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Economic Democracy and Enterprise Form in Finance*

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Abstract

This article considers the relative advantages of alternative enterprise forms in finance from the point of view of public accountability. The business corporation is compared to the state agency or authority, the cooperative, the state corporation, and the charitable nonprofit. These forms can be distinguished according to whether they aspire to enhance general electoral democracy or stakeholder democracy and whether their democratic controls operate directly or indirectly. The article suggests that the indirect democratic forms may be more promising than the direct ones. It also argues that the project of democratizing finance depends on the development of practices of multifactor or "dialogic" performance assessment. Such practices must be institutionalized through public or private organizations that extend across firms.

Keywords

economic democracy, finance, business organizations

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The institutional design of "democratizing finance" could play out in either or both of two trajectories. First, there is what Fred Block in his article in this issue, titled "Financial Democratization and the Transition to Socialism," calls the "public utility model." This approach would tighten the regulation of enterprises that would continue to be organized as for-profit or investor-owned corporations. The second would transfer responsibility and resources to organizations constructed to internalize public goals and values. Robert C. Hockett's updated Reconstruction Finance Corporation, Block's local nonprofit banks, Michael A. McCarthy's sovereign wealth fund, and Lenore Palladino's "public investment platform" are examples.[1]

The first course is less radical. The public utility model is basically the one that is now in place. Block would tighten regulation, but only one of his proposals seems a major departure from current practice—limitations on profits. The alternative institutions emphasized in the second approach currently exist in various manifestations, but moving them to the center of the financial system would involve an epochal change.

To the extent that reform is guided by democratic ideals, the two approaches involve different instantiations of democracy. In the regulatory approach, actors accountable to general electoral processes impose external constraints on organizations that retain discretion to pursue private goals within the constraints. In the second approach, political responsibility is imputed to actors within the organization, and they are expected to use their discretion to further public values as well as the private interests of the organization's constituents.

I propose to consider the rationales for the second approach and the forms that democratized, ground-level financial institutions might take. There are two relevant types of democracy—general electoral democracy and stakeholder democracy. And with each of these types, it is worth distinguishing between relatively direct and relatively indirect forms of democratic control. I suggest reasons for thinking that the most directly democratic forms are not necessarily the most promising.

The key rationale for the move to more democratic forms is to encourage the better alignment of managerial incentives with public interests. Such alignment requires not only redirection but also a broadening of incentives. Thus, effective enterprise reform requires the creation of techniques of monitoring and performance assessment that accommodate multiple, complex, and competing goals. Such techniques do not exist in any fully developed form; they are in the process of creation. These techniques have further implications for institutional configuration. They suggest that informal lateral connections among peer institutions may be as important as the internal structure of the institutions.

The Problem with the Business Corporation

The call for democratization at the enterprise level arises from dissatisfaction with the business corporation, the critical defining features of which are (a) the attachment of control rights to capital rights and (b) free transferability and accumulability of ownership interests. In the 1980s, these features produced two critical phenomena: (a) the market for corporate control and (b) legal recognition of maximizing shareholder value as the meaning of managerial fiduciary duty.

The for-profit corporate firm lodges control in the firm's investors, that is, those who have the residual claims on its income and assets. This fact creates uniquely powerful incentives for maximizing profits. It gives strategic discussion within the organization what Claus Offe and Helmut Wiesenthal call a "monological" character.[2] From the investor's perspective, this characteristic is advantageous; it reduces "decision costs."[3] Offe and Wiesenthal, writing from the left, and Henry Hansmann, writing from the center, attributed the dominance of the business corporation over competing forms to its superior ability to devise and commit to a coherent strategy. It is easier to agree on a strategy to maximize profits than on one to optimize multiple conflicting goals of various constituencies.

However, from a social perspective, there is a disadvantage. To the extent that the corporation's activities generate negative externalities, powerful internal incentives push against taking account of them. Public concerns can be addressed through regulation to the extent that officials can formulate and enforce regulations effectively. But the powerful incentives of the for-profit form can induce activity designed to defeat effective formulation and enforcement.

