organizational routines to show that employment preservation can have a crucial role in building systemic integrity of the labor process, which can lead ultimately to better worker welfare and organizational performance (Harcourt & Wood, 2007). The systemic role of the limitation of dismissals is interpreted within the framework of the emergence and development of a non-traditional form of organizing production in

an entrepreneurial way (Valentinov, 2004; Thompson & Valentinov, 2017; Valentinov & Thompson, 2019) .

The remainder of the paper is organized as follows: after the introduction, Section 2 spells out the basic problem focusing on EPRs as peculiar characteristic of worker cooperatives. Section 3 deals with the theoretical background introducing the concept of collective rationality in the evolution of governance rules and organizational routines in WCs. Section 4 introduces some case studies coming from the Mondragon group of worker co-ops and from Italian cooperative legislation. Section 5 discusses the impacts of new EPRs on human capital, productivity and wage dynamics in WCs. Section 5 concludes with some discussion and policy implications.

2. Stating the problem: employment protection regimes in worker cooperatives

The pronounced tendency of worker co-ops to stabilize employment can favor the emergence of an evolutionary pattern underpinning strong EPR regimes that are peculiar to the control rights and governance of this organizational form. Employment protection can be achieved in the absence of legal constraints, as the result of implicit contracting between members and the organization. Members may accept lower and fluctuating wages in exchange for heightened job stability as indeed shown by the outstanding empirical evidence (Bartlett et al., 1992; Bonin, Jones & Putterman, 1993; Pencavel, Pistaferri & Schivardi, 2006; Navarra & Tortia, 2014; Albanese, Navarra & Tortia, 2015). Alternatively, strong EPR can be progressively made explicit and institutionalized, by working out rules that limit the possibility of layoff. This kind of regulation can also be found in IOFs, in cases in which layoffs are restricted by law to a limited number of negative conditions (e.g. financial or economic crisis of the organization and employee malfeasance), or when they are subject to arbitrage or bilateral bargaining between firms and workers' representatives (Commons, 1931, 1950).

In worker cooperatives, given the overlapping of roles between the employer (the organization) and employed workers (members), rules need to be adapted to this specific institutional set up. Also, the rationale of the emergence and development of EPRs specific to WCs can be different in different organizational forms. In IOFs, EPRs are usually justified by the necessity to protect the weakest contractual party (the employee), or by the risk of unfair treatment, or discriminatory dismissal. EPRs have also been justified by the argument that they favor the accumulation of human capital, since restrictions

on layoffs and job stability increase the incentives for both workers and employers to invest in training and long-term adaptation of workers' competencies to organizational objectives. This way, job stability can support increased productivity of labor (Estevez-Abe, Iversen, & Soskice, 2000; Harcourt & Wood, 2007). In WCs, given the dual role of workers as members and employees, the risk of unfair dismissal is expected to be comparatively lower than in IOFs. On the other hand, the accumulation of firm specific human capital is expected to be of critical importance in cooperatives too, the more so in WCs, in which labor intensive production processes are dominant, and labor is the most strategic factor of production (). Since worker-members have a say in the definition of employment policies of WCs, they are likely to favor policies that guarantee job stability to protect their own job position. To make this preference come true, members are expected to invest in training and development of firm specific skills that can increase labor productivity.

On the negative side, reports of exploitation, abuse of power and poor working conditions are not alien to WCs too and can indicate the need to increase the protection of workers' rights and better regulation of managerial discretionary decisions also in WCs (Iannuzzi & Sacchetto, 2020). In order to address these problems and achieve the desired objectives, this document introduces and discusses the possibility of strong employment protection (restriction on or exclusion of dismissal) in WCs. The imposition of an equal minimum wage for all worker members is a complementary tool ensuring job stability and needs' satisfaction at one and the same time for the whole collective of members.

2.1. Employment protection in investor owned firms versus worker cooperatives

Wage rigidity is one dominant feature of labor contracts in IOFs, as especially explained in the implicit contract and principal-agent literature (Knight, 1921; Baily 197; Azariadis 1975; Azariadis & Stiglitz 1983; Stiglitz, 1975). If wages were flexible and state dependent, the employer could behave opportunistically by exploiting information advantages and contractual power in order to lower wages, intensify work effort, and make the worker bear the negative consequences of his/her choices (Ben-Ner 1988; Screpanti 2001; Dow 2003). Lack of protection against unfair dismissal can favor exploitation, moral hazard and abuse of power by the employer (Ben-Ner, 1988, 1993; Ben-Ner & Jones, 1995; Sacconi, 1999). On the opposite side of the employment relationship, employment protection (the possibility of dismissal is constrained by law) can lead to exacerbating conflicts and inefficient outcomes, as excessive protection can decrease effort contribution and favor morally hazardous behavior by workers, as per the principal-agent and efficiency wage models (Jensen & Meckling, 1976; Shapiro & Stiglitz, 1984). Such fundamental contractual failures on both sides of the employment relationship can only increase transaction costs (especially control costs) and negative external effects in terms of negative consequences of wage rigidity and the costs of unfair dismissals.

