Inequalities and the reasonable utopia of corporate governance democratisation: a viable proposal for Works and in-Company Citizenship Councils[1]

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Pre-distribution and Corporate Governance

Two of the most prominent Democratic candidates in the forthcoming USA presidential elections, Bernie Sanders and Elizabeth Warren, are proposing in their manifestos forms of economic democracy that would radically alter the structure of American corporate governance. A country which, rightly or wrongly, is seen as the source of the "shareholder value" model and the idea of "shareholder primacy" in corporate governance, that entails also the primacy of the financial sector over the real economy. While Sanders proposes a national fund that would give workers (partial) access to ownership of corporations in general (not only the firm in which they are employed), Warren (more coherently) proposes to introduce forms of workers participation in corporate governance (as such, not as shareholders), inspired by the German experience of co-determination. In the past, such ideas would have been unthinkable in the United States.

However, it is certainly not casual that more or less at the same time the *Business Roundtable*, an association of CEOs of the main American corporations, issued a new statement on the "corporate purpose" that should lead corporate governance practices (*Business Roundtable* 2019). Their statement is a clear affirmation of the "stakeholder approach" (see Freeman et al. 2010), in which all the stakeholders (consumers, employees, suppliers, local communities and last shareholders) are considered as equally essential to the purpose of the firm. A clear step back from the shareholder primacy doctrine that led all of them across the last forty years. Admittedly, the statement can be read as a response to a need of re-legitimization of "Corporate America" in the American society, and also as a pre-emptive move with respect to the new proposals of reform that could change the legal rules of corporate governance according to the stakeholder perspective (they seems to say "we already are in line with the interests of all corporate stakeholders, no need for reform!") Nevertheless, this is a clear sign of the importance of the democratization of corporate governance issue in the US.

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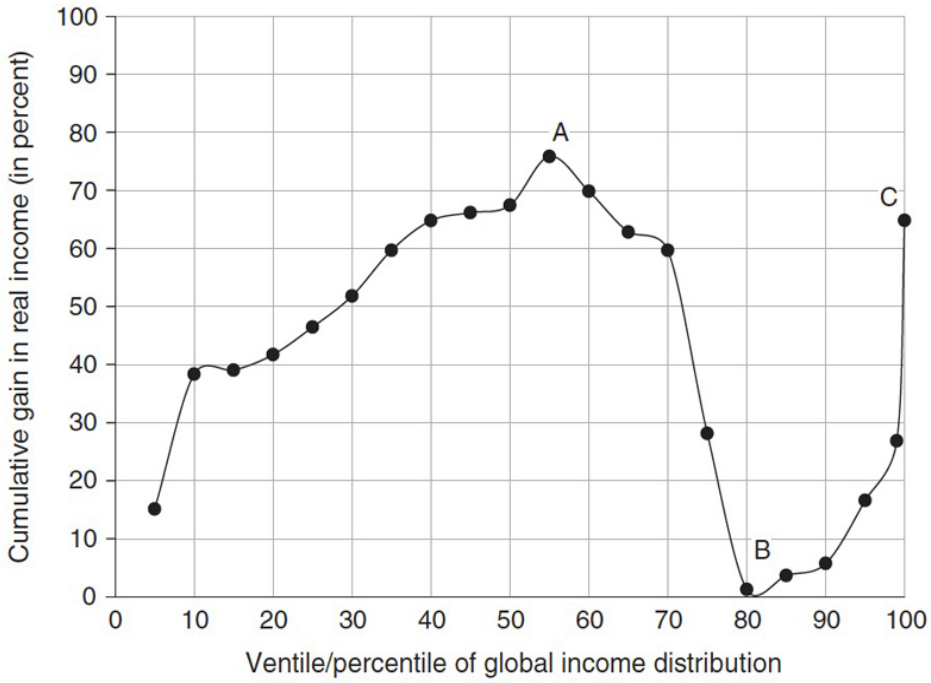
In Italy, while democratic, left-wing and reformist political parties, as well as the so-called 'populist' movements, maintain a deafening silence on the relation between the democratization of corporate governance and the fight against inequality, a proposal has been put forward by the *Forum on Inequalities and Diversity (Forum Disuguaglianze e Diversità).* This project seems more carefully designed than either of those mentioned above and consists - through proposed a partial reform of company law - of the establishment of *Works and in-Company Citizenship Councils* (*WiCCC* hereafter) in any company above a minimal dimensional threshold (see *Forum Disuguaglianze e Diversità*, 2019.)

