Overcoming Barriers to the Development of Worker Cooperatives in Canada

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Introduction

This report investigates how innovative policy can promote the development of worker cooperatives in Canada. There exists a vast academic literature and a multitude of studies on worker cooperatives from around the world, a full treatment of which is beyond the scope of this report. However, the report does offer a brief overview of this research in the 'Background' section below, which discusses what worker cooperatives are, some reasons as to why Canada should promote their development, and the current state of the worker cooperative sector. Following this, the primary barriers to worker cooperatives are identified, and it is argued that raising startup and expansion capital is typically their greatest challenge. Five examples of existing solutions to this problem from Quebec, Uruguay, Italy, Spain, and the United States are then described. After a discussion of key considerations for policy design within Canada, three policy recommendations are proposed that draw inspiration from previous research and existing solutions. These are; conditional tax incentives for worker cooperatives, funding for worker cooperative development investment funds, and a worker buyout guarantee.

Background

What is a Worker Cooperative?

Worker cooperatives represent a business structure alternative to the conventional investor-owned firm. In a worker cooperative, employees share ownership of the firm and make management decisions collectively. Equity is divided between worker-members in the form of wages, dividends, and/or personal accounts, with some portion of profits being reinvested back into the business.[1] Newly hired employees may undergo a probationary period wherein they are paid primarily or entirely in wages, after which they become a member.[2] Some worker cooperatives also contract-out certain work to non-members on short-term bases.[3] However, in order to be considered a genuine worker cooperative for the purposes of this report, the majority of those employed by the firm must be members. In many worker cooperatives, business decisions are made through direct democracy. In other, especially larger businesses, workers may choose to elect councils to represent them.[4] In either case, management decisions ultimately represent the will of the firm's employees, with members each having equal voting power.[5]

Worker cooperatives are a subcategory of economic cooperatives and are distinct from member, consumer, producer, community, and housing cooperatives.[6] They also differ meaningfully from various programs in conventional firms which include elements of worker-ownership or decision making, such as employee stock ownership plans and worker representation on boards, insofar as said firms remain primarily investor-owned.[7]

Empirical evidence from across various countries has shown that, on average, worker cooperatives are comparable to conventional capitalist firms in profitability, value added, and financially sustainability, while exhibiting higher labour productivity and greater resilience to

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[1] George Cheney, Iñaki Santa Cruz, Ana Maria Peredo, and Elías Nazareno, "Worker Cooperatives as an Organizational Alternative: Challenges, Achievements and Promise in Business Governance and Ownership," *Organization* 21, no. 5 (2014), 593.
[2] David P Ellerman, "Theory of Legal Structure: Worker Cooperatives," *Journal of Economic Issues* 18, no. 3 (1984), 878-879.
[3] Thomas Ferretti, "Mondragon in Five Points: Advantages and Challenges of Worker Co-operatives," *Renewal: A Journal of Social Democracy* 23, no. 4 (2015), p. 41.
[4] Priya Baskaran, "Introduction to Worker Cooperatives and their Role in the Changing Economy," *J. Affordable Hous. & Cmty. Dev. L.* 24 (2015), 359.
[5] Greg Lawless and Anne Reynolds, "Worker Co-operatives: Case Studies, Key Criteria and Best Practices," *Madison, WI: University of Wisconsin* (2004), 3.
[6] Cheney et al., "Worker Cooperatives as an Organizational Alternative," 592.
[7] Ibid.

economic shocks.[8] For instance, a robust longitudinal study conducted by Burdín demonstrates that worker cooperatives in Uruguay have a 29% lower hazard of dissolution than conventional firms.[9] As such, worker cooperatives have proven competitiveness in economies dominated by investor-owned firms, and there is potential for sustained growth in this sector.[10]

Why Should Canada Promote the Growth of a Worker Cooperative Sector?

A substantial worker cooperative sector would offer several benefits to Canadian workers, and to the Canadian economy generally.