The conception of the corporation as single-mindedly devoted to profit maximization has been around for a century and a half, but it has only recently been embraced by the law, and business elites were quite divided about it for much of the twentieth century. In the mid-twentieth century, most lawyers and many economists advanced a different view, according to which the "separation of ownership and control" arising from the dispersion of shares meant that shareholders had limited practical opportunities to discipline management. (The main practical opportunities were the proxy contest and the derivative suit, both of which were expensive and rare.) Managers thus had a good deal of discretion. They could use this discretion to benefit themselves; but they could also use it to benefit nonshareholder constituencies, such as organized labor, local communities, and customers. Some interpretations of the large mid-century corporation portrayed the manager's role as mediating among shareholders and those other constituencies to hold the enterprise together in some productive collaboration. That portrayal was, to varying degrees, both normative and descriptive.[4] The courts generally upheld management discretion to act in the interest of nonshareholder constituencies.

Since the 1980s, however, the courts and the corporate elite have embraced the monological conception. On the legal scene, the key development has been the hostile takeover. Before its advent, the monological conception would have been difficult to enforce. Managers could assert that benefits to nonshareholder constituencies served long-run shareholder interests in reputation and collaborative relations. Courts did not feel able to second-guess such rationales. But the takeover allows enforcement of shareholder primacy by the market for corporate control. Entrepreneurs who believe management is failing to maximize profits can earn their own profits by acquiring control and replacing the incumbents. The courts, as they cleared the way for the takeover, began to speak about "shareholder value" as the governing norm with unprecedented clarity.[5]

The social disadvantage of the organization's single-minded focus on profit is especially acute to the extent that there is asymmetry of information between public regulators and the organizations. If the risks regulation addresses are caused by technology that is exceptionally complex, evolves rapidly, or varies locally, regulated actors are likely to have better understanding than officials. Their incentives are to use their superior understanding to further profits for the enterprise at the expense of exacerbating risks that are substantially borne by others.

In banking, the most pertinent challenges arise from government subsidization of risky activities through such mechanisms as deposit insurance, last-resort lending, and implicit "too big to fail" bailout insurance. The banks push against regulatory constraints to take on more risk because government subsidizes it. They finance speculative investment at the expense of investment in the real economy despite the fact that social returns to the latter are higher. And they are indifferent to positive externalities that come from investment in underdeveloped regions or disadvantaged people or the environment.

A further concern is the potential arising from the relative complexity of even routine financial transactions for the exploitation of unsophisticated customers. The increased exposure of banks to competition since the 1980s has improved customer service in some ways, but customers are egregiously exploited in others. The recent Wells Fargo scandal that led to the firing of 5,000 employees is one of the most extensive consumer frauds in history.

Banking is not the only area where the social desirability of the for-profit form is being questioned. In the late twentieth century, in several areas where public or charitable provision was customary, experiments were undertaken with for-profit enterprise. Efforts were most notable in health care and education. More radical initiatives founded on the same logic occurred with prisons and military services. In all these areas, aggregate performance of for-profit enterprise has disappointed proponents, and there have been many scandals.

Varieties of Enterprise Democracy

In the enterprise context, democracy can be understood as greater accountability to the general electorate on the one hand or to stakeholders on the other. And within the general and stakeholder fields, we can distinguish relatively direct and relatively indirect forms of accountability. These two parameters yield four types of enterprises: state corporations, state agencies, charitable nonprofits, and cooperatives (Table 1).

In the next two sections, I assess the relative advantages of the different types, considering first the relatively directly democratic forms and then the relatively indirectly democratic ones. In general, I suggest that the indirect approach is more promising in most relevant contexts.

Table 1. Democracy and Form of Enterprise.

	Type of Democracy	
	General	Stakeholder
Intensity of public control		
Indirect	State corporation or authority	Charitable nonprofit
Direct	State agency	Cooperative

Source: Author's elaboration.

Relatively Directly Democratic Enterprise Forms

Legally, the incidents of relatively directly democratic enterprise control are, first, the power of elected officials or stakeholders to remove enterprise directors at will and, second, strong control by elected officials or stakeholders over the organization's resources. In other words, the enterprise is dependent on elected officials or stakeholders for frequent budget appropriation or expenditure approvals. The key relatively directly democratic forms are the state agency and the cooperative.

The State Agency

The state agency is an organization governed by directors appointed by elected officials. If we take the form in which democracy—here, electoral control—is strongest, the directors would serve at the pleasure of elected officials, and the entity would rely entirely on annual appropriations from a general government. Its resources would be redeployable at the will of the general government. It would have neither taxing nor borrowing authority of its own. Its contracts would be subject to approval by the general government.