Leaving aside the differences among these proposals, all of them are born out of an acute awareness of the processes responsible for an explosion of income and wealth inequalities in 'developed' countries, as clearly described by Branko Milanovic's 'elephant ghaph' (Milanovic 2017), which shows how in the 20 years of maximal globalization of international economy the low-income classes in these countries have experienced no percentage income growth (see point B in the graph), while those who were already at the top of the income distribution pile have seen vertical growth (the higher their starting point, the greater the growth; see point C in the graph). There has been a clear shift from labour returns to capital returns, independent of the dynamics of labour productivity. And, as far as labour returns are concerned, there has been an income polarisation in favour of top management positions and senior professionals in institutions and organisations that affects corporate decisions on finance or the acquisition and exploitation of technological patents. Many of these positions – as Piketty (2014) says - set their own remuneration for their 'job', relating it to the shareholder value (as far as it is upwards) of the company they lead, and that they are able to affect or manipulate (for a related analysis of inequalities in Italy see AGIRE 2018) .

Through taxation, the redistributive policy of the welfare state has an important impact on income inequality. Yet it is not capable of making significant corrections to a disproportionate inequality in 'market' income, which (i) develops out of the unequal distribution of property and control over resources, capabilities and rights; and which (ii) then increases through market mechanisms and the institutions operating in the market – especially firms, i.e. institutions wherein residual control rights base authority relations and are far from being neutral when it comes to the distribution of wealth and income (in other word, authority relations based on the allocation of residual control rights substantially affect the appropriation of the firms' surplus obtained through the cooperation of its essential stakeholders). This happens not only as a result of the different professional qualifications of

those who are involved in the labour market, or their marginal productivity, but because the initial unequal distribution of control and decision-making rights generates inequalities in terms of distribution of the corporate earnings, increasing the income and wealth gap well beyond any level that could be justified in terms of desert or personal contribution. Consequently, any aspiration to put a brake on inequality requires not only redistribution (through taxation) but also the pre-distribution of resources, abilities and rights (of ownership, decision-making and participation) that will allow individuals to take part in market operations and shape the functioning and outcomes of market institutions and organization – first of all the firms.



RELATIVE GAIN IN REAL PER CAPITA INCOME BY GLOBAL INCOME LEVEL, 1988–2008

(source: B. Milanovic, Global Inequality, 2017, p.11)

Failing this, redistribution turns out to be a Sisyphean task, or – in other words – becomes something like the paradox of Penelope's canvas: whatever the visible hand of the welfare state weaves during the day is unravelled at night by the hands not so much *invisible* as *hidden* of the market institutions and organizations (Sacconi 2014).

I must clarify that the pre-distribution strategy is not limited to giving greater bargaining power to workers by boosting their qualifications and employability: good school training for everyone is not the only strategy. The issue is the allocation of *control*, that is to say *who* holds the decision-making rights that allow or prevent access to the firm's assets, and that are exercised in relation to choices concerning the distribution of value created by the use of resources and the employees skills. Especially their specific human capital resulting form their firm or job specific investments. A higher professional qualification certainly may make a difference, but it is not enough to unravel the distributive outcomes. What counts is *who has the right* to make decisions about the way in which the jointly created surplus is distributed.

