Chapter Five

Democracy and power as foundations of employee control

Andrew D. Mitchell

Liberal democratic countries have long emphasised values of liberty and freedom while encouraging individuals to participate in political decision-making. A political consensus has developed, providing the citizen with democratic rights over the state, as well as property and contract rights. However, the employer/employee relationship often falls outside the boundaries of this consensus (D'Art 1992, p. xiv). This is not surprising, given that most of these countries have adopted a free-enterprise industrial system in which their citizens are employed in hierarchical 'top-down' organisations (Deery and Plowman 1991, p. 460).

Yet in these kinds of organisations, employees are inherently dependent on their employers (D'Art 1992, p. xiv). They are often forced to accept managerial control mechanisms in stark contrast to the relatively high degree of participation that they enjoy as citizens of the state. The dependency of employees is premised upon a dichotomy between the firm and the state. Democratic principles apply to institutions of the state. In contrast, a corporate approach, with directors/shareholders as the core decision-makers, applies to the business community. This dichotomy sustains asymmetries of power, participation and equality.

This chapter provides some background on the theoretical underpinnings of the citizen's right to participate in the government of his or her state. It then considers the extent to which these underpinnings can be extended to employees in their relationship with their employer firms, and the implications that this has for employee participation in controlling the firm. I also examine whether similar reasoning applies to the participation of other stakeholders in the firm. In addition to this 'democratic' foundation, I consider 'power' as a theoretical foundation of employee control (or industrial democracy). In this regard I examine the way in which power is typically shared between the employee and the firm, and what this means for the employee's participation in the firm.

The citizen's right to participate

The principle of equal liberty (a core principle of liberalism) suggests that an individual's choices should govern his or her actions to the maximum extent possible while remaining compatible with an equal freedom for all other individuals (Archer 1996, p. 14). In the context of a state, a dictatorship is not compatible with the principle of equal liberty because the dictator's choices govern his or her actions without any constraints imposed by the wishes of citizens, who must act in accordance with the dictator's decisions rather than their own. In turn, the 'all-affected principle' (Archer 1996, p. 14) maintains that 'Everyone who is affected by the decisions of government should have the right to participate in that government' (Dahl 1970, p. 64).[1] This is a basis for democracy: citizens' right to participate in government.

The principle of equal liberty and the all-affected principle can be extended beyond the relationship between the citizen and the state to the relationship between any individual and any association that makes decisions that affect that individual. In any such relationship, the individual should be entitled to control the association's decisions. Control may be exercised in two different ways. The first type of control is direct control, which is exercised by making decisions or choosing from available options given particular constraints. Voters exercise direct control when they choose between a number of given candidates for election. The second type of control is indirect control, which is exercised by setting constraints on how direct power may be exercised. 'Exit control' is one example of indirect control (Hirschman 1970, p. 4). Exit control allows individuals to exercise a personal veto, meaning a veto over the ability of the association's decisions to affect them. This is the greatest possible form of indirect control. It occurs, for example, when a citizen emigrates from one country to another.

The type of control that an individual should be entitled to exercise over an association depends on whether or not the individual is subject to the authority of the association. Subjection to authority involves surrendering one's right to act in accordance with one's own judgement (Raz 1986, p. 39), and hence being bound by the decisions of the association (Green 1988, pp. 27, 40). Another way of viewing this distinction is to ask whether the individual's choices have been replaced by those of the association (Raz 1986, p. 46; 1987; Green 1988, p. 38, 42). Those individuals who are affected by an association's decisions and are subject to its authority can be termed 'subjects', while those who are affected by an association's decisions but not subject to its authority can be termed 'affected non-subjects'.

In the case of a subject, the association's rather than the individual's choices regulate the individual's action. In order to comply with the principle of equal liberty, the individual must therefore have an opportunity to ensure that the association's choices are the same as the individual's choices. In order for all subjects of a particular association to have this opportunity, they must share direct control over the association's decisions. This is called the 'all-subjected principle' (Archer 1996, p. 18). In the case of an affected non-subject, the individual's choices determine the individual's actions – although the association's choices also affect the individual. In this situation, the principle of equal liberty demands that the affected non-subject be able to constrain the association from making decisions that have an unwanted effect on that individual. Therefore the affected non-subject should be able to exercise indirect control over the association. It is not appropriate for the affected non-subject to be able to exercise direct control over the association, as this would involve making decisions that bind others (the association's subjects) but that do not bind the affected non-subject.