While orthodox economics predicts that restrictions on layoffs would result in inefficient outcomes also in cooperatives (Alchian & Demsetz, 1972; Jensen & Meckling, 1979), we believe this may not be the case and a layered system of contextual influence, sanctions, control mechanisms and incentives is proposed to address this problem. In WCs, the absence of a clear divide between principals and agents (the two categories overlap) modifies the structure of interactions and the nature of organizational costs, including agency costs (Ostrom, 1990; Hansmann, 1999). The associative nature of the organization, control rights attributed to members and the ensuing reduction of contrasting interests imply that the risk of abuse of power by decision

makers is reduced, since the latter are appointed by and accountable to the former. Social dilemmas are more easily overcome (Ostrom, 1990), and EPRs can be implemented to foster the accumulation and protection of firm-specific human capital.

Some distinctive mechanisms show how the implementation of strong EPR in WCs needs not result in inefficient results. First, the ability of co-ops to make labor costs (wages) flexible, a feature that allows adaptation of costs rather than employment to the business cycle., Second, even when dismissal is limited or excluded, the risk of business failure due to low productivity and opportunism on the part of the members corresponds to a fundamental contextual influence that selects *ex ante* individuals and organizations capable of carrying out collective entrepreneurial action in a productive way (West, Griffin & Gardner, 2007). As we shall see, collective rationality and internal rules and routines can play a crucial role in ensuring alignment between individual behaviors and organizational objectives in pursuing the survival and growth of the firm. Third, intentional shirking and sabotage lead to dismissal even in the presence of strong EPRs. In such cases, the threat of dismissal exercises its full potential *ex ante* deterrent role as in other organizational forms. Fourth, peer pressure and horizontal control can prevent shirking (Ben-Ner & Elman, 2013; Carpenter, Bowles & Gintis, 2006). Fifth, involvement in decision-making, participation and deliberation (voice rather than exit) would function as non-monetary incentive mechanism that enhances intrinsic motivations to work, strengthen engagement and loyalty, and support the development of interpersonal relationships and trust (Ben-Ner, 1988; Ben-Ner & Elman, 2018).

In the remainder of the paper we discuss some relevant examples of the management of redundancies in WCs and layoff regulation in some specific countries. We review the examples of the Mondragon group of worker co-operatives in the Basque regions of Spain, and the Italian employment protection legislation. We then turn to the proposal of a third, more radical option, concerning the possibility to restrict or altogether eliminate layoffs in WC. When dismissals are excluded, only voluntary resignation, rather than involuntary dismissal with the exclusion of

misbehavior (disciplinary cases of layoffs) is allowed.¹ Less radical solutions (partial exclusion of layoffs) can be envisaged as intermediate cases between the complete exclusion of layoffs and absence of employment protection regulation.

While the introduction of strong EPRs in WCs poses serious organizational and institutional challenges, its importance lies in its potential to achieve full protection of members as holders of the right to control the organization. As many HRM studies show that job security is ranked very high among workers' preferred contractual features, these preferences contribute to explain the economic rationale of job protection (Guest 2007; Li et al., 2021; Kim & Kim, 2020). It also allows for the possibility of assess the impacts in terms of efficiency and performance of cooperatives.

We now turn to some theoretical premises backing the proposals for new EPRs in the last parts of the paper. In the next section we deal with collective rationality, organizational routines and the systemic role of EPRs regimes in WCs.

3. Theoretical insights

Classics in institutional economics have dealt with collective action in varied ways. Among the most notable cases, Commons (1950) was the most prominent scholar in the first half of 20th century to give a central role to collective action in his economic theorizing. Among the crucial concepts spelled out by Commons is "goodwill" which can be connected with the idea in this paper that cooperatives operate in areas where goodwill value in their relations with customers and workers is needed. In our approach, cooperatives secure the goodwill of worker-members by offering strong employment protection, which makes transactional terms "reasonable", in Commons terminology (Valentinov, 2009). Following a similar approach Granovetter (1985) critiqued

¹ This paper does not deal with employment protection regimes in other co-operative typologies (consumer, credit, user, producer co-operatives etc...).

transaction costs economics on the grounds of its under-socialized neglect of the embeddedness of social relations, and excessive focus on opportunistic tendencies of individual objectives (Martinez & Dacin, 1999). Within the cognitivist and behavioural approaches to the theory of the firm, organizations and other social institutions consist of individuals who act in relation to each other (March, 1978). Collective decision-making implies problems of conflicting objectives and values of different participants. Individual preferences can be inconsistent and change over time. Collective decision outcomes combine individual calculations through coalition formation, sequential goal setting, information bias and mutual incentives. The Ostrom (1990) approach to collective action in the management of common-pool natural resources is closer to rational choice theory, and has delivered fundamental contributions to the study of the governance of rivalrous, but non-excludable resources (Ostrom, 1990; Tortia, 2018). On the other hand, social systems theory has itself dealt with the structural features of social interaction, including the economics of organizations, and especially their emergence, evolution and interaction with the surrounding social environment. Both theoretical streams can contribute important insights in understanding how new rules limiting dismissal of worker-members in WCs can be conceived, their feasibility and sustainability over time.