Firstly, worker cooperatives exhibit less wage inequality than conventional firms, with typical ratios between highest- and lowest-compensated workers being about 6:1 to 3:1.[11] Additionally, these businesses often offer comparably high compensation to lower skilled workers.[12] Since members of worker cooperatives have shares in their firm they can accumulate more capital than workers in conventional firms. Research has shown that capital ownership is essential to provide people with financial security as well as access to loans and other opportunities.[13] Canada has experienced rapidly rising wealth and income inequality over the

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[8] Carla Dickstein, "The Promise and Problems of Worker Cooperatives," *Journal of Planning Literature* 6, no. 1 (1991), 19-21; Ben Craig, John Pencavel, Henry Farber, and Alan Krueger, "Participation and Productivity: A Comparison of Worker Cooperatives and Conventional Firms in the Plywood Industry," *Brookings Papers on Economic Activity. Microeconomics* (1995); Ferretti, "Mondragon in Five Points," 42; Gabriel Burdín, "Are Worker-Managed Firms More Likely to Fail than Conventional Enterprises? Evidence from Uruguay," *ILR Review* 67, no. 1 (2014), 526.
[9] Burdín, "Evidence from Uruguay," 226.
[10] Erik K. Olsen, "The Relative Survival of Worker Cooperatives and Barriers to their Creation," in *Sharing Ownership, Profits, and Decision-Making in the 21st Century*, vol. 14, (ald Group Publishing Limited, 2013); Morris Altman, "Workers Cooperatives as an Alternative Competitive Organizational Form," in *Participation in the Age of Globalization and Information*, (Emerald Group Publishing Limited, 2006), 222.
[11] Nathalie Magne, "Wage Inequality in Workers' Cooperatives and Conventional Firms 1," *The European Journal of Comparative Economics* 14, no. 2 (2017), 304; Ferretti, "Mondragon in Five Points," 41-42.
[12] James J. Kennelly, and Mehmet Odekon, "Worker Cooperatives in the United States, Redux," *WorkingUSA* 19, no. 2 (2016).
[13] Ferretti, "Mondragon in Five Points," 42.

last four decades, with the pre-tax income of the top 1% of tax-filers doubling from 1982 to 2015 while growth in earnings of the bottom 50% has not even kept up with inflation.[14] Large inequalities have been found to have detrimental effects on economic stability and growth, as well as erode social and political solidarity within nations.[15] Promoting the development of worker cooperatives in Canada has the potential to reduce these economic inequalities and mitigate their negative effects while improving the wages of lower-skilled workers.[16]

Another important advantage of worker cooperatives over conventional firms is that they offer greater job security. In recessions, worker cooperatives tend to reduce profits or wages rather than lay-off employees, which contributes to their aforementioned higher survival rate.[17] They reduce employment more slowly than conventional firms when revenue decreases, and they increase both employment and wages more rapidly than conventional firms when revenue increases.[18] Whereas increasing automation is leading to unemployment and job insecurity in many conventional firms, members of worker cooperatives which invest in automating technologies are more likely to benefit from reduced hours with the same or higher levels of compensation (because their pay is relative to profits, rather than being a fixed amount).[19] On average, worker cooperatives report higher levels of job satisfaction and safety than other firms due to the control that worker-members can exercise over their work environment through

[14] Lars Osberg, *The Age of Increasing Inequality: The Astonishing Rise of Canada's 1%*, (James Lorimer & Company, 2018), 28, 112-148.
[15] Ms Era Dabla-Norris, Ms Kalpana Kochhar, Mrs Nujin Suphaphiphat, Mr Frantisek Ricka, and Ms Evridiki Tsounta, *Causes and Consequences of Income Inequality: A Global Perspective*, International Monetary Fund, 2015; Osberg, *The Age of Increasing Inequality,* 166-183.
[16] Kennelly and Odekon, "Worker Cooperatives in the United States," 182; Ferretti, "Mondragon in Five Points," 52.
[17] Ferretti, "Mondragon in Five Points," 42; Gabriel Burdin and Andrés Dean, "New Evidence on Wages and Employment in Worker Cooperatives Compared With Capitalist Firms," *Journal of comparative economics* 37, no. 4 (2009), 526.
[18] Fathi Fakhfakh, Virginie Pérotin, and Mónica Gago, "Productivity, Capital and Labor in Labor-Managed and Conventional Firms," (2011); Burdin and Dean, "New Evidence on Worker Cooperatives," 526.
[19] Jürgen Schwettmann, "Cooperatives and the Future of Work," In *Cooperatives and the World of Work*, pp. 34-56, (Routledge, 2019), 39, 50.