Control of the firm: the employee as analogous to the citizen

If democracy is an appropriate defence for the citizen against the arbitrary exercise of power by the state, the same could be said in relation to employees and their employers. In terms of the all-affected principle, employees are equally affected by decisions of their firms as are citizens by those of their state (Bowles and Gintis 1996, p. 73), and so should be accorded similar democratic rights within the firm. The state clearly makes decisions affecting important aspects of citizens' lives, such as the amount of tax citizens must pay, and where citizens may park their cars on public streets. Firms also have the capacity to make decisions that affect all aspects of their employees' working lives, such as decisions regarding salaries, retrenchment and recruitment policies, and allocation of work tasks. As parties affected by firms' decisions, employees should therefore have some control over those decisions.

Employees are also subject to the authority of the firm, just as citizens are subject to the authority of the state. This flows from the fact that the exchange of labour for a wage is not like other commodities – it is a fictitious commodity. 'Labour is only another name for a human activity which goes with life itself' (Polanyi 1957, p. 72), and therefore employees cannot detach 'labour' in exchange for a wage. To direct labour in a specific manner, the employer must direct the employee. To direct the employee effectively, the employer must exclude and replace the employee's choices with his or her own. A necessary component of effective utilisation of the employee's labour is thus the exercise of authority by the firm over the employee (Dahl 1970, p. 79). As subjects of the firm, employees should have direct control over its decisions.

These reasons for employee control are enhanced in circumstances where the employee may lack any real choice as to whether or not to remain within the firm. The costs to the employee of leaving a firm may be comparable to the costs to the citizen of leaving a particular state. Dahl asks:

> is not 'exit' (or exile) often so costly, in every sense, that membership is for all practical purposes compulsory – whether it requires one to leave a country, a municipality, or a firm? If so, then the government of a firm looks rather more like the government of a state than we are habitually inclined to believe: because exit is costly, membership in a firm is not significantly more voluntary or less compulsory than citizenship in a municipality or perhaps even in a country (Dahl 1970, p. 5).

This demonstrates the similarities between the positions of the employee and the citizen in relation to the firm and the state respectively. An employee under the authority of a firm who disagrees with its directions is free to leave the firm. Similarly, a citizen living in a municipality with by-laws of which he or she disapproves is free to move to another municipality. A citizen living in a state with laws or policies of which he or she disapproves is free to leave that state. However, in all three cases this freedom is largely illusory because of the high costs involved in leaving.

Other stakeholders in the firm

Employees are not the only parties affected by the decisions of their firms. The all-affected principle therefore requires an examination of other parties affected by those decisions. The decisions of firms affect five other groups:

1. Consumers
2. Suppliers of raw materials and producer goods
3. Creditors, banks and other financial institutions
4. Local residents
5. Shareholders (Archer 1996, p. 19)

The distinction between subjects and affected non-subjects means that these parties are not all necessarily entitled to exercise direct control over the firm. Only those parties that are under the authority of the firm and who can therefore be classified as subjects need to have direct control. First let us consider categories 1 to 4 in the above list. None of these stakeholders could be said to be under the authority of the firm. Although the firm's decisions affect them, they remain capable of allowing their own choices to govern their actions. Accordingly, each of these stakeholders should be entitled to exercise only indirect control over the firm. In some cases this indirect control may take the form of exit control, but in other cases it will need to take the form of government regulation. Specifically, the ability of these stakeholders to exercise exit control requires both competitive markets and low costs of exit. In the absence of either, government regulation is required to give stakeholders indirect control. For example, consumers may be unable to exercise exit control (by not purchasing a firm's product) in a non-competitive market, ie where the firm is a monopoly supplier.

