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Achieving Harmony and Sustainability through Chinese Company Law

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In an earlier paper, “Can a Socialist Enterprise Survive in a Market Economy?” (*Nature Society, and Thought*, vol. 20, no. 2 [2007]), we concluded that the new Chinese Company Law allows only for ownership by private shareholders, who control the company’s operation and are entitled to its surplus. There are no legal rights for workers and consumers. As the definition of capitalism is the private ownership capital, this company structure can only be described as capitalist.

The slogan ‘Getting rich is Glorious’ is often heard in China. It is sometimes argued that China’s growing importance in the world - leading perhaps to its pre-eminence within the next 30 years—is due to rapid economic growth arising from the introduction of capitalist methods.

Under the right conditions capitalism has undoubted strengths. It:

Enables new start-up companies to be launched easily

Encourages rapid development and spread of entrepreneurialism and innovation

Can lead to rapid economic growth

However, with the above there can be disadvantages:

Growth generally takes place at the expense of equality—the rich get richer and the poor poorer

Inequality undermines social cohesion, segregates social classes and prevents the harmonious development of society—in the worst case leading to an alienated under-class living in poverty with growing criminality.

While new investment will create employment, pressure for cost-reduction nearly always leads to job losses in the long run. Growing unemployment is a major anxiety in modern China.

Economic and political power is given to a small super-class of top business-people. Like the oligarchs or former nomenklatura of Russia, they control all economic activity, including the media.

This nomenklatura becomes self-perpetuating, passing its wealth and power from one generation to another, becoming in effect a new ruling class in Marxist terms..

In the period after 1800 in Britain the new working class, living near the poverty line with no social services as backup, began to set up their own collective funds to assist with sickness, death and burial, unemployment, housing and subsequently manufacturing. Though each individual could afford very little, the cumulative total from the large numbers involved meant that large sums could be raised.

The cooperative and mutual sector grew rapidly throughout the 19th Century and is now well established throughout the world. Some examples illustrate this:—25% of world life insurance is now mutual; the mutual Credit Agricole Group is now the largest bank in France; worker-controlled John Lewis partnership is one of the most successful retailing organisations in Britain, as is Migros (with 85,000 employees) in Switzerland.

The above are some of the top 300 successful cooperative and mutual organisations around the world listed by the International Cooperative Alliance in its Global 3000 initiative.¹ The first 30 of this list are shown in the Appendix.

Rather than fight the class war, Owen and his followers advocated solving the economic problems of the time through co-operation and self-help at all levels of society. It is significant that they gave the name Harmony Hall to the productive home colony that they set up in Hampshire, England. This was visited by Engels in 1844 and he described it enthusiastically as a ‘Communist Community’ in an article for a German review.² A much larger community in the USA subsequently was named New Harmony. Use of the word harmony reflected their aspirations.

Owen’s attempts to build communist communities did not survive directly. They were dismissed by the world as ‘utopian’. Indirectly, however, Owen’s realisation that capital could be hired for the service of man, rather than vice versa—by the simple expedient of limiting the return paid on capital—has led to a successful, non-confrontational economic system in which about 1 billion people are now participating—namely the international cooperative movement.³ This movement, because of its mass participation over long periods of time, is inherently more sustainable than its competitors based on private capital

Capital Formation

It is frequently said of coops and mutuals that they have difficulty in raising capital in the market economy. It is a common fallacy amongst economists to assume that market and capitalist economies are the same thing. The market is a way of agreeing prices; it is only indirectly related to the way in which capital is raised. A socialist market economy is perfectly feasible provided the economy is made up of non-capitalist -e.g. mutual enterprises.

We have seen above that some of the biggest financial and trading institutions in the world have managed to raise and accumulate their capital within the world market economy

without the traditional device of selling ordinary shares—that is, without giving lenders unrestrained ownership of a share of the business.

To some extent the word ‘capitalist’ is a misnomer. All enterprises require capital whether they be private, mutual (collective) or public (local, sectoral or national)

Thus many of the advantages of capitalism given above may arise from the market nature of the enterprise, rather than the private ownership of its capital.

Recent economic growth in China does not necessarily arise from the capitalist nature of the enterprises set up under the new Company Law.

Rather it may come from opening up the market economy, easing start-ups and freeing entrepreneurial abilities among the population. There is nothing to prevent these attributes being found also in mutual enterprises, where relations between workers and managers as co-owners are harmonious rather than antagonistic.