3.1. Collective rationality and organizational routines in the evolutionary tradition

One notable criticism against the possibility of restricting dismissals of worker members in WCs concerns individual versus collective rationality. Since entrepreneurial action in cooperatives has collective nature, classical arguments on the failure of collective action concerning the tragedy of the commons and prisoners' dilemmas apply in their case too (Hardin, 1968, Ostrom, 1990). While the whole collectivity of members would clearly benefit from high organizational performance, which requires high performance of each member, restricting dismissals can favor myopic behaviors leading individuals to underperform, that is deliver only perfunctory and not consummate cooperation (Williamson, 1993). In this respect, the concept of collective rationality can be

exploited to show, as in several works in evolutionary economics, that inter-connective and relational dimensions of rationality induce individuals to recognize the collective nature of the institutional and organizational contexts, to develop had hoc rules to pursue collective objectives implement collective organizational objectives in their day to day operations. Resorting to incentive mechanisms and sanctions directed to forestall opportunism is not excluded, but coordination can more often take place through involvement, trust and deliberation.

In the evolutionary literature, collective rationality arises from the need to achieve collective objectives that cannot be reduced to individual preferences. In turn, individual outcomes represent a necessary condition for satisfying individual needs. In accord with DiMaggio and Powell (1983), it is possible to state that the collective side of rationality emerges and is crystallized in a dynamic way out of elaboration of rules and routines in inter and intra-organizational interactions, through institutionalization, or "structuration". Growing information and communication loads, and the development of a mutual awareness among participants represent the cognitive side of this process.

Most authors subscribe to the idea that organizational routines have collective nature, implying that their emergence and development is based on some sort of collective rationality, which does not need to be incompatible, but needs to be reconciled with individual rationality (Becker, 2004). Dosi, Nelson and Winter (2000: 5) stated that "... clarity would served by reserving the term "skills" to the individual level and the term "routines" to the organizational level". Collective rationality and learning have been widely regarded as arising from collective interaction on and outside the market (within organizations). Collective interactions represent mechanisms that select technologies, routines and strategies. Aggregate phenomena are emergent properties of the social system. Organizational forms and institutions emerge as self-maintaining results of both intentional and unintentional collective interactions. Organizational rationality is interpreted as a collective phenomenon that cannot be reduced to individual rationality except through a reductionist approach. Organizational rationality and learning are incorporated into routines and other

organizational practices (Dosi & Marengo, 2007). Lazaric (2000) finds the foundation of rules and routines in cognitive and social dynamics of individual and collective learning inside organizations. Similarly, but on more cognitive terms, Cohen et al. (1996) state that routinized behaviors emerge in social contexts, and especially in organizational settings, at both individual collective levels. Challenging or conflicting environments require coordination among large numbers of individuals. Routinization can be the result of active search for sets of rules coordinating collective actions, passive adaptation or interiorization, such as in the case of imitation, and introjection of existing norms. More critical stances underline a lack of micro-foundations in the analysis of routines and call for renewed attention to the central role of individual behavior and interactions, rather than assuming the existence of collective behaviors and outcomes (Felin & Foss, 2009).

Cohendet and Lierena (2003) highlight some potentially critical elements for this work. The emergence, nature and extent of organizational routines differs fundamentally in different types of communities, which may be hierarchical or functional and require disciplinary specialization, or instead defined horizontally, such as communities of practice, which require a common interest in a given activity and production of specialized knowledge to carry out collective production plans. The different communities provide different local contexts in which learning takes place leading to important differences in the replication of power and the generation of knowledge. This interpretation is consistent with the idea that cooperatives can develop their own peculiar rules and routines, which undergo contextual influences and follow paths for the achievement of organizational objectives that are different from other organizational contexts.

As will be deepened in the next sub-section, the collective rationality that guarantees the conjugation of individual preferences and organizational objectives emerges as a function of organizational systems rather than individual behavior. It is consistent with the evolution of organizational routines, which must function collectively as interconnected behavioral models that ensure firm survival, expansion and resilience to negative shocks. To this end, organizational

flexibility is guaranteed by the flexibility of organizational routines that evolve together with organizational governance and employment relationships to create framing effects that influence workers' expectations and behaviors (Feldman & Pentland, 2003).

In an organizational context informed by collective action and relational intensity, individual workers can recognize the economic and social value of holding job positions that minimize the risk of dismissal. If the danger of reduced productivity is eventually overcome, restrictions on layoffs show important benefits by combining collective rules and individual outcomes. EPRs reduce the danger that layoffs will occur in favor of dominant member groups and that collective action will cease without significant help given to the most vulnerable groups. Furthermore, they also limit the possibility that, fearing dismissal, cooperative attitudes will be replaced by individualistic and self-seeking behaviors. Economic security in terms of long-term expected income streams can further strengthen the motivational drives and mutual trust to achieve efficiency through consummate rather than perfunctory cooperation.