Next let us consider the final category of affected parties, shareholders. One objection to industrial democracy is that shareholders are subject to the authority of the firm and therefore should have direct control of it. This direct control could be shared with employees. This objection fails to recognise that capital, unlike labour, can be exchanged without remaining attached to the person who sells or rents it. The separation of capital from the capitalist means that shareholders cannot realistically be regarded as subject to the authority of the firm. Although the firm exclusively controls the capital that the shareholder has sold or rented to the firm, the capitalist, separate from the capital, is not so controlled. Accordingly, shareholders are affected non-subjects of the firm and, like the other stakeholders listed, are entitled only to indirect control. Although this may conflict with traditional notions of capitalism, it is not far from the present reality of shareholder participation:

> Even though shareholders in capitalist societies nominally have direct control over their firms, it is arguable that, for some time, indirect control exercised through their power to 'exit' has been by far the most important source of control available to them (Archer 1996, p. 25).

The power relationship between the firm and the employee

A second theoretical foundation of industrial democracy derives from the power imbalance between employees as individuals and the firms that employ them. When combined with the reasons discussed in the previous sections of this chapter, this power imbalance makes it even more important that employees be provided with a controlling role within the firm. The greater power of employers compared to employees must be checked by democratic processes, just as the power of the state over citizens must be checked. The first three parts of this section describe how employee obligations in the employee/employer relationship are enforced by the employer exploiting the power difference between the parties. The final part of this section also explains why the parties cannot be said to have bargained for this power imbalance through wages.

Exogenous and endogenous enforcement

A tension often exists in employment relationships between the employee's desire to minimise the labour or effort they expend on a job and the employer's desire to maximise it. This raises the question of how employment obligations can be enforced. Broadly, obligations between parties can be enforced either exogenously or endogenously. Exogenous enforcement occurs where the obligations of the parties in a relationship are enforced by an element external to the relationship. Endogenous enforcement occurs where the parties' obligations are enforced by an element within their relationship. Exogenous enforcement may be infeasible or excessively costly in some circumstances, such as where *B*'s goods or services possess attributes that are valuable to *A* and costly for *B* to provide but not fully defined in an enforceable contract. This can be termed a 'contested exchange'. The contest is between *A* and *B* as to how to arrange for the valuation and transfer of an attribute that cannot or has not been defined in writing. In these circumstances, the terms for enforcement are determined endogenously by the strategies *A* adopts to induce *B* to provide the desired level of the contested attribute as well as the counter-strategies available to *B* (Bowles and Gintis 1996, p. 69).

The employer/employee relationship is an archetypal form of contested exchange (Bowles and Gintis 1996, p. 70). The employee agrees to submit to the authority of the employer for a specified period in return for a wage or salary. In other words, the employer buys the employee's labour power (Marx 1976, p. 270), but not labour itself. Generally, employment contracts cannot specify that the employee provide X units of labour in return for Z wage.[2] The employer must therefore be satisfied with purchasing the employee's labour power. The employer then extracts the labour during the course of the employment relationship. This sets up a fundamental tension, since work is costly for the employee to provide, valuable to the employer, and difficult to measure (Bowles and Gintis 1996, p. 70). Although employers could turn to the state (for example, through the courts) to ensure that the maximum labour contracted for is obtained, in general it is not economically and industrially feasible to do so. Instead, endogenous enforcement mechanisms of the enterprise ensure the delivery of any particular level of labour services per hour of labour time supplied (Bowles and Gintis 1993).

This model of endogenous enforcement in labour markets was developed by Karl Marx, and has recently become the standard among microeconomic theorists. Marx termed this model the extraction of labour from labour power (Stiglitz 1987, p. 1; Bowles 1985, p. 6). He likened it to the extraction of funds and compliance by the state from its citizens:

> the capitalist formulates his autocratic power over his workers like a private legislator ... unaccompanied by either that division of responsibility otherwise so much approved of by the bourgeoisie, or the still more approved representative system ... (Marx 1976, pp. 549–550).

Contingent renewal strategy

One way in which employers enforce employees' obligations endogenously is through a strategy of contingent renewal, based on the desire of employees to retain their jobs. At any wage level, the employee determines how hard to work by weighing up the marginal disutility of additional effort with the utility of the wage and the likely effect of the additional effort on the probability of the employee's retaining the job. The employment benefits required to create an incentive for the employee to retain the job are termed the 'employment rent' (Bowles and Gintis 1996, p. 70). The employee sets this wage floor. The employer sets the actual wage, through a process of balancing the cost of increasing the wage against the benefits arising from a higher wage, eliciting more work from employees, and perhaps the lower monitoring costs that flow from a higher wage (Bowles and Gintis 1996, p. 70).