It is worth quoting the seminal work of Berle and Means⁴ written at the start of Roosevelt’s New Deal in 1930s America—the nearest the US ever came to socialism. Many of the surviving mutual organisations in the US date from this period. They wrote:

It is clear that the function of capital supplying and risk taking must be performed and that the security holder⁵ must be compensated if an enterprise is to raise new capital and expand its activity, just as the workers must be paid enough to ensure the continued supplying of labor, and the life based on it.

But what if profits can be made more than sufficient to keep the security holders satisfied, more than sufficient to induce new capital to come into the enterprise?

Where is the social advantage in setting aside for the security holder profits in an amount greater than is sufficient to ensure the continued supplying of capital and taking of risk. Such extra profits, if given to the security holder, would seem to perform no useful economic function. (our emphasis)

Berle and Means are talking about the allocation of surplus (profit) in enterprises. The question they ask, as did Marx and Engels, is why should shareholders be entitled to all the surplus value generated by an enterprise to an unlimited extent?. Surely money has a price that is limited, as in the aptly-named money markets. No one will pay 12% for money that can be procured at 8%.

The Owenite corporation solves this problem by limiting the return on capital—a point first realised by Owen in his 3rd Deed of Partnership of 1813 when capital was limited to a 5% return. (See my earlier paper “Can a Socialist Enterprise Survive in a Market Economy?”). The fact of this limited return on capital releases the balance of surplus (where it exists) for other purposes—e.g. as re-investment, rebate to customers, bonus to workers and social or cultural purposes.

It is a common fallacy in the West that the Stock Exchange is essential to the raising of capital. In the 1960s, UK industry raised only 3.3% of its capital by issuing ordinary shares

on the Stock Exchange. 14.5% was provided by banks, 6.3% by the issue of fixed interest instruments and about 72% came from reinvested profits.⁶

Now, some 40 years later, profitability is so high that the figure for total new investment though the Stock Exchange is negative. Of course there are still some new issues, but these are more than offset by return of profits to shareholders through share buy-backs, issues of scrip and bonus shares etc.

The Chinese authorities will be aware of the scope for financial instability inherent in an economy based on ordinary shares that inevitably require a stock market to trade them. Fixed interest shares can also be traded in a market—there is no need for owners to be ‘locked in’—but the degree of volatility will be much lower, returns being largely determined by the interest rate set by the Central Bank.

It is significant that those economies like China without a large equity (ordinary share) component, fared much better in the collapse of confidence which took place in Asia in 1997. In Korea for example stock market fluctuations were huge and many companies were forced into liquidation.

Before allowing a large private corporate sector to develop, regulators should be aware that in a developed economy Stock Exchanges perform almost no function in raising new capital. They function as giant casinos speculating in the prices of ordinary shares fluctuating like the throw of a dice. It is seldom realised that the huge sums of money changing hands generally purchase shares already in existence, and that none of this money reaches the companies themselves as investment.

Northern Rock—a Case History

The case of Northern Rock makes an interesting study in the relative stability of mutual and joint stock companies.

One of the most successful outcomes of the Owenite tradition was development of so-called Building Societies—so named when groups of artisans started coming together in the UK in the 1820s to build themselves houses. Using their savings to buy land and materials they would then contribute their own labour until they had completed a number of houses intended for their own use, when the fund would be wound up.

Soon these skilled workers realised that the fund need not be wound up once they had their own houses, but could be maintained in perpetuity—hence the word ‘permanent’ in the title of many of these institutions. The permanent Building Societies expanded rapidly, taking in largely working-class savings which could then be lent out on mortgage to members to buy or build houses. Their mutual structure, 50% capital to loan ratio and other protections

set out in an Act of Parliament give Building Societies the highest credit rating and security for their depositors.

The Building Society movement prospered in the UK, funding the majority of house purchases, building up huge reserves together with a guarantee fund in case one of their number should fail. There has been no such failure, at least since before 1945... The Owenite Cooperative Permanent Building Society changed its name to the Nationwide in the 1960s and is now the largest such institution in the world.

In the mid 1990s some individuals in the UK realised that though Societies could not, by law, distribute trading profits to their members, members were, in fact, entitled to receive the net assets on winding up. This eventuality had been foreseen by Owen some 150 years earlier; he insisted that the Articles of a true cooperative or mutual should provide for so-called 'disinterested devolution' of the net assets on winding up—that is, they should be passed to another mutual or charity and not to the members.