That is why the *capabilities approach* (in Amartya Sen's sense) is so productive in any debate about pre-distribution. In fact, it is not only a question of training to increase skills, but of assigning equal and maximal capabilities, in terms of *the freedom to choose how to use skills and therefore how to operate in the work environment in order to achieve the employee functionings.* This is the way to raise levels of well-being. Such capabilities are 'positive freedoms' for workers. They imply valid claims to non-exclusion and participation. And they inevitably limit the authority that comes from ownership - understood as the *exclusive right* to determine who may access the firms' physical assets, how to use such assets in the face of non-contractible events going beyond what the employment contracts explicitly says, and how to distribute the surplus deriving from their use.

Hence, the capability approach entails a constraint over this authority, so that property rights in the corporate domain are not anymore an exclusive right (see Fia and Sacconi 2018). Corporate governance should thus be a limited and legitimate form of "private government" (cf. Anderson 2017) that respects the autonomy of every stakeholder (each citizen in the company) and above all the autonomy of the employees.

No doubt this argument (which as a normative economic theory is informed by Sen's *capability approach*, see Sen 1997, 2009) has implications difficult to understand for economists and lawyers indoctrinated with the neo-liberal creed. In fact this view sees corporate governance as essentially *a matter of social justice*, which comes *before* efficiency. (Exactly the opposite of the law and economics orthodox views, like Kaplow and Shavell (2009), who completely ignore how fairness in the social contract view may play the role of an equilibrium selection device, allowing institutions to satisfy the equilibrium property, which has logical priority with respect to the efficiency of the law. This is a subject to which

we will return shortly - but in order to find a general justification of the previous statement see Binmore 2005, my essay in Sacconi, Blair Freeman and Vercelli 2011 and finally Basu 2018).

Summing up equal citizenship demands a certain level of capability (positive freedom) to participate in corporate governance as a citizen in the company (cf. Fia & Sacconi 2018). Private and company law are not immune to the demands of social justice (cf. Sacconi 2019.)

The proposal for WiCCCs

These theoretical hypotheses form the basis of the proposal for *WiCCCs*. In the absence of wide reforms to company law, the best-known form of workers participation – the appointment of workers' representatives to the board of directors – risks being ineffective, because of the principle that obliges directors to seek a "corporate interest" understood as reflecting the shareholders' interests. The form of workers democratic participation in corporate governance here defended, which has already been extensively trialled in Germany and the Netherlands, is therefore that of *Works Council* (on the German case see Page 2018, Gelter 2009 and Osterloh, Frey and Zeitoun, 2011.) These are bodies giving workers institutionalised representation at the factory and company level, separate from the board of directors and therefore able to avoid the constraint of being committed to the "corporate interest" (as currently defined), but nonetheless accepted as part of the corporate governance process, through the various powers and legal rights assigned to them. They would have nonetheless an institutionalised link to the board of director, with one or more representatives attending board meetings and having a say and the right to make proposals in relation with all subjects of strategic importance but voting rights only in relation to specific matters.

As compared to previous European experiences, the Italian proposal has some important new features: the inclusion in the council of all workers who make a relevant contribution to the company value creation (or the production district value) regardless of contractual arrangements, and the 'voice' given in the council to representatives of other stakeholders. In fact, the proposal envisages the councils as extending their reach to include employees not only linked to the firm through a direct permanent contract but also temporary contracts, or located in the production districts, contractual networks and the supply chains of a main firm, as well as representatives of local communities affected by the environmental consequences of the business's activities and indeed consumers or service users. This is the reason for the

name *Works and in-Company Citizenship Council (*see Sacconi, Denozza and Stabilini 2019, and *Forum Disuguaglianze e Diversità* 2019)

In order to grasp the scope of the proposal, consider the areas in which the *WiCCC* would be involved: a) decisions of a general strategic importance (new products, new investments, disposals and acquisitions, technological research & innovations, managerial structures; b) decisions that are of general interest to employees, such as recruitment campaigns and reorganisations resulting from innovation processes; c) decisions that have a practical impact on individual or groups of workers. In all these areas, the *WiCCC* would have the right to information and consultation in good time, which would imply the ability to make counterproposals and an obligation on the part of management to respond. As regards c) above, the *WiCCC* would additionally have a veto right unless full agreement is reached – i.e. an effective co-determination power.