This description fits many public entities exercising regulatory authority, such as the Environmental Protection Agency or local zoning boards, and entities providing services, such as Veterans Affairs or most public schools or police departments. However, whether such entities are well suited to play major roles in financial or economic development has often been doubted. The reasons relate to problems with this kind of democratic control. First, it is difficult under strong electoral control to execute long-term plans or projects that extend over many election cycles. Voters can be short-sighted, and their attention can wander. Only a few issues can be salient in a general election, so electoral decisions may be inconsistent over time as attention flits. And of course, politicians may use their control opportunistically to get short-term electoral benefits. Think of Richard Nixon pumping up the money supply in 1972 or Governor Chris Christie of New Jersey canceling the Hudson River tunnel to protect tax cuts in 2012.

An individual or a private organization can undertake long-term projects by making long-term contractual commitments. But government long-term commitments compromise strong electoral democracy. Or at least that is one influential view. It explains the current constitutional rules in most states that require balanced budgets or the common nineteenth-century rule that precluded many municipalities from committing to contracts that extended beyond the terms of the officials approving them. On a larger scale, it explains the resistance to independent monetary authorities or central bank independence. Independent monetary authorities compromise democratic control. And they are accused of favoring dogmatic or class-biased tight money policies. But popular pressures for alternative policies can cause harmful inflation or interest rate rises.[6]

The general effects of direct popular control seem unclear, but there are ample grounds for caution. Nathan Jensen and Edmund Malesky, for example, recently reported a study of local government incentives for business investment. They echo the view widely held among economists that such subsidies tend to be ineffective or unnecessarily generous and to have regressive fiscal impacts.[7] They looked at the relative effects of direct and indirect electoral control on the propensity to offer such subsidies, comparing cities managed directly by elected officials—mayors and city councils—with cities in which elected officials manage indirectly through an appointed city manager. City manager regimes were inaugurated in the Progressive Era out of concern that direct management by elected officials was susceptible to voter short-sightedness and official corruption. The study vindicates at least the short-sightedness part of the hypothesis. Mayoral regimes are substantially more disposed to offer pointlessly generous subsidies to attract businesses than city manager ones. The authors suggest that voters penalize officials when enterprises leave or fail to come in, but not when subsidies conferred on them turn out to be ineffective or unnecessary.

The Cooperative

The second version of direct democratic enterprise is the stakeholder-controlled corporation. The paradigm here is the cooperative, a private entity controlled by its "patrons," who have some active connection to the enterprise in addition to investment, typically as customers, workers, or suppliers. The patrons are the residual claimants on the firm's income and (although there is some ambiguity here) assets. In uniting control and residual economic claims, the cooperative resembles the business corporation. But there are key differences. The patron's economic claims cannot be transferred independently of their control claims, and, since their control claims are premised on some active participatory role, new owners must be approved by the remaining owners. So shares are not freely transferable. There is thus no possibility of a hostile takeover.

In addition, control rights in the cooperative are generally distributed equally without regard to investment. Each member gets one vote. Financial reward is distributed on the basis of a combination of investment and economic participation ("patronage").

The cooperative is the enterprise form that most embodies democratic ideals. But it has disadvantages, and experience with it has been mixed. Two problems arise from the incompleteness of representation. Typically, only one set of stakeholders is represented, although others are affected. For example, agricultural marketing cooperatives, which are controlled by suppliers (farmers), have engaged in anticompetitive practices that harm consumers. And the democratic promise is fulfilled only when stakeholders who are represented devote effort to governance. Passive or indifferent patrons are vulnerable to exploitation, as illustrated by some cooperative (mutual) insurance companies that have been reorganized to allow management to appropriate patron capital.

Moreover, cooperatives have difficulty expanding because they cannot provide controlling interests (equity) to outsiders.[8] They can expand only through debt or capital contributions and retained earnings of patrons. In many organizations, patrons will have limited ability to finance themselves.