3.2. Systems theory and the emergence of EPRs in cooperatives

Social systems theory, especially in the works of Luhmann (1995, 2013), has been fruitfully applied to the organizational context as well as to many other social contexts. It investigates the condition in which social systems emerge, differ from the surrounding social environment and are able to achieve internal complexity with respect to external complexity through a process of self-production (autopoiesis) similar to the process of emergence and development of biological organisms (Maturana and Varela, 1980). The interaction with the environment takes place through a process of complexity reduction of the interaction towards the outside, whereby social systems, including organizations, build internal structures (rules, routines and governance structures) that are aimed at interacting with the environment only in those aspects that are useful and functional to the development of the system itself. The reduction of external complexity is a process necessary for

the development of social systems, given the unmanageable variety of elements and processes that characterize the social environment (Valentinov and Roth, 2021). Limited rationality of individuals requires that the rules and internal structures routinely deal with those processes that have a fundamental importance for the functioning of the system (Simon, 1955) through internal communication flows (Luhmann, 1988; Boldyrev, 2013). The creation of specific communication flows and structures allows the autopoiesis of the system and its differentiation from the social environment in general. In this way, through the reduction of complexity and the self-production of its internal functioning, the system builds its distinctive identity. All the elements that do not constitute the functioning of the system, including the individuals who act within it, fall outside its boundaries and interact with it through “structural coupling”. In particular, individuals (psychic systems) interact through the psychic mechanism of expectations on the outcomes of the functioning of the system. The psychic system of individuals cannot be confused with the system itself, even if the two can be deeply interpenetrated (Rempel, 2001). Given the recursive nature of the operations and communications produced by the system, this is said to be operationally closed with respect to the external environment (Lee, 2000; Seidl and Morman, 2015). In turn, the operational closure allows the possibility that the system interacts with the environment itself, selecting those types of interactions that are necessary and favorable to its development. Operational closure also supports the autopoiesis process, that is, the growth of internal complexity through the development of communication and other systemic structures, which differentiate the system from the external environment (Seidl and Mormann, 2015).

Structural coupling of a system with other systems creates exchanges and feedback mechanisms, but can lead to both better adaptation and mismatch, conflict and negative impacts. For example, in this perspective, the worsening of the climate crisis affecting natural ecosystems around the world derives from the tendency of the economic system to overload the natural system with its negative effects in terms of CO₂ emissions and excessive consumption of resources

(Valentinov, Roth and Pies, 2021). In this perspective, regarding the explanatory objectives of this work, collective rationality can be interpreted as an emerging feature of organizational systems, as embodied in organizational communication, and in the functioning of organizational routines and governance. The collective side of organizational behavior interacts closely with the bounded rationality of individuals (Seidl and Mormann, 2015).

The boundary of the organization separating the internal processes of cooperatives from their social environment is given by membership rights, which allow cooperatives to reduce external complexity, since they bestowed upon individual members upon entry and defined their capacity to partake an equal basis all decisional processes (viz the “one member, one vote rule”), also the most strategic ones and give decision making power to the member on (Birchall, 2011). This extreme procedural simplification in entitlements and control rights creates room for the growth of the internal complexity of cooperative governance, of which job stability is one single, but important part. Internal complexity, in turn, is directed to satisfy members’ needs rather than shareholder value.

The limitation of exclusion of dismissal would instead represent a yet to be completed outcome of the auto-poietic process of self-production of internal rules and routines in cooperatives. The direction taken by such an auto-poietic process would be the achievement of complete operational closure in the labor process, which would be functional to the accumulation and complete preservation of the human capital of the organization. This process of development, institutionalization and enforcement of operational closure can lead to increased competitive advantage through increased X-efficiency, and development of dynamic capabilities (Leibenstein, 1966; Teece and Pisano, 1994). Efficiency and productivity gains due to stricter regulation of dismissal can be strong in the medium to long run, while in the short term it may be possible to observe limited efficiency losses due to lack of coordination and erratic appearance of opportunistic

behaviors (cfr. Porter and van der Linde, 1995, on the competitiveness vs environmental costs debate).

The connection between the unique capabilities of the organization and operational closure relates, in Luhmann's terms, to the foundation of the system's identity: if the system were not operationally closed, its operations would be occurring anywhere in the environment, and thus the system could not be identified as such (Valentinov, 2014). The impossibility of "imitability in the environment" is the core of unique dynamic capabilities which underlie competitive advantage; operational closure thus emerges in the novel light as something to be achieved in an evolutionary way. Strong employment protection clearly relates to the possibility that operational closure constitutes a "protective function" for the resource of labor. In Luhmannian terms, this allows to create "internal degrees of freedom", which are expressed e.g. in the workers' commitment, goodwill, and excellence (Luhmann, 2006).