In a successful society the reserves are the result of the thrift and industry of many generations of members; it is therefore quite unfair that they should be acquired by 'carpetbaggers' (asset strippers) who may be members of only one or two years standing in the society, and may have joined purely to obtain a windfall..

Unfortunately very few building societies had such protective clauses in their constitutions and in the rush to privatisation following Mrs Thatcher's government (she once said 'there is no society!') in the mid 1990s, the members of many of the biggest societies were bribed by windfalls of up to \$5000 from the societies' reserves to vote for conversion to banks as joint stock companies. One such conversion was Northern Rock Building Society, formed from the successive amalgamation of some 50 small societies in the North East of England.

Comparative studies, in particular that made by a committee of the House of Commons,⁷ showed that the newly converted banks did not grow appreciably faster than the remaining building societies, except for Northern Rock which had an aggressive policy of expansion, borrowing from, amongst others, the subprime (low credit rating) market in the USA and elsewhere.

In September 2007, when the subprime market faltered, Northern Rock became insolvent and long queues were seen outside its branches as depositors queued up to withdraw their savings. This was said to be the first run on a bank in the UK in 100 years. Rather than countenance the failure of a major bank, the British Government stepped in with guarantees of a phenomenal \$140 billion—nearly \$3,500 for every adult in the country. At the time of writing (February 2008), after exploring all options, the Government decided that the only way to deal with the appalling problems created by the greed of the bank's private owners was for the bank to be nationalised..

As a result of this experience, public opinion has swung strongly in favour of building societies and mutual insurance companies which are clearly seen to offer greater security

than private alternatives. They also give a better return to their members, because they do not have to absorb the cost of paying dividends to private shareholders.⁸ Further, with their large memberships they are much more responsive to the needs of ordinary people and much less likely to undertake risky ventures in search of quick profits.

Relevance to China

From examination of Chinese company law it is clear that a dynamic capitalist sector is now growing in the Chinese economy. Whether this is intended by the authorities or is just happening of spontaneously is not clear.

Some of the most advanced economies in the world - such as Sweden - exhibit a form of 'social capitalism', with health, welfare and education services free to all citizens.. However there is no indication of any intention in China to raise taxation to the level found in Sweden. High taxes are tolerated by the Swedes as the price of one the highest living standards in the world.

If the Swedish model of capitalism is not to be followed, then it would be better to allow companies to police themselves by adopting a mutual structure. All the state has to do then is to ensure that the statutes under which companies operate follow established mutual principles, tried and tested over 200 years, not forgetting a bar on asset-stripping by winding-up, a rule which has now been adopted by most remaining building societies.

If it is felt that a joint-stock (private share capital) structure is essential to persuade entrepreneurs to launch new companies (rather than, for example, spinning off new firms from existing enterprises) then, as suggested in Part 1, a company structure can be developed by law whereby such private companies must convert themselves into mutuals on reaching a certain size.

If, for example, the conversion point were turnover of \$1m. then the share value might be anything up to \$1m. This value would then accrue to the initial shareholders in proportion to their investment, and would be converted into fixed interest loans in proportion to their shareholding. on the basis of one-man-one-vote regardless of size. In addition, those most closely associated with the business, whether as workers or consumers, would also become members.

The original entrepreneurs could remain with the company as employees or they could use their skills in fresh start-ups, from which they could derive additional benefits, or they could choose to retire, drawing a pension based on their investment in the company.

The conversion process could be overseen by a mutual bank—on the model of the Mondragon Caja Laboral (workers bank)⁹—which could hold accumulated reserves in trust at the time of conversion, pay pensions and generally oversee and assist mutual companies to

get established. Such companies could become members of the bank, as with federal cooperatives such as the UK Coop Bank.

Such mutual firms trading in a free market could truly be called a Socialist Market Economy because, in the terms set out by Berle and Means, although the company starts off with a private capital structure, if successful it is soon transformed so that its return on capital is limited.

Companies that remain below the limit can continue with the private model unconstrained, because the discipline of the market will ensure that they do not exploit their position. Apart from ensuring that they obey the law and file their annual returns in a Companies Registry, the state will not need to be involved with millions of small businesses.

Conclusion

This paper shows that there has developed over two centuries within the capitalist market economy an alternative form of economic organisation not dependent on the private ownership of capital.

This mutual sector, in many forms, involves about 1 billion people around the world in retailing, agriculture, fishery, banking, insurance, housing, energy and many other fields. In such enterprises capital is owned collectively by their members who share the benefits.