It should be clearly recognizable that such a change would have a significant effect on the workforce's bargaining power in certain critical circumstances: one only has to think of the recent corporate crises in Italy like as that of *Whirlpool* factory in Naples and *Mercatone,* or the selling of the *Pernigotti* brand to other producers – that would have left the original factories without a recognizable identity of their products. In all these cases it would have been simply impossible to reach such unilateral decisions for closure, redundancies or disposal. Any such decisions would have had to go through a procedure that allowed for information, consultation and a response to any counterproposals from the *WiCCC.* And in the end, they would have been blocked if not accompanied by plans to reduce the social cost of restructuring – plans that would have had to be put in place well before redundancies or plant closures were publicly announced. Or consider the case of the steel company *Ilva* in Taranto: had governance involved workers and representatives from the local area affected by the environmental impact of production, the needs of finding a balance between the claims for safeguarding jobs and protecting health would have urged well before, many years before, to introduce gradual but effective technological renovation and productive conversion of the factory.

Acceptance by the business world

Why then do we not proceed in this direction? Some well-meaning commentators may ask where the advantage lies for entrepreneurs and company owners in agreeing to such a change. Here I must admits that the standard economic reasoning centred on the recourse to the

criteria of mutual advantage (or efficiency in the sense of Pareto principle) can be insufficient. To be sure, many studies on the theory of the firm show that forms of governance which aim to ensure an equitable balance between all key stakeholders are more efficient than unilateral arrangements (see Aoki 1984, 2010 and in general the essays in Sacconi et al. 2011). This is self-evident, considering that unilateral governance in a context of specific multi-lateral investments (including investment in specific human capital by workers) risks an abuse of authority and therefore also risks, together with expropriation, a reduction in incentives to invest and the consequent loss of opportunity for joint value creation and mutual benefit. The Japanese Stanford economist, Masahiko Aoki, showed that the most innovative and successful Japanese firms are characterised by complementarity between the cognitive resources of workers and management and by their reciprocal co-essentiality (the decisions of one cannot be implemented without the cooperation of the other). He also demonstrated that in face of such an alliance, which is essential to the firm productivity, holders of financial investments can at most play an oversight role (like as a supervisory power) but cannot hold an actual residual decision right and managerial responsibility (Aoki 2010).

But if we take as starting point a situation of unilateral governance – already imposing shareholder primacy - greater efficiency will not nevertheless be enough to ensure the transition to a shared form of governance. Put simply, set against the general benefits, the personal incentive may be lacking. A larger pie in the long term may mean a smaller slice in the short term for those who initially have residual control. So, giving not enough incentive to accept the new form of governance. Obviously, in the long run a managerial and business strategy that aims to guarantee an equitable balance between stakeholders can have positive reputational outcomes. But there are too many possible kinds of reputation, and in the face of radical uncertainty about the future and unpredictable events, the probability of being able to acquire one specific kind cannot be determined.

Hence, in fact, different forms of capitalism persist, characterised by different forms of corporate governance, that show equilibrium and stability properties each contingent on their own context, without a proof that they are in general the most efficient. This is what economists call *multiplicity of institutional equilibria*.

For example, the model of central Europe and Scandinavian co-determination, or the Japanese model, co-existed with the ‘shareholder value’ model ideologically and *de facto* dominant in Anglo-Saxon countries along the last forty years. Italy has clearly associated

itself with this model at least since the latest reform of company law (2003) – which is a phenomenal producer of inequalities. It is not efficiency that prompts the choice of a institutional equilibrium, but the prevalence of a social norm: a concept of social justice or an economic ideology (a mental model that frames the representation of the firm) and ultimately a version of the social contract which selects a particular equilibrium path or directs the equilibrium selection dynamics toward a particular institutional equilibrium.