Still another problem arises from the distributive disjunction between control and reward. Control is distributed equally, but there can be wide variation among economic shares. So the problem arises that members with poor economic endowments may use their control in ways that redistribute away from those with relatively rich claims. If there is inequality, the poor may have different preferences about retaining and distributing earnings and about consumption within the enterprise. These differences can produce the kind of internal conflict that threatens the enterprise.[9] A relevant phenomenon recently seen in law firm general partnerships—which used to and still can resemble cooperatives—is disagreement over retirement programs. High-billing partners may object to firm-wide pension programs, which tend to be relatively egalitarian. If they are outvoted, they may leave, sometimes causing the partnership to collapse. Alternatively, if the members with relatively large accounts have voting control, they may use it to alter the enterprise form to enable them to cash out the full value of their equity. The prohibition on outside equity narrows the class of buyers for the shares of retiring members to newcomers willing to be and acceptable as patrons. This fact lowers their value. Older members of successful cooperatives may have strong incentives to push to convert the enterprise out of the cooperative form so it can be sold to outside investors. The remaining owners then become employees.[10]

Perhaps the most distinctive disadvantage of the cooperative form from a democratic perspective is a bias toward exclusion. The bias has two sources. First, because the cooperative relationship is a relatively thick one involving multiple dimensions, cooperators may be choosy about new entrants in a way that corporate shareholders (assuming we mean public corporations) would not be. Second, cooperators may worry about internal redistribution. If new entrants generate less income, they will still have equal control rights. So new entrants who seem likely to perform below the average of incumbents will be disfavored.

An extreme example of the bias is the New York City housing market, where for a long time building-wide resident cooperatives were favored over individual condominium ownership. The cooperative form meant that residents were mutually responsible for the building mortgage, which made them reluctant to admit newcomers with less than average financial resources. That problem, however, could have been mitigated by adopting the condominium form, where collective responsibility applies only to the common areas. Nevertheless, the cooperative form was favored because it not only encourages but legitimizes certain forms of discrimination that might otherwise be difficult to achieve. Condominium owners have no standard mechanism to veto people to whom their neighbors wish to sell. And the law makes it difficult to achieve such vetoes contractually by severely limiting enforcement of "restraints on alienation." The cooperative form, on the other hand, requires a collective judgment before a sale can occur.[11] Residents can use their veto to exclude people they dislike for virtually any reason. In theory, they are still bound by antidiscrimination law with respect to race and other protected characteristics, but it is very difficult to prove that a decision was based on such considerations.

In the financial sector, cooperative banks, or "credit unions" as many are called, typically limit lending to depositors and often require, in addition, that depositors and borrowers have some further relation, such as employment by a common employer. This arrangement makes for trust and information sharing and is associated with lower borrower default rates. But it limits the range of potential participants.

Relatively Indirectly Democratic Enterprise Forms

The drafters of the US Constitution rejected “democracy,” their term for relatively direct forms of popular rule, for “republicanism,” their term for relatively indirect forms.[12] The president is not elected directly; voters choose electors who in turn choose the president. And until the Seventeenth Amendment, senators were chosen by state legislators.

The drafters’ suspicion of popular control arose in large part from the fear that voters would be short-sighted or reckless in financial matters. Their solution—indirect control—was designed to “refine and enlarge” the views of public officials by attenuating their accountability to the electorate.

The specific processes of indirect control in the Constitution are not highly regarded today. The indirect election of senators has been eliminated, and hardly anyone defends the Electoral College. But if we look at the institutions that have developed to combine public accountability with financial or economic development, something like the idea of indirect control is prominent. The key examples are the government corporation and the charitable nonprofit corporation.

The Government Corporation

I use the term “government corporation” to describe a range of entities that are sometimes called corporations—for example, the Reconstruction Finance Corporation—but also go by other names, especially “authority,” as in the Tennessee Valley Authority or state and local redevelopment and transportation authorities.

The government corporation is an entity treated as a separate accounting unit with authority to take various actions (e.g., contracting, holding property, borrowing) in its own name and on its own initiative. However, ultimate control and financial rights are retained wholly or mostly by the general government. The governing board of the corporation is mostly appointed by elected officials. They may include stakeholder representatives, but they have fiduciary duties to the entity as a whole, not to the narrow interests of a specific constituency.

Typically, electoral control is attenuated by two sorts of mechanisms. The first are governance procedures. The tenures of board members may be staggered across electoral cycles, and removal may be precluded except for demonstrable cause. Thus elected officials can change control of the corporation only gradually and sometimes only over more than a single electoral cycle. At the subnational level, insulation can be achieved by sharing control of a corporation across separate municipalities, counties, or states. If control is divided among members chosen by different jurisdictions, no single electorate can induce a change of control unilaterally.

The second kind of insulating mechanism concerns finance. The corporation can be given borrowing authority and control over income or assets. Using the assets or income as collateral for borrowing removes them from control of elected officials. And if the corporation controls income flows that exceed its operating and debt service costs, it may have substantial discretion to undertake projects free of electoral oversight.