democratic processes.[20] Worker cooperatives therefore have the potential to provide safe, fulfilling, and reliable jobs to communities in Canada and reduce the Canadian economy's vulnerability to economic shocks.[21]

Finally, an expansive worker cooperative sector may lead to higher levels of industry process innovation, due to workers having both ownership incentives and decision-making means to utilise their tacit 'shop-floor' knowledge to improve production efficiency.[22] Worker cooperatives have also been shown to achieve advantages in innovation through inter-cooperation and R&D sharing.[23] These advantages are especially relevant for the Canadian economy, as it has suffered from significant business under-investment in capital and process innovations as compared to other OECD countries.[24]

The Current State of Worker Cooperatives, Globally and in Canada

Despite the advantages highlighted above, worker cooperatives represent a small fraction of firms worldwide. Italy and Spain are by far the countries with the highest incidence of worker owned and managed firms (with 25,000 and 18,000 respectively), followed by France.[25]

As of 2020, only 365 worker cooperatives are active in Canada, representing a national

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[20] Ronald McQuaid, Emma Hollywood, Sue Bond, Jesus Canduela, Alec Richard, and Gemma Blackledge, "Health and Wellbeing of Employees in Employee Owned Businesses," (2012); Kennelly and Odekon, "Worker Cooperatives in the United States," 168.

[21] Virginie Pérotin, "Worker Cooperatives: Good, Sustainable Jobs in the Community," *Journal of Entrepreneurial and Organizational Diversity* 2, no. 2 (2013), 41-42; Ferretti, "Mondragon in Five Points," 52.

[22] Ronald Mascitelli, "From Experience: Harnessing Tacit Knowledge to Achieve Breakthrough Innovation]," *Journal of Product Innovation Management: an International Publication of the Product Development & Management Association* 17, no. 3 (2000).

[23] Imanol Basterretxea, Jon Charterina, and Jon Landeta, "Coopetition and Innovation. Lessons from Worker Cooperatives in the Spanish Machine Tool Industry," *Journal of Business & Industrial Marketing* 34, no. 6 (2019).

[24] William BP. Robson, "Thin Capitalization: Weak Business Investment Undermines Canadian Workers," *CD Howe Institute Commentary* 550 (2019).

[25] Pérotin, "Worker Cooperatives: Good, Sustainable Jobs in the Community," 36.

growth rate of only 5.5% in this sector since 2010.[26] The vast majority of Canadian worker cooperatives exist in Quebec, with other per capita concentrations in Atlantic Canada and numerical concentrations in Ontario, Nova Scotia, and Winnipeg.[27] Quebec's relative success in this respect can be attributed to several provincial policies which will be discussed below.[28] The federal Cooperative Development Initiative was cancelled in 2013 and Ontario's provincial Social Enterprise Strategy was cancelled in 2018, inhibiting the subsequent formation of new worker cooperatives.[29] Although there is $25 million available in Canada's Cooperative Investment Fund, it does not provide funding for the technical assistance that early-stage worker cooperative entrepreneurs require, and it is not exclusive to worker cooperatives.[30] In some provinces such as Ontario, cooperative incorporation is separately administered from conventional business structures and involves relatively more complex and inaccessible procedures, while many worker cooperative entrepreneurs report a lack of affordable support resources (such as a cooperative development network) with which to navigate this process.[31]

[26] Statistics Canada, (2023), "Co-operatives in Canada, 2020"; P. Hough, D. Wilson, and H. Corcoran, (2010), "The Worker Co-op Sector in Canada. Canadian Worker Cooperative Federation and Canadian Social Economy Research Partnerships," 9.
[27] Hough et al., "The Worker Co-op Sector in Canada," 9.
[28] Monica C. Adeler, "Enabling Policy Environments for Co-operative Development: A Comparative Experience," in *Canadian Public Policy* 40, no. Supplement 1 (2014).
[29] Jason Spicer and Michelle Zhong, "Multiple Entrepreneurial Ecosystems? Worker Cooperative Development in Toronto and Montréal," *Environment and Planning A: Economy and Space* 54, no. 4 (2022), 621.
[30] Spicer and Zhong, "Worker Cooperative Development in Toronto and Montréal," 622-623.
[31] Ibid., 622.