At the same time, economists should accept that not everything can come out of the aggregation of individual market behaviours (neither in case such behaviours are virtuous, as it is true for responsible consumption or sustainable finance.) Some institutional equilibria cannot be reached only through a process of molecular adaptation if the starting point is another institutional equilibrium, even though it may be less efficient and less fair. Collective action (i.e. public choice based on alternative aggregation mechanisms of individual preferences and values) is needed. In other words, institutional change needs a trigger either through the selection by agreement of an alternative equilibrium path, or the joint adoption of a 'mental model' that can facilitate the passage from one path to another. Along such a path micro-interaction then contribute to reinforcement of a new behaviour rule and beliefs system, until a new institutional equilibrium state is reached. From a normative perspective, the social contract, an initial impartial agreement between the parties concerning principles, is the most effective trigger for starting a process that can lead to a new institutional equilibrium state.

This does not mean that acceptance of *WiCCCs* should be 'imposed' on businesses. The good news, which comes out of the discoveries of behavioural and experimental economics (see Faillo, Ottone and Sacconi 2015), is that an impartial deliberation (agreement) engenders reciprocal beliefs in compliance. At the same time it activates conditional dispositions that – as far as compliance is mutually expected - motivate actual compliance choices with the wholly endogenous (i.e. not imposed) agreed principles. This in turn prompts behaviour characterised by mutual support, set in motion by the initial agreement. In the end the resulting (governance) institutions are rules of behaviour that the parties would adhere to because they think the others are doing so.

Implementation Process

The process for implementing the *WiCCC* proposal is consistent with this approach (see *Forum Disuguaglianze e Diversità* 2019; Sacconi, Denozza and Stabilini 2019.) The idea is

to ‘attack’ both ‘from above and below’ at the same time: that is to complement regulation via general mandatory rules with self-regulation by means of agreements between the parties and experimentation even at the level of individual firms, which may take advantage of private autonomy. Indeed, a complete and concrete legislative discipline would not work. There are too many aspects to the problem in terms of the different kinds and sizes of firms, and legislators would lack the requisite detailed knowledge. On the other hand, for companies a purely voluntary and self-regulation approach would not work either (and did not work for *corporate social responsibility*, CSR, a topic on which they already faced the demand for an extension of corporate fiduciary duties toward all the essential corporate stakeholders). Complementarity of regulatory and self-regulatory tools promises to be more effective.

First of all, a trigger factor is needed for starting a process: a general legal norm, based on a wide political support, would establish general principles and settle a minimum *imperative* content concerning the legal obligation for any company to establish a *WiCCC. Such norm* would have mainly a programmatic value. With this as a starting point, leeway can be given for self-regulation and soft law, not approached unilaterally but as a definition of rules to be implemented through agreement between the interested parties at different levels. A national committee would be set up for this purpose, representing the corporate constituencies (entrepreneurs and corporate owners through business associations and employees through trade unions) and the organisations that best represent consumers and environmental interests, with the aim of establishing bylaws models and implementation rules to be adopted through mutual consensus. This committee would be assisted by an independent technical-administrative commission, composed of publicly appointed experts who would oversee the consistency between agreed implementation rules / bylaws models and legislation relating to the establishment of *WiCCCs*, and who would be able to complete the implementation rules should the parties not reach agreement.

Such regulations would constitute the default rule for company level implementation, i.e. would apply in the absence of a different choice. Companies would normally reform their statutes as required by the bylaw models. But if they were able to provide reasonable justification, they could choose to opt out from the proposed schemes and adopt an alternative solution that would still offer a form of implementation at the single company level – through a different statute reform – nonetheless consistent with the law. Should such arrangements not be consistent with legal requirements, corrective action would need to be taken. Together with reporting obligations, the implementation rules should allow plenty of

scope for bottom-up monitoring and for independent verification carried out by third party bodies, formed as voluntary initiatives by active citizenship associations, trade unions, business associations and certification professionals. These would be organised so as to be shielded from conflicts of interest and would verify compliance and the efficacy of the solutions adopted by single companies.