Transportation and development authorities at the subnational level illustrate the advantages and disadvantages of such arrangements. The authorities are able to execute long-range plans that require commitments across many electoral cycles and coordination across multiple jurisdictions. Without their relative autonomy from the electoral process, short-sightedness or inconsistency and parochialism might preclude valuable initiatives. On the other hand, political insulation is also associated with arrogance and contempt for nonelite interests.

The advantages of the state corporation are displayed in the story of the massive cleanup of Boston Harbor in the 1980s and 1990s. For decades the harbor was scandalously polluted. Efforts to remedy the situation failed, despite the illegality of much of the contributing conduct and broad political support for remediation. A major obstacle appears to have been the extreme fragmentation of authority. Effective intervention occurred only after an ambitious lawsuit, and its centerpiece was the creation of the Massachusetts Water Resources Authority—"a new independently financed state authority to take over the roles of planning, constructing and administering" the cleanup.[13] Having proved intractable to electoral institutions for decades, the problem was solved with the interventions of two nonelectoral ones—the court and the independent authority.

Of course, the dark side of the independent authority is even better known, especially through Robert Caro's account of how Robert Moses turned the Triboro Bridge and Tunnel Authority into an empire more powerful than the elected government of New York. Moses created a modern, automobile-based transportation infrastructure at a cost that included neglect of public transportation, the destruction of many vital neighborhoods, and the herding of poor people into dysfunctional and undermaintained high-rises.[14]

The Charitable Nonprofit

The other relatively indirectly democratic enterprise form is the charitable nonprofit corporation.[15] The charitable nonprofit is an extremely flexible instrument. Anyone can form one, and the law permits many control arrangements. Governing board members can be appointed by public officials or private individuals, elected by members (if there are members, but there need not be), or filled by remaining incumbents as others depart. Officers and board members must act disinterestedly. They may not use control to benefit themselves at the expense of other stakeholders.

Government subsidizes the organization through tax exemptions for the organization and tax benefits for donors. It polices the organization to make sure that (a) its activities are confined to areas that could broadly be characterized as charitable (i.e., perform some social good not adequately served by for-profit enterprise), (b) it is not being used for private inurement, and (c) it is devoting donated resources consistently with its undertaking to donors. But within these broad constraints, directors and officers have discretion to pursue the organization's public-regarding goals comparable to the discretion of for-profit managers to pursue profit maximizing.

Viewed individually, charitable nonprofits are not necessarily democratic, although they can be. Nonprofits need not have members at all, and their boards can be self-perpetuating oligarchies. However, excessively narrow control groups may raise doubts about whether activities are truly charitable or involve private inurement and are thus discouraged by the prospect of regulatory scrutiny. Moreover, nonprofits can be strongly democratic, and both private and public contributions to them can be conditioned on democratic governance. For example, nonprofits wishing to be characterized as "community development corporations," in order qualify for certain grants, must admit all interested members of their catchment areas to membership and allow them to elect a portion of the board.

Viewed collectively, the nonprofit sphere has democratically attractive features. Since it accommodates initiative so easily, it makes diversity and experimentation possible.

Governance aside, accountability can arise to the extent that the enterprise depends on public financial support. The law is ambivalent about the degree of economic autonomy nonprofits should have. An enterprise that starts out with or accumulates a large endowment can operate on its passive income without any need to raise more. Many view this situation as problematic. Just as control over public resources can insulate the state corporation from political accountability, control over its own capital can insulate nonprofits from the accountability that arises from the need to convince current donors, contractors, or patrons of the value of its services. Thus there are doctrines designed to limit this kind of insulation, although they tend to be half-hearted. One rule measures how much of a nonprofit's income comes from "public support" (current donations, fees for charitable services, government contracts), as opposed to passive income, and imposes some disadvantages on those who fail to meet a minimum. Another requires "private foundations" (enterprises that make grants from endowment income) to spend at least 5 percent of their endowment each year.

The Influence of Dialogic Assessment on Enterprise Form

The four alternative forms either demand or permit control structures more conducive to democratic accountability than those of the business corporation. They also prescribe or encourage enterprise norms that are diverse and public regarding. They require "dialogic" assessment that considers and reconciles multiple values. (The cooperative is a partial exception to the need for public-regarding ends. In principle, cooperatives maximize the