Comment

Ignacio Ortuño-Ortín
UNIVERSIDAD DE ALICANTE

Bowles and Gintis have presented an interesting model on the relationship between the fraction of workers in democratic firms and the level of workers' wealth. They analyse both the democratic and the capitalist firm as institutions characterized by two principal-agent problems, stated as: 'eliciting effort from a team of workers and inducing the firm's managerial decision-makers to act in the interest of the firm's debt and equity holders'. Perhaps the main conclusion of their chapter is that higher levels of worker wealth support higher numbers of democratic firms. In my opinion, this is an important result and it would be interesting to consider how far this is true for more general models. In particular, it might be useful to investigate whether the changes proposed in the following comments would lead to different conclusions.

1. The authors define the utility function $V(w)$ as the workers' present value of having wealth w. This is the function workers consider when deciding how much of their wealth to provide as equity. But the equity level will affect the workers' payment y, and the employment value v^d. Thus, it would be reasonable to assume that $V(w)$ and v^d are not independent.
2. In the democratic firm, by increasing their equity in it, workers are exposed to a higher risk level. Therefore, the return on this equity has to be increased. This is the main problem with the democratic firm and, assuming decreasing risk-aversion, it explains why this type of firm is not viable for low levels of wealth. It may be asserted, however, that a natural way to lessen the problem is to allow outside investors to acquire equity in the firm. In this way both workers and capitalists are residual claimants. Moreover, the firm can remain democratic if workers hold half the total equity. It also seems reasonable to believe that this degree of worker ownership will be enough to guarantee access to outside credit. Thus, this type of democratic firm with capitalist participation may have an equity : debt ratio close to the one in the pure capitalist firm.
3. In equilibrium the fraction of workers in democratic firms is determined by the condition $v^c(f) = v^d(f,W)$: that is, the expected present value of utility in the democratic and capitalist firm have to be the same. There is, however, an asymmetry in the way these two values are defined. It is only in the democratic firm that this expected present value depends on the wealth level W. In the case where the function v^c also depends on W, higher values of W would imply higher levels of v^c. This possibility could complicate the relationship between W and the fraction of workers in democratic firms.
4. The equilibrium values for the fraction of workers in democratic firms and the workers' wealth are jointly determined by two functions: $f = \phi(W)$ and $W = \psi(f)$. The difficulty about supporting this approach is that in the first function W represents a given deterministic value whereas in the second it stands for the expected wealth level. When this fact is taken into account it may be the case that the level of workers' wealth and the number of democratic firms are jointly determined in quite a complex way.