Summing up, a collective choice (a law with a minimal imperative content, establishing general principles and providing guidance) can be the trigger for a major deliberative work-in-progress, exploring new forms of economic democracy at the national, local and company level. The idea is that impartial deliberation at these various levels can in turn create incentives and preferences to support the adoption and implementation of democratic corporate governance throughout companies of different nature, dimension and sector. Well beyond what would be possible based solely on the hypothesis of rational egoism and self-interested behaviour of the involved parties. (Note that even if a bit optimistic, this is not wishful thinking: it is based on the behavioural economics results quoted at the end of the previous section.)

Acceptance by trade unions

There is therefore a reasonably solid theory of implementation. What then still lacks to enable progress to be made? We cannot shy away from the fact that the principal obstacle is the trade unions' potential fear, understandable but unfounded, that the *WiCCC*s would deprive them of their role, at least in terms of the role that unions play through integrative negotiations at the factory or territorial levels. However, the function of councils – enabling employee participation in corporate governance – is clearly distinct from the function that trade union play in representing employees in bargaining over (integrative) employment contracts. What governance does is different from what can be done through the ex post bargaining of contracts, and it steps in at very different points. Governance intervenes in the process of deliberating the corporate intentions, plans and choices, before they can be brought to the negotiating table with the unions. An involvement in governance *therefore* provides employees with the opportunity to participate in the corporate decision-making process well before it gets to the point of 'take it or leave it'. On the other hand, trade unions are free associations of workers with legal autonomy from the company and can undertake collective actions (like strikes) that are not open to the *WiCCC*, as an institutional organ of corporate governance.

Although governance and the negotiation of work contracts are distinct in terms of the nature, functions and timing of their interventions, there is nothing to prevent trade unions from being a protagonist in both. In particular by organising the participation of employees in the *WiCCC* election by a proper selection and support given to the union's candidates and their electoral programs. In other words, it has the possibility of operating in both spheres, rather than just the sphere of integrative contracts bargaining, which is only relevant to a small minority of companies in Italy.

Additionally, although they are different and belong to separate stages, the two functions are complementary. Consider decisions reached through the firm strategic decision process that are often made well before they are discussed publicly and so – admitted the possibility exists for company level negotiations –often reach the negotiation table as an ultimatum. Then workers are left with the option of acquiescence or the need to seek a compromise against the most negative end-effects of choices that they have had no way of influencing:

- *Digital technological innovation and use of AI in the reorganisation of work, with consequent employment impacts (especially in the use of IT applications that may or may not replace jobs).*
- *Corporate welfare, with paternalistic offers of services that 'privatise' social welfare, or that can be shared and integrated with local social welfare systems.*
- *The granting of productivity bonuses and arrangements for variable pay relating to the company's performance.*
- *Maximum remuneration differentials within the company between managers or directors and the low or average pay workers (which have a critical impact on inequality).*

Unless they are involved in governance, trade unions representatives cannot influence the company decisions on theme matters. So that the final terms the company representatives will deliver to the bargaining table with the unions (assuming company level negotiations are active) will not incorporate the employees' viewpoint. In these cases, the role of the *WiCCC* in shaping the corporate plans and decisions, which will then reach the stage of company level negotiations with unions, complements the unions' bargaining power, since it is instrumental in ensuring that company proposals better reflect the interest of employees and ease that they are acceptable to the unions.