Primary Barriers to the Development of Worker Cooperatives

Given that worker cooperatives are not an inferior form of economic organisation and are competitive with conventional investor-owned firms, and that they offer several advantages as discussed above, the natural question is why they are so uncommon.[32]

There are several possible answers to this question. Firstly, there is a lack of expertise in managing worker cooperatives, and the sector is too small in most countries for such a labour market to exist.[33] Furthermore, worker cooperatives may have trouble attracting managers as they typically pay them less than more hierarchical investor-owned firms.[34] Secondly, entrepreneurial culture is highly individualistic, and entrepreneurs stand to gain more economic rents through sole ownership of a business, so they are financially disincentivized from developing cooperative ownership models.[35] Thirdly, worker cooperatives usually start small and therefore often face the same disadvantages as other small businesses when attempting to enter non-niche markets dominated by larger conventional firms.[36] Investor-owned firms often grow through the takeover of other businesses, but this is more difficult for worker cooperatives as they cannot raise acquisition capital by offering shares and may have difficulty absorbing a lot of new members who likely have no experience with cooperative working.[37] Additionally, the

[32] Olsen, "The Relative Survival of Worker Cooperatives”.
[33] Chris Cornforth and Alan Thomas, "Cooperative Development: Barriers, Support Structures and Cultural Factors," *Economic and Industrial Democracy* 11, no. 4 (1990), 456.
[34] Dickstein, "The Promise and Problems of Worker Cooperatives," 25.
[35] Olsen, "The Relative Survival of Worker Cooperatives,” 99; Dickstein, "The Promise and Problems of Worker Cooperatives," 25.
[36] Cornforth and Thomas, "Cooperative Development,” 456; Dickstein, "The Promise and Problems of Worker Cooperatives," 25-26.
[37] Cornforth and Thomas, "Cooperative Development,” 456.

democratic nature of worker cooperatives may in itself inhibit growth because other concerns such as worker well-being or a sense of community take higher priority.[38]

However, the greatest barrier to the creation and growth of worker cooperatives is likely difficulty in raising the necessary capital. Worker cooperatives are often undercapitalized from the beginning because they are typically formed by people without sufficient personal funds to invest, and because internal financing means that worker-members risk both their past savings and their future incomes in a single venture.[39] External financing is also challenging because issuing voting shares compromises the principle of worker ownership, and non-voting shares are unlikely to attract investors.[40] This means that worker cooperatives are often reliant on loans and reinvestment of profits to finance new developments, rather than equity investment.[41] Loans are difficult to obtain, however, because banks and other conventional lenders do not typically have experience with worker cooperatives or know how to assess them.[42] The rest of this report will be concerned with policy solutions that specifically address these issues of financing with respect to worker cooperative development in Canada.

[38] Dickstein, "The Promise and Problems of Worker Cooperatives," 26; Cornforth and Thomas, "Cooperative Development," 456.
[39] Cornforth and Thomas, "Cooperative Development," 456; Dickstein, "The Promise and Problems of Worker Cooperatives," 24-25.
[40] Cornforth and Thomas, "Cooperative Development," 455; Dickstein, "The Promise and Problems of Worker Cooperatives," 24-25.
[41] Cornforth and Thomas, "Cooperative Development," 455.
[42] Dickstein, "The Promise and Problems of Worker Cooperatives," 24.

Examples of Existing Solutions

This section describes five different existing systems from around the world which have demonstrated success in promoting the development of worker cooperatives, particularly with respect to better-facilitating or incentivizing the process of raising start-up and expansion capital.