It is suggested that in further developing Chinese company law, mutual structures in other parts of the world should be studied as to their advantages and disadvantages, and visits made where desirable. It is hoped that lessons can be drawn towards developing a Socialist Market Economy that is more harmonious and sustainable than the unrestrained free market in which the rich get richer and the poor get poorer.

NOTES

1. International Co-operative Alliance, Global 300. www.global300.coop
2. Engels, F 'Description of a Recently Founded Communist Colony Still in Existence', *Deutsches Burgerbuch*, Darmstadt, 1844; Jessop, B 'Karl Marx's Social and Political Thought', Routledge, London & New York, 1999, p265.
3. International Cooperative Alliance www.ica.coop/ica/
4. Berle, A.A. 'The Modern Corporation and Private Property', Macmillan, New York, 1932
5. 'security holder' means 'shareholder'.
6. The Times, London, February 22 1965
7. 'Windfalls or Shortfalls—the true cost of Demutualisation', All-Party Parliamentary Group, Building Societies and Financial Mutuals', London, 2006

8. Coles, Adrian, 'Mutual Societies in an Enlarged Europe', Building Societies Association, London, 2003

9. Mondragon can be contacted through Global 300 www.global300.coop

Appendix. First 30 Coop-Mutual Enterprises out of first 300 worldwide Ranked by turnover (UDS million)