At the level of the working of the whole economic systems, operational closure makes the system exclusionary (Valentinov and Iliopoulos, 2021), but some of these excluded human needs can be served by cooperatives, which can survive in this precarious regime by establishing their own operational closure to protect and develop their resources. Operational closure can create internal degrees of freedom in such a way that systems come to overstrain their environment, as for example when the economic system causes an ecological or social crisis. In this case, however, operational closure does not only imply "deviant consequences", but can instead constitute at least partly an evolutionary adaptation intended to create "protected spaces", where key resources and competencies can be cherished and developed, not dissipated.

In the presence of restrictions on dismissals, internal organizational processes and working rules are modified. Given the difficulty or impossibility to layoff workers, the organization is forced to invest in training and human development of its incumbent human resources. Correspondingly, workers are incentivized to invest as well, since their perspective stay in the firm becomes long-

term and stable. These processes take place also in IOFs. However, in their case, dismissals of redundant workers is used on a routine basis and can be interpreted as a form of partial maladaptation of the internal working of the organizational, which reduces operational closure, since the system is often forced to shed valued resources in its interaction with the external environment, losing part of its distinctive identity and dynamic capabilities. In turn, this loss can endanger the system's ability to function and pursue its objectives. As said, the inability of IOFs to achieve operational closure in terms of limitation of dismissal can be due to the existence of contrasting interests and agency costs, that is to the imperfections of the employment relation. Worker cooperative can overcome at least part of these imperfections, since members holding control rights can target wage levels and production processes that minimize redundancies, while preserving efficiency and competitiveness.

These theoretical premises are coherent with the idea that the formalization of the rules of EPRs in WCs corresponds to the emergence of important elements of collective rationality embodied in a system of formal rules and organizational routines. By forestalling opportunism and depletion of human capital, the ability of such rules to limit the consequences of the contractual imperfections in the employment relation would correspond to a new form of operational closure based on emerging mechanisms of involvement, incentives and sanctions that support worker needs' fulfilment, while preserving alignment between individual and organizational objectives.

4. Examples: Mondragon in Spain and EP legislation in Italy

Two relevant examples of employment stabilization solutions in worker co-ops and in IOFs enterprises are discussed in this section. The first deals with the Mondragon group of worker cooperatives in the Basque region of Spain, the second with the Italian labor legislation in the period spanning from 1970 to 2015.

The Mondragon group of worker cooperatives was formally born in 1956, after a long process of training and institutional development that lasted about 10 years. The group currently employs more than 80,000 people in around 100 cooperatives on various continents. About 74% of the workers in industrial cooperatives are members.² During the severe financial and sovereign debt crisis of the period 2008-2012, layoffs were very limited, although the bankruptcy or liquidation of some large cooperatives forced the group to operate intra-group relocations and early retirements (White and White, 1991; Arando et al., 2014).

The number of layoffs from the origins of this group has been close to zero, although the legislation does not prevent co-operatives from firing workers. Spanish labor legislation is in force for all businesses, including cooperatives. It regulates two main types of dismissal: collective dismissal for economic, technical, organizational or productivity reasons and individual dismissal for objective or disciplinary reasons linked to the inability of the worker, for economic, technical, organizational and/or productivity reasons; lack of attendance at work, discipline or insubordination. Consequently, the strong employment stability in the Mondragon groups is to be considered as the result of the implicit bargaining between the workers and the cooperative, informed by the intrinsic characteristics of the cooperative governance discussed in the previous sections. The benefits to the organization in terms of accumulation of specific human capital and development of dynamic capabilities correspond to the members' demand for stable employment (Bretos, Errasti, Marcuello, 2019). As in most cooperative enterprise models, the flexibility of workers' pay and working hours, and both the wage and employment insurance function of reserves are the main tools used to achieve this result (Arando et al., 2010; Borzaga et al., 2021).

The importance of EPR and job stability is also evidenced by the development of dedicated legislation for conventional businesses in several countries. Taking Italy as a notable example of a Western European country, labor legislation has introduced strict legal constraints on the possibility

² MCC 2019 annual report: <https://www.mondragon-corporation.com/2019urtekotxostena/assets/downloads/eng/annual-report-2019.pdf>

of dismissing employees from "typical" permanent positions as early as 1970 in the so-called "Workers' Statute. "(law 300/70). The Statute is still in force today, but largely modified by successive reforms of 1997, 2001, 2012 and 2015, which led to the dismantling of the strictest rules limiting the possibility of dismissal to a closed list of cases. Article 18 of Law 300/70 aimed to uphold the right of workers to stable employment, and to limit the danger of unlawful dismissal and abuse of power by employers. Between 1970 and 2012 illegitimate dismissals (eg motivated by gender, ethnic, political, religious reasons) were always prohibited, while the possibility of firing workers was limited to "just cause" and "justified motivation", that is economic reasons (presence of redundancies and organizational crisis) and disciplinary dismissal (poorly performing workers with improper behavior). In all cases, the economic reasons and employee misconduct had to be proven by the employer. The same law also governed severance pay, minimum notice periods, administrative authorization for dismissals and prior discussion with representatives of trade unions and / or labor market administrations (Spataro, 2018). Failure to prove "just cause" or "justified motivation" would have entailed the reintegration of the worker into his/her job position by the Labor Court.