Quebec's Provincial Policies

As discussed above, Quebec has seen a much higher rate of development in the worker cooperative sector than the rest of Canada, and this can largely be attributed to the historical entrenchment of a network of credit unions, other non-financial cooperatives, as well small business and social enterprise funding centres in the province.[43] More recently, the worker cooperative sector has benefited from several provincial policies including government-seeded investment funds for cooperatives, legislative changes which enable firms to transition to increased worker ownership and management via employee purchases of shares through the worker-shareholder model, the System Cooperative Investment Tax Incentive which provides members with an income tax deduction of up to 150% for any personal capital invested in their cooperative, and the establishment of the $140 million Investment Quebec fund that provides loans to cooperatives.[44] Quebec also grants a 15% tax credit to investments in funds which actively reduce barriers to cooperative entrepreneurship, and instituted a policy which directs profits from the sale of cooperatives back into the sector.[45] Finally, the government of Quebec's

[43] Adeler, "Policy Environments for Co-operative Development," S55; Spicer and Zhong, "Worker Cooperative Development in Toronto and Montréal," 624.
[44] Adeler, "Policy Environments for Co-operative Development," S55-S56
[45] Spicer and Zhong, "Worker Cooperative Development in Toronto and Montréal," 621.

Cooperative Development Assistance Program provides Regional Development Cooperatives $3 million annually to support the creation of new cooperatives, strengthen existing ones, and organise regional cooperative networks.[46] While many of Quebec's policies provide assistance to cooperatives in general rather than targeting worker cooperatives specifically, their success underscores the importance of a network of economic cooperatives and support organisations within which it is much easier for worker cooperatives to develop.

Uruguay's Legislative Framework and Conditional Tax Incentives

In Uruguay, at least 80% of a firm's permanent employees must be share-owning members of the firm for it to be considered a worker cooperative, and this status grants certain tax exemptions.[47] As such, this policy encourages the formation of worker cooperatives while simultaneously discouraging their degeneration through excessive employment of non-member workers. Additionally, Uruguayan legislation requires that worker cooperatives repay all capital investments worker-members have made into the firm when those members leave, thereby reducing the risks of internal financing.[48] In order to promote internal reinvestment of retained earnings and ensure that worker cooperatives have the liquidity to repay these leaving members' capital contributions, no more than 80% of annual net revenues can be distributed among members.[49] Finally, while worker cooperatives are granted significant freedom to decide upon their own associational rules, they must comply with collective bargaining agreements at the industry level and each worker-member must have equal voting power regardless of capital

[46] Adeler, "Policy Environments for Co-operative Development," S56
[47] Burdin and Dean, "New Evidence on Worker Cooperatives", 519.
[48] Ibid.
[49] Ibid., 520.

contribution.[50] The economic competitiveness of the worker cooperative sector in Uruguay highlights the advantage of a clearly defined worker cooperative structure and conditional incentives for firms to form according to this structure.

Italy's Marcora Law Framework for Worker Buyouts

Italy's Marcora Law framework supports the development of worker cooperatives by facilitating the process of workers buying-out closing, failing, or bankrupt firms and has assisted in converting more than 257 conventional firms to worker cooperatives since its inception in 1985.[51] Under this framework, workers can begin the process of a worker buyout once they anticipate that the firm will close, if a group of employees have been or will be laid off due to its closing, if the owners offer part of a firm to its employees, or after at least nine workers from the closing firm form a new company.[52] The purchase can be financed from workers' personal savings, advances of up to three years of portions of their unemployment benefits, as well as debt capital.[53] Each worker must contribute at least €4,000 to the startup capital, but in most cases the new firm will be registered as a limited liability worker cooperative, meaning that workers will not lose their invested personal assets if the venture fails.[54] Newly formed worker cooperatives can also access debt capital and technical assistance through various cooperative federations, and by extension the Mutualistic Fund, a national fund for cooperative development.[55] 3% of all Italian cooperatives' yearly net revenue, as well as the profits from the sale of cooperatives, must

[50] Burdin and Dean, "New Evidence on Worker Cooperatives," 519, 521.
[51] Marcelo Vieta, "The Italian Road to Creating Worker Cooperatives from Worker Buyouts: Italy's Worker-Recuperated Enterprises and the Legge Marcora Framework," (2015), 8.
[52] Ibid.
[53] Ibid., 8-9.
[54] Ibid., 9.
[55] Ibid.

be contributed to this fund.[56] Finally, the Italian government has established two state-level funds to prevent unemployment which contribute to cooperatives' start-up financing by matching worker's investments at a 1:1 ratio (cooperatives must pay this funding back in 7-10 years).[57] Due to the partnership between workers, cooperative development organisations, the state, and institutional investors under the Marcora Law framework, new worker cooperatives arising from worker buyouts of conventional firms have been remarkably successful in Italy. They demonstrate relatively long lifespans and financial sustainability despite the challenge of restarting production in often unfavourable economic circumstances.[58]