Rank 2005	2004	Co-op's name	Short notes	Structure	Industry	Country	Date founded	Turnover 2005	Assets 2005
1	1	Zen-Noh (National Federation of Agricultural Co-operatives)	ZEN-NOH, Japan's federation of agricultural co-operatives is one of the largest in the world. It purchases and distributes material and equipment for agricultural production for almost 3 million farm households in Japan.	Consortium + Federation	Food & Agri	Japan	1948	63,449	18,35
2	2	Zenkyoren	National mutual insurance federation of agricultural co-operatives in Japan with nearly USD 3 billion in policies.	Consortium + Federation	Insurance	Japan	1951	46,819	406,22
3	3	Crédit Agricole Group	France's largest bank with 21 million customers, owns more than 20% of French bank branches (9100); the top mortgage lender and product provider with over 24% of the personal banking market.	Co-operative Group	Div. Financials	France	1897	30,722	1,385,63
4	5	National Agricultural Cooperative Federation (NACF)	Over 4,000 branches provide financial services to farmers, rural communities and agriculture by carrying out various businesses such as marketing and supply, banking, etc.	Consortium + Federation	Div. Financials	Korea	1961	24,687	199,78
5	4	Nationwide Mutual Insurance Company	One of the largest insurance and financial companies in the world. 4th largest homeowner insurance, 8th largest automobile insurer and 7th largest property and casualty insurer in the USA.	Mutual	Insurance	USA	1925	24,392	116,16
6	6	Groupama	Groupement des Assurances Mutuelles Agricoles/Groupama is the 1st insurance mutual in France and present in 8 Southern-European countries. The multi-line insurance group belongs to a large agricultural mutual.	Mutual	Insurance	France	1899	15,684	95,05
7	9	Edeka Zentrale AG	EDEKA is no. 1 in German food retail trade with 28% market share. It includes 50 distribution stores, 148 building and garden centres and 181 self-service department stores.	Co-operative	Retailing	Germany	1898	15,660	5,00
8	7	Migros	No. 1 retailer in Switzerland with a market share of 17.9% and 580 supermarkets, convenience and department stores. Migros holds position 10 with its bank in Switzerland.	Consortium + Federation	Retailing	Switzerland	1925	15,475	12,74
9	10	Mondragon Corporation	MCC is a business group made of 264 companies and entities active in three sectors: financial, industrial and retail. It is Spain's 7th largest industrial company.	Co-operative Group	Materials	Spain	1956	14,040	27,20
10	8	The Co-operative Group	One of the world's largest consumer co-operative and the UK's largest commercial farming operation. It has over 3000 outlets – comprising food stores, travelcars, funeralcare and Co-op pharmacy, insurance and banking.	Co-operative Group	Retailing	UK	1863	12,726	71,32
11	14	Groupe Caisse D'Epargne	The Groupe has capital funds of €19.4 billion, net banking income of €10.3 billion and net earnings of €2.2 billion. It has one of the highest credit ratings enjoyed by any French banking institution (AA/As2/AA).	Co-operative Group	Banks	France	1983	12,196	703,42
12	19	CHS Inc	A Fortune 500 company. A diversified energy, grain and food co-operative. CENEX is the energy brand. CHS is the 13th largest convenience store chain in the USA.	Co-operative Group	Food & Agri	USA	1931	11,941	4,72
13	16	Confédération Nationale du Crédit Mutuel	Second largest retail bank in France. 4760 branches serving 13.8 million customers. The bank is decentralized with local, regional and national layers. It ranks first in bank insurance.	Co-operative Group	Banks	France	1890	11,405	516,66
14	11	Rabobank Group	The dominant bank in the Netherlands with 9 million customers and serving over 50% of the population. Market leader in mortgages with 28% share.	Co-operative Group	Div. Financials	Netherlands	1898	11,085	599,35
15	20	The Norinchukin Bank	One of the largest institutional lenders in Japan specialising in loans to Japanese agricultural, fishery and forestry co-operatives. Credit rating: A1 (S&P).	Controlled by Co-ops	Banks	Japan	1923	10,971	57,794
16	n/a	Debeka Group	One of the top ten insurance and financial services groups in Germany active in the insurance and home savings business.	Not Classified	Insurance	Germany	1905	10,842	66,43
17	13	Coop Swiss	Coop Swiss is the no. 2 retailer in Switzerland with an overall market share of 16.7%. It has over 1500 shops and hypermarkets as well as petrol stations, banks and restaurants.	Consortium + Federation	Retailing	Switzerland	1890	10,729	8,54
18	15	Coop Norden	Coop Norden comprises three groups – Coop Norden Danmark (Denmark), Coop Norge (Norway) and Coop Norden Sverige (Sweden) with 1080 stores and hypermarkets.	Controlled by Co-ops	Retailing	S&N&D	2002	10,307	2,57
19	17	Metsäliitto	One of Europe's biggest forest industry groups and Europe's largest wood producer. Biggest supplier of tissue and cooking paper products to households in Europe.	Co-operative	Food & Agri	Finland	1934	10,233	10,28
20	21	Groupe Banques Populaires	Groupes includes 22 regional banks, 94 businesses of mutual guarantee, 2692 agencies and a federal bank with 6,600,000 customers. BPG is one of the world's leading providers in credit insurance and credit management.	Co-operative Group	Div. Financials	France	1878	9,758	341,81
21	18	R+V Versicherung AG	It is a leading German insurance business with 16,500,000 policies.	Mutual	Insurance	Germany	1922	9,463	51,60
22	12	UNIPOL	The fourth largest insurer in Italy with 6.5 million customers. Its overall market share is 10.2% of which 9.8% in life and 11% in non-life.	Controlled by Co-ops	Div. Financials	Italy	1963	9,352	47,47
23	n/a	John Lewis Partnership PLC	All 88,000 permanent staff are Partners who own 26 John Lewis department stores, 185 Waitrose supermarkets, an online and catalogue business. Britain's favourite retailer 2007.	Employee Owned	Retailing	UK	1929	9,172	6,21
24	23	Zenrosai	Zenrosai works closely with trade unions for workers' welfare movement. Of the 61,000 trade unions in Japan, over 50% are associated with Zenrosai.	Co-operative	Insurance	Japan	1957	9,057	24,58
25	22	Dairy Farmers of America	The largest producer-owned marketing co-operative and food business in the USA. It processes and markets 56.5 billion pounds of milk each year.	Co-operative	Food & Agri	USA	1998	8,909	2,44
26	24	Fonterra Co-operative Group	One of the top 10 dairy businesses in the world and accounting for a third of international dairy trade – 60 manufacturing plants including 35 in New Zealand.	Co-operative	Food & Agri	New Zealand	2001	8,702	8,34
27	29	Danish Crown	The largest pork processing business in the European Union with 90% of pork and 58% of beef production in Denmark. Accounts for 54.4% of Danish agricultural exports.	Co-operative	Food & Agri	Denmark	1887	7,851	3,75
28	31	Desjardins Group	The leading financial institution in Québec and the largest cooperative financial group in Canada.	Consortium + Federation	Div. Financials	Canada	1900	7,813	101,89
29	26	BayWa Group	Active in agriculture, building materials and energy. The Group has over 2400 sales locations in eight European countries, mainly in Germany, Austria and Eastern Europe.	Co-operative	Food & Agri	Germany	1923	7,740	3,07
30	25	ReWe Group (Zentral-Aktiengesellschaft FU)	REWE Group is the number three player in the European food trade with supermarkets, discount stores, superstores and hypermarkets. It also has specialist outlets and travel agencies.	Co-operative	Retailing	Germany	1927	7,662	1,42