Under a contingent renewal strategy, the employer promises to renew the employee's contract if the employee works satisfactorily, and to dismiss the employee otherwise. To be effective, this strategy requires the employer to adopt a reasonably accurate system of monitoring the work levels of employees. It also requires the threat of dismissal to represent a costly sanction to employees (Bowles and Gintis 1996, p. 70). This will occur where the wages and other benefits of the job are preferable to the alternatives, such as unemployment benefits or seeking an alternative job. In theory, two results flow from contingent renewal strategies. The first is that the threat of sanctions drives employees to work harder than they would have in the absence of the threat. The second is that employment rent creates a situation where employees without jobs would prefer to have them.

Short side power

The employer's contingent renewal strategy is only effective where the supply of labour exceeds demand, creating a power imbalance between employees and employers. Classical equilibrium in a market is achieved where total supply and demand for products or services in that market are exactly equal. The result is that the market clears. In this situation, no party can impose sanctions on another party in the market, unless the parties collude. In the context of the labour market, this would mean that employers could not exercise power over employees. For example, in the absence of collusion between employers against a particular employee, it would mean that an employer's threat of dismissal would not perturb the employee because the employee could easily obtain another job at the same pay.

In fact, there generally is an excess supply of labour compared to demand. In these circumstances, the employer, who can purchase as much labour as he or she wants, is on the 'short side' of the market. Employees, some of whom cannot sell as much labour as they would like (and may be unemployed or under-employed) are on the 'long side' of the market (Bowles and Gintis 1996, p. 72). Since the employment relationship is a contested exchange, the employer can sanction the employee through dismissal, and the employee can sanction the employer through exiting. However, exit of the employee will only be a considerable threat if the employee has a high amount of skill or is difficult to replace. Owing to non-clearing labour markets, a minority of employees are in this position (Bowles and Gintis 1996, p. 70–71.[3] For those who are, the threat to leave is not always a credible sanction because its implementation may nevertheless reduce the welfare of the employee. As a result, a distinct power imbalance exists between employers and employees. This imbalance heightens the need for the employee to be able to control the decisions of the firm. In other words, it strengthens the call for industrial democracy.

Bargaining for power

It could be argued that the parties have bargained for the power imbalance in the employment relationship. In other words, the parties agree that the employer will add a sum of money to the employee's salary or wage in order to purchase a degree of power in the relationship. This sum could be termed 'power rent'. On this view, the power imbalance alone could not be used to justify the adoption of democratic principles within the firm, because it is something that the parties have already negotiated. However, firms' objectives are simply to maximise profits. They are indifferent to the nature of the authority relationship *per se*, and would generally not seek to obtain power in this way (Bowles and Gintis 1996, p. 72). It is therefore artificial to suggest that the parties have agreed on a power rent.

Conclusion

This chapter has illustrated two theoretical foundations of industrial democracy. First, the principles of liberty and autonomy are as relevant to the employee's relationship with the firm as they are to the citizen's relationship with the state. Accordingly, just as the citizen has rights of participation in the state, the employee should be entitled to an analogous role in participating in and controlling the firm. Moreover, key features of the employee/employer relationship distinguish the employee's rights to control the firm, from the rights of other stakeholders in the firm. Second, a distinct power imbalance exists between employees as individuals and the firms that employ them, heightening the need for industrial democracy. To prevent firms from abusing their dominant status, the power imbalance must be regulated through democratic processes, just as the power of the state over citizens should be checked.

States might never decide to impose industrial democracy in a widespread fashion, and firms might never discover a form of industrial democracy that generates high profits and high morale. Indeed, the widespread failure of firms to adopt industrial democracy may reflect negative competitive consequences for firms that adopt such a management structure. However, any practical reasons for denying industrial democracy must be viewed in light of their ideological significance – in particular, acceptance of a contradiction between the democratic nature of the state and the authoritarian structure of work, and acceptance of a power imbalance unchecked by democratic control. If industrial democracy is ultimately rejected, at least we will know at what conceptual and moral cost (Vaughan 1983, p. 326).

Notes

1. Where government refers to any association, not just the ruling organisation of a state.
2. An obvious exception is performance-related pay, such as where employees are paid per unit they produce.
3. A non-clearing market is one where unsatisfied demand or supply exists.

Note

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