Mondragon's System of Cooperative Banking and Social Shares

The Mondragon Corporation, located in the Basque region of Spain, is often cited as one of the most successful conglomerates of worker cooperatives (and other kinds of cooperatives) in the world, having provided life-long jobs for its 35,000 members since its founding in 1956 and being the seventh most important industrial group in the country as of 2015.[59] Mondragon has overcome the challenges of external financing for worker cooperatives through the institution of a dedicated cooperative bank.[60] It has also solved problems of internal financing through its innovative system of personal accounts: New worker cooperatives are in part financed by members being required to purchase a 'social share' (different from a conventional share) for about €15,000, which new workers can accumulate during a probationary period of up to three years. After workers' wages and other operating costs are paid, 10% of the firm's profits are

[56] Vieta, "The Legge Marcora Framework," 9.
[57] Ibid., 9-11.
[58] Ibid., 23-27.
[59] Ferretti, "Mondragon in Five Points," 38.
[60] Ibid., 44.

transferred to a social fund according to Spanish law, and 50% are kept in a reserve fund to ensure that the cooperative can overcome any future financial difficulties.[61] Each worker-member's social share grows through a capital account, into which is transferred the remaining profits according to pay level and hours worked.[62] Members cannot sell their social shares to non-members or withdraw money from them until they leave or retire, so they essentially act as long-term loans that the cooperative can use to finance substantial investments.[63] Since workers' wages and capital accounts are distinct, workers have a steady stream of income and are still able to diversify their investments through savings from their wages (which are often higher than those for comparable jobs in the country).[64] Members also retain equal voting power regardless of differences in their social shares.[65] This model has allowed Mondragon to engage in rapid capitalization, especially during the period of initial growth in the 1960s and 1970s.[66]

Seed Commons' Non-Extractive Loan System

An example of an innovative system for external financing of worker cooperatives is the Seed Commons Community Wealth Cooperative, based in the United States. This organisation provides worker cooperatives with debt capital through a non-extractive loans system wherein borrowers are not required to make repayments on principal or interest until they start making profits, and only assets purchased with the loan can be used as security.[67] Seed Commons

[61] Dickstein, "The Promise and Problems of Worker Cooperatives," 24; Ferretti, "Mondragon in Five Points," 44.
[62] Dickstein, "The Promise and Problems of Worker Cooperatives," 24; Ferretti, "Mondragon in Five Points," 44.
[63] Dickstein, "The Promise and Problems of Worker Cooperatives," 24; Ferretti, "Mondragon in Five Points," 44.
[64] Ferretti, "Mondragon in Five Points," 44-45.
[65] Ibid., 44.
[66] Ibid.
[67] Seed Commons, *Non-Extractive Finance*, (2021, May 8), https://seedcommons.org/about-seed-commons/seed-commons-approach-to-non-extractive-finance/

mitigates risk by working closely with the borrowers to regularly assess business plans as well as provide technical assistance and expertise.[68] The fund has undergone rapid growth, and is an example of a sustainable debt-financing model for worker cooperatives that lowers financial risk to workers while improving the chance of their venture's success.

Key Policy Considerations

There are several Canadian stakeholders whose interests would be affected by policies that make it easier for worker cooperatives to raise capital. These include currently-existing worker cooperatives, competing firms, workers seeking to create a cooperative but who lack the necessary start-up capital, nonprofits such as Cooperatives and Mutuals Canada, federal and provincial governments, and the tax base who would fund policies with net expenses. Each of these stakeholder's interests must be considered and balanced in policy design.

Policies which relate to banking or federal tax credits would require the support of parliament, whereas provincial tax credits and most legislative adjustments would be the responsibility of provincial governments.[69] Funding could come from either level of government, or both. Policies which combine these jurisdictional responsibilities would require buy-in from and cooperation between both federal and provincial governments, increasing the difficulty of implementation. This may be why most Canadian policies related to worker cooperative development have been exclusively provincial.