The risk that on occasion the elected members of the *WiCCC* might have different views from grassroots union representatives ultimately comes down to the ability of the union to

coordinate what the union's left hand and right hand are doing in terms of organising two different forms of employee representation. But it is not clear how this possibility can outweigh the great advantages for the role of confederal trade unionism itself, which never accepted to be confined to the mere role of salary negotiation. In fact the *WiCCC* would offer representation within the same council to all the types of labour that collaborate in a given business firm, but which the organisation of work and the diversification of contracts tend to keep apart or set against each other: permanent, fixed-term and semi-subordinate workers; those with collaboration agreements and those with a phoney status as free-lance professional collaborators; the so called 'riders' - *de facto* employees under piece-work contracts with firms organizing work through a digital platforms (even though the firm pretends the platform to be a neutral market to which single riders participate as free -lance in competition with one another); workers in the supply chain or in the network (or district) to which the company belongs as the main hub in the network – and that in reality constitutes an alternative organisational solution to the very same problem of coordination that could be addressed by a unified organisation. Then, there would be a forum where workers separated by their different contractual typologies could be reunited through involvement in governance and where unions could organize their unified representation, identifying a participation program that would express an equitable balancing of their interests.

At the same time, the involvement in the councils of local communities representatives, in particular those representing environmental interests, would help the unions to resolve, through their participation, possible conflicts between the claims to preserve jobs and to protect the environment within a perspective of social and environmental sustainability. It is not necessary to assume that these representatives would have the same powers as workers' representatives. They could, for example, have rights to consultation but not co-determination in relation to issues directly affecting the material conditions of workers. Nevertheless, the *WiCCC*s would work as place of deliberation on projects aimed at the use green technologies and production processes with reduced environmental impact and energy consumption, respecting the importance of health without sacrificing jobs or creating new ones affordable also to the same employees. In other words, they would function as forums for balancing future generations' claims to environmental (and inter-generational) justice with the claim for intragenerational justice in terms of the equitable distribution of sustainability costs within the present generation.

Conclusion

To conclude, there is an even more general issue. Confederal trade unionism has never accepted that it should reduce its function to a negotiation for the price and quantity of labour sold by employees to their employers. Traditionally it has identified itself as a mean to enable workers to take part in the democratic life of society. The question is: why not so also at company level? In fact, however much one wants to expand the substance of contract negotiations, the contract always defines a commercial transaction: remuneration for labour rendered. But this means that labour remains a means acquired by the company to achieve a further goal that is independent, and maybe stranger to the workers' goal.

However, consider that even for the theorists who explain the existence of the firm through the incomplete nature of contracts (viz. Williamson 1975), the firm as an organization and its governance structure do exist precisely because there are decisions that must be taken which cannot be ex ante contracted, so that they are outside the contract's scope. The variety and radical uncertainty of events that affect joint production are too wide and ex ante unmanageable to allow to treat them via an ex ante detailed employment contract. For deciding on these matters some ex post flexibility and discretion is needed, that must be able to resolve potential coordination and cooperation problems emerging when unpredicted events occur, and in the context of which details of such a cooperative endeavour are not preestablished. Hence, the relevant discretionary decisions fall within the sphere of authority of those who are running the company. Such authority sphere allows for discretionary choices which attest the entrepreneurial and managerial autonomy and entails a claim of (voluntary) acceptance on the employees' part. We contend, however, that outside the contractual sphere managerial authority should be limited or shared with workers (or made compatible with the employee's positive freedom and capabilities), even if they do not have ownership rights over the company's physical assets, for the simple reason that they are *free and equal persons*, equally worthy of *consideration* and *respect*.

This has an impact on the workers autonomy. As long as they are only providers of means, they cannot be included among those who are in the position to establish the purpose or goals of that artificial social actor called 'corporation' or 'company'. They cannot therefore exercise autonomy in the sense of taking part in setting goals for the form of social cooperation in which they are involved. They are treated like a mere means to an end. Conversely economic democracy in the form of *WiCCC*s, very closely attuned to the actual circumstances of life and work, would ensure that the goals of the various stakeholders were brought together for the purpose of defining the corporate end. This would mean that all the

stakeholders, and above all the employees, were treated – in Kantian sense – as always sources of ends *on their own*, and never instrumentally as mere means to any further end.

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