This type of strong job protection has led to a reduction in turnover and stabilization of employment for most workers, reducing both inflows and outflows from total national employment and the labor market. On the flip side, it also favored the emergence of a dual labor market made up of different categories of workers in a protected or "typical" (permanent) contractual position, and in the emergence of a secondary category of workers in a " atypical "(for example fixed-term contracts and casual workers; cfr. Vindigni, Scotti, and Tealdi, 2015). EPR has been accused of lowering productivity growth and employment levels, given the slow rate of entry into the labor market and high unemployment for the weakest social categories (especially women and young people; see Bertola, Boeri and Cazes , 1999, 2000). Contrary to the Mondragon case, legal constraints, not implicit bargaining, seem to represent the crucial premise of the stabilization of employment in IOFs in the Italian case.

5. Working rules and the economic effects of employment protection in worker cooperatives

Given the introductory premises, theoretical arguments and examples spelled in the previous sections, we will now proceed to develop a new proposal for an EPR that is specifically thought for worker cooperatives alone. The reasons for this special focus is that WCs represent the only organizational form in which employed workers coincide by law with the membership of the organization holding control rights, which implies their ability to take strategic decisions over organizational processes and employment policies (the labor process and wage setting). Besides, WCs have demonstrated to be able to protect employment levels better than IOFs. Membership rights are understood as subjective (non-saleable) control rights of the individual worker (Ellerman, 2016, 2020). They imply the right to keep one's own job position and the impossibility to separate the owner of the right to manage from his/her job position in all but a very restricted number of cases that have to do with worker proven misbehavior, retirement, and voluntary resignation. These peculiar characteristics set WCs apart from other organizational forms and can envisage the possibility to introduce new and more protective employment legislation in favor of their members.

This proposed restriction on layoffs in WCs can also be seen in relation to a similar right that rests with the position of shareholders as owners of IOFs. In the same way that shareholders cannot be forced to sell their shares and give up their control rights in IOFs, worker members holding control rights in WCs cannot be forced to leave their employment position against their will. The prohibition on forcibly compelling members to give up or sell their membership position would apply to both shareholders in IOFs and members in WCs. From a needs perspective, the associative rights linked to a job position in WCs aim at satisfying the needs of workers, in particular survival needs through the payment of a wage, and also security needs, which are satisfied by guaranteeing job stability. . This perspective is clearly consistent with Maslow's (1943) human psychology and

his theory of the hierarchy of needs, in which survival and security needs occupy the two most fundamental layers and represent the most "prepotent" needs.

5.1. Human capital and productivity

Strong EPRs proposed in this paper can be appealing to defenders of workers' rights inside organizations, but can also encounter severe criticism and rebuttal, on the grounds that strong employment protection can: (i) reduce the market value of the organization by increasing the cost of redundant labor; (ii) reduce productivity by increasing workers' possibilities to shirk and misbehave, distancing themselves from optimal organizational objectives; (iii) impeding efficient allocation of the labor input since workers cannot be relocated to the most productive occupations; (iv) reduce entrepreneurs' ability to choose the best performing workers and to substitute underperforming workers with more productive ones. These problems affect IOFs in a particularly strong way since, in their case, hoarding labor results almost automatically in a lower market value of the organization, wage rigidity limits the possibility to reduce labor costs during crisis, and contrasting interests make it particularly difficult to monitor workers that cannot be easily laid off.

The next step in our analysis requires asking whether worker cooperatives would run into the same problems, to what extent, whether these problems can be more easily circumvented in WCs than in IOFs, and whether strong EPRs can also have positive, not just negative, implications on the human capital and productivity in WCs. Given the strong spontaneous tendency of WCs to reduce layoffs, stricter employment protection can be interpreted as a process of organizational evolution which institutionalizes and reinforces trends already spontaneously observed. Formalizing strong EPRs in cooperatives can strengthen incentives to accumulate human capital and develop dynamic capabilities as the additional economic remuneration would be less likely to be dissipated by layoffs. The expected losses could be linked only to the risk of failure of the organization, while the higher costs generated by greater employment protection would be repaid in the medium to long

term by increased productivity. As discussed in the previous sections, the emergence of models of collective rationality, dedicated rules and routines, inclusive governance including monetary and non-monetary incentives and sanctions, would support the alignment of individual and collective goals. The evolution of cooperative governance can be understood as a process that aims to build internal structures that make the organization sustainable and resilient to external shocks, amending the failures of collective action.

On the negative side, strong EPRs can be criticized in cooperatives too, on the grounds that the ban on dismissals would eliminate the expected costs of unemployment as a worker discipline device, this way reducing productivity or requiring increased efficiency wages (Shapiro and Stiglitz, 1984). Furthermore, individual members may not be able to identify and pursue those behavioral patterns that are conducive to maximize collective outcomes.

Potential failures of collective action can be overcome through different channels. First, as concerns the risk of lower productivity, even in the absence of the expected costs of dismissal, the expected cost of bankruptcy or in any case of the economic crisis of the organization would still be clearly perceived by individual worker members (Titman, 1984; Bae, Kang, and Wang, 2011). If workers engage in sub-optimal behaviors, the probability of negative outcomes increases and so do the expected costs of bankruptcy. Given the close link between wages and company results in WCs (labor income is not defined as contractual remuneration but as a shares of residual earnings), worsening performance implies lower income and the endangering of members' livelihood. In the most extreme cases, low productivity would lead to company closure and job loss. Loss of efficiency in collective action is clearly a prisoner's dilemma like problem (Alchian and Demsetz, 1972), but peer pressure is likely to intervene as powerful behavioral mechanisms that induces under-performing workers to improve their results. (Ostrom, 1990). In more general terms, cooperative governance is likely to evolve in ways that guarantee the efficiency of collective action by including coordination mechanisms supporting adequate monitoring and sanctions (Commons, 1950; Ostrom, 1990; Bowles and Gintis, 1993).

Second, the increased expected economic value of the job itself can favor increased members' active participation and increased productivity. Job stability in the long term implies that the economic value of the job to the member is increased, while at the same time the expected cost of job loss decreases, especially when members' horizon is particularly long (e.g. young members that are willing stay with the organization for several years). Job stability and its higher economic value strengthens the incentive to stay with the organization and invest in professional growth. In turn, cooperatives with these characteristics are expected to hire committed workers characterized by a long-time horizon of permanence in the firm, which would match the expectation of long-term professional growth and support increased future productivity. Furthermore, the development of interpersonal relations that are specific to the organization, the accumulation of social capital and trust can contribute to lower transaction costs and support the development of the organization.

Criticisms concerning costs are crucial as well, since strong EPRs may be expected to favor demands of wage increases, and prevent cost reduction during downturns. As said, however, the lack of a clear distinction and contrasting interests between employers and employees implies that EPRs are not likely to engender strong demands for wage increases (Albanese et al., 2019). Furthermore, wage flexibility characterizing co-ops favors the adaptation of labor costs to the business cycle, also in its negative phases (Roelants et al., 2012; Delbono and Reggiani, 2013). We now turn to a more thorough analysis of wage dynamics and voluntary resignation as dominant mechanism of reallocation of labor to more productive occupations.

5.2. *Wage dynamics*

The strong link between wages and company results in worker co-ops, on the one hand, and the exclusion of dismissal on the other, would have radical impacts on wage and turnover dynamics. In general terms, wages are pro-cyclical in worker co-ops more than in IOFs, where they are more strongly correspond to market equilibrium levels. Co-ops can, and indeed do often choose to

stabilize the level of wages by setting quasi-fixed rates, while end of the year residuals and accumulated reserves of capital are left to absorb negative shocks (Navarra and Tortia, 2014).

In the framework developed in this paper, a minimum wage level equal for all members would have the function of guaranteeing the satisfaction of workers' basic needs in the same way for each individual member.³ On the other hand, co-operatives are expected to and can differentiate wages above the minimum in order to align income with productivity and work experience. This way, two fundamental distributive objectives can be achieved at one and the same time: workers' right to a fair income satisfying their needs, and remuneration on the basis of desert. The ratio of the highest to the lowest wage cannot be defined ex-ante, since it depends on a long list of intervening causes, among which individual workers' innate ability, effort contribution, the availability of outside options, firm dimension, sector of operation.

When layoffs are limited by law or other regulatory constraints, internal working rules must ensure stability, especially during negative economic phases. When the organization is forced to reduce labor costs to regain economic sustainability and achieve resilience to crisis, all wages can be proportionally reduced down to the minimum level, which can be set by the organization itself or by law, later to return at the initial level when external economic conditions improve. This automatic wage reduction mechanism is purely quantitative and can be used for its unequivocal simplicity to pre-empt the danger of distributive conflict. It can be put in place whenever the company demonstrates the inability to pay back wages, and is clearly functional to ensure its survival. Wages would increase based on productivity and experience during expansion, while automatically adjusting to external conditions during contraction.

When wages fall, workers who have better external options, who are also the workers who presumably hold the best professional skills and competencies, may decide to resign. In this way,

³ This basic rule can be changed in large and stratified cooperatives, where there are different categories of workers. Despite the importance of defining the basic characteristics of distribution patterns, this problem is not the main topic of this article and is deferred for future research.

total employment would be reduced not due to layoffs, but to voluntary resignations. Other workers can resign voluntarily when the wage paid falls below their participation constraint (reserve wage), due to the existence of unemployment benefits, or by preference given to self-employment. When the available resources are not even sufficient to pay the minimum wage to each individual member, the cooperative can decide either to lower the minimum wage down to legally permissible levels, or to stop operations and go into liquidation. This mechanism would ensure economic sustainability and the allocation of work to the most productive occupations.

In bad economic times the cooperative may be forced to pay wages to redundant worker-members, resulting in an inefficient allocation of wage funds. This apparently inefficient distributive pattern, would fulfill its wage insurance function and the hoarding of labor can allow for the preservation of valuable skills and human capital, which would be lost in the event of dismissal. The acceptance of these rules takes place upon the worker becoming a member and takes place under the veil of ignorance, since at the time of signing the cooperative social pact workers cannot accurately predict the future economic conditions of the organization and which workers would become redundant and dismissed in the case of a crisis (Sacconi et al., 2011). As a result, risk-averse members may prefer to subscribe to this type of rule not only to guarantee fair outcomes, but also to insure themselves against unpredictable negative events.

To conclude this section, it is important to note that criticisms of the possibility that limiting or excluding dismissal would reduce the incentive to be productive and to invest in professional growth and the creation of new human capital appear misguided. Highly skilled and experienced workers would enjoy better opportunities for professional growth within the organization and better external options for new jobs in the event of a crisis, and collapsing wages. Low skilled workers would be forced to face falling wages without the possibility of finding alternative employment, especially when the most skilled workers leave. Skills, training and human capital would be all the

more important to ensure the efficient functioning of organizations and good prospects for professional growth.⁴

6. Conclusion and policy implications

The proposal in this article can be interpreted as the elaboration of a new “social technology” (Nelson and Sampat, 2000) in the tradition foreseen by the economics of collective action (Commons, 1931, 1950). Its premise is the incompatibility of the owner's control rights with the involuntary separation from one's working position in worker cooperatives. However, in reality layoffs are observed in many worker co-operatives in most countries. Employment contracts and employment relationships in cooperatives are similar in many respects to those found in IOFs. In the most extreme cases, workers who are members of a cooperative can enjoy less employment protection than employees in IOFs, since employees benefit from trade union protection clauses, while membership rights in worker cooperatives are often interpreted as pertaining to self-employment (Iannuzzi and Sacchetto, 2020). This interpretation supports the possibility for cooperatives to dismiss members at their discretion and risks undermining the distinctive cooperative identity which has to do with the protection of workers' rights and the satisfaction of their needs. To address these problems, the proposal in this paper has discussed the possibility of limiting the right to dismiss members in worker cooperatives. It is consistent with existing empirical evidence that worker co-ops resort to layoffs less often than IOFs due to the characteristics of cooperative governance. The proposal seeks to institutionalize and strengthen existing practices in order to better guarantee workers' rights and prevent the risk of deviant organizational behavior.

⁴ The importance of studying the position of workers who do not want or cannot join WCs as members (eg temporary or casual workers or workers who prefer to stay self-employed) cannot be understated in any way. However, we are forced to leave this crucial topic for future research.

Critical observations may consider the fact that prohibitions (including the prohibition of dismissal) carry the risk of inefficiencies and can give rise to elusive behavior: if compressed by prohibitions and regulatory rigidity, economic forces take their revenge leading to under-the-counter agreements and reduced efficiency of transactions. The arguments developed in this work highlight that rights in organizations imply, in addition to the risk of inefficiencies, also significant systemic benefits in terms of increased well-being, and greater incentives to invest in human and relational capital, and in organizational skills. These positive elements can easily overcome the burden of inefficient resource allocation. While IOFs need layoffs to achieve profit and shareholder value maximization, they have proven unable to ensure job stability for all workers and overcome some basic contractual imperfections, including wage rigidity. The same is not true for cooperatives that pursue the satisfaction of workers' needs. A second crucial criticism is that, in the absence of the possibility of layoff, workers would acquire too much bargaining power and could use it to raise wages and reduce effort, thereby reducing profits and organizational growth. On the other hand, the job positions and professional growth of members crucially depend on the prosperity and sustainability of the collective enterprise. The collective rationality embodied in internal regulation and routines should take into account and manage the danger of unbalanced concessions, which would endanger the survival of the company and the very right to a stable job. In this, worker cooperatives can leverage the absence of conflicting interests between owners and employees, which implies that the risk of excessive wage demands can be kept in check, while information asymmetry can be more easily overcome to ensure the efficiency of labor processes.

Final considerations lead us to affirm that the radical characterization of the proposed institutional solutions does not recommend introducing binding legal constraints for all work cooperatives. In a more minimalist way, the new labor protection regimes can be implemented on a voluntary basis by those individual worker cooperatives that independently recognize their potential benefits. This argument is valid for both newly created cooperatives and existing cooperatives, which would have to take several intermediate steps to reach the new organizational set-up.

Workers would leave the firm on a voluntary basis, either because they have better external opportunities (in other organizations or as self-employed workers) or because their wages become so low that they violate their participation constraint. Future research will focus on identifying in a more refined way the most suitable working rules to support the restriction of layoffs and measuring their impact on individual and organizational outcomes.

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