Another key consideration of all public policy is cost, and any policy will bear costs of implementation. Policies to support the development of worker cooperatives may incur

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[68] Seed Commons, *Non-Extractive Finance*.
[69] Government of Canada, (2021, October 5), *The Constitutional Distribution of Legislative Powers*, https://www.canada.ca/en/intergovernmental-affairs/services/federation/distribution-legislative-powers.html

additional costs insofar as they involve grants, subsidies, or decrease government revenue through tax credits. These costs may be offset if said policies lead to effective growth in the worker development sector (entailing more taxable economic activity), to the extent that this growth does not crowd-out existing firms. As such, tax credits which incentivize the creation of new worker cooperatives that otherwise would not have existed may actually increase government revenue in the long term. Cost may also be offset by reduction in public service expenses such as employment insurance or social security because increased development of worker cooperatives can lead to less unemployment and job insecurity, as discussed above.

A final consideration that is unique to worker cooperatives is the risk of them 'degenerating' into conventional firms over time by selling equity to non-workers, through excessive employment of non-members, or by resorting to increasingly hierarchical management structures.[70] On this latter point however, empirical findings show that the typical lifecycle of a worker cooperative is to adopt more specialised management as it grows, but then regenerate as it grows further and increased worker input is required to efficiently manage the complexities of a large business.[71] Additionally, many worker cooperatives have effectively implemented systems with strict divisions of labour without compromising democratic worker control.[72] In any case, it is prudent for policy programs to disincentivize degeneration and to clearly define what is considered a worker cooperative, especially to prevent predominantly investor-owned firms from exploiting such programs.[73]

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[70] Dickstein, "The Promise and Problems of Worker Cooperatives," 26-27; Kennelly and Odekon, "Worker Cooperatives in the United States," 171.
[71] Dickstein, "The Promise and Problems of Worker Cooperatives," 27.
[72] Chris Cornforth, "Patterns of Cooperative Management: Beyond the Degeneration Thesis," *Economic and Industrial Democracy* 16, no. 4 (1995).
[73] Dickstein, "The Promise and Problems of Worker Cooperatives," 30.

Policy Recommendations

This section outlines three broad policy recommendations that Canadian provincial governments, perhaps in conjunction with the federal government, can implement to overcome barriers to worker cooperative financing and encourage growth in this sector. These include conditional tax incentives, funding for worker cooperative development investment funds, and a worker buyout guarantee. While each of these policies could be implemented independently, they will be most effective if implemented in combination.

Conditional Tax Incentives

Governments should clearly define worker cooperatives and streamline the process of incorporation, while introducing conditional tax incentives for firms to adopt the worker cooperative business structures that have been proven to best promote their long-term viability through such examples as discussed above.[74] These conditions are that at least 80% of the workers employed must be members, that at least 80% of shares in the business must be owned by worker-members, and that at least 3% of annual profits must be contributed to one or more regional cooperative development/investment funds/banks. Additionally, members must have equal voting rights regardless of capital contribution, all capital contribution by members must be repaid to members over a period of five years after they leave or retire from the firm, and at least 20% of annual profits must be held as reserves or be reinvested in the worker cooperative. If worker cooperatives meet these conditions, they would be granted a 20% corporate tax

[74] Burdin and Dean, "New Evidence on Worker Cooperatives," 519-521; Vieta, "The Legge Marcora Framework"; Ferretti, "Mondragon in Five Points"; Dickstein, "The Promise and Problems of Worker Cooperatives," 24.

exemption and worker-members of such firms would be granted an income tax deduction equal to 150% of the money they invest in their cooperative. Finally, external investors and funds would be granted a 15% capital gains tax deduction for investments made in worker cooperatives which meet these conditions.

This policy would increase the viability of worker cooperatives raising capital through their own employees and improve incentives for external financing while incentivizing existing firms and entrepreneurs to adopt the worker cooperative model. The eligibility conditions ensure that worker cooperatives do not degenerate over time and that conventional investor-owned firms cannot take advantage of the advantages provided by this policy. A special consideration is that, if the policy includes both provincial and federal tax incentives, it will necessitate significant cooperation between the different levels of government. A risk is that the policy does not trigger growth in the worker cooperative sector, which would lead to a decrease in government revenue. This risk can be mitigated by ongoing monitoring of the economic effects of the policy during its implementation, and adjusting tax incentives or conditions accordingly.

Worker Cooperative Development Investment Funds

This recommendation proposes that province-wide and regional cooperative development investment funds or banks (WCDIFs) be instituted by provincial governments in provinces which do not already have them as has been done extensively in Quebec, Italy, and Spain.[75] These funds would work closely with worker cooperatives in the province to provide them with technical assistance, expertise, and non-extractive loans as described in the example of Seed

[75] Adeler, "Policy Environments for Co-operative Development"; Vieta, "The Legge Marcora Framework," 9-11; Ferretti, "Mondragon in Five Points," 44.

Commons above.[76] WCDIFs should be themselves cooperatively owned and managed by their members, employees, and clients. Under this policy, provincial (and perhaps federal) governments would provide these WCDIFs with initial funding that is phased out over three years as they grow through returns on their investments and via the contributions each worker cooperative is required to make to receive tax benefits as described in the previous recommendation. Note that these WCDIFs would also be eligible for the 15% capital gains tax deduction outlined above.

The creation of WCDIFs is the the most long term policy solution to overcome financial barriers to the development of worker cooperatives in Canada as it incentivizes the development of a network of institutions which can provide capital and technical assistance. As these institutions grow, the worker cooperative sector will become increasingly independent and entrenched in the economies of these provinces, thereby lessening the necessity of government support. A disadvantage of this policy is that it will require government expenditure, and it may take several years before this investment is paid off by growth in the worker cooperative sector. If this is a concern, governments can target funding specifically to WCDIFs which provide loans to worker cooperatives in regions or industries which are more likely to have faster payoffs, such as industries which have high labour-intensity and low capital-intensity.[77]

Worker Buyout Guarantee

As a final recommendation, provincial governments should implement legislation guaranteeing that workers in conventional firms which are closing, failing, or in the process of bankruptcy will

[76] Seed Commons 2021
[77] Dickstein, "The Promise and Problems of Worker Cooperatives," 19.

have the first opportunity to collectively buy the business and convert it to a worker cooperative. Under this policy, the price offered to the workers cannot be higher than any subsequent offer made on the market if they decline, so if the owners of the closing firm wish to lower the price, then the workers will again have the first opportunity of purchase. Worker buyouts may be financed by a combination of worker's personal savings, loans from the worker cooperative development investment funds described above, as well as other investors. Additionally, workers would be permitted to finance part of the buyout through advances on portions of their severance pay and employment insurance, similarly to Italy's Marcora Law framework.[78] Worker cooperatives formed through worker buyouts should be classified as limited liability, meaning that workers will not lose the personal savings they have invested if the venture fails.

A worker buyout guarantee provides another avenue for the creation of worker cooperatives, and conventional firms converted to worker cooperatives via worker buyout have been shown to be very successful in the case of Italy.[79] This policy would also assist in promoting worker cooperative development in more capital-intensive industries because purchasing the capital sold as part of a business's closing or bankruptcy process is likely to be cheaper than purchasing it outright as a new firm. While investors may be dissuaded from investing in a business that has previously failed, it will also come with the assurance that its previous employees (who often have the most intimate knowledge of the firm) are confident that they possess the skills and restructuring plans necessary to make it profitable. There is however a risk that mandating a worker buyout guarantee will increase transaction costs due to potentially repeated negotiations between workers and owners, and this may extend the process of bankruptcy for businesses.

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[78] Vieta, "The Legge Marcora Framework," 8-9.
[79] Vieta, "The Legge Marcora Framework".

Summary

A substantial worker cooperative sector in Canada has the potential to reduce economic inequality, decrease unemployment, and improve the economy's resilience in recessions. Worker cooperatives can provide fair wages and fulfilling long term jobs for Canadian communities. The primary barrier that worker cooperatives face is the difficulty of financing their creation and expansion. However, there are several successful solutions to this challenge from both within Canada and around the world that have proven success. Drawing on these examples, this report recommends that Canadian provincial governments, perhaps in conjunction with the federal government, implement three policies; conditional tax incentives for worker cooperatives, worker cooperative development investment funds, and a worker buyout guarantee. Through these policies, Canada has the potential to be a global leader in the cooperative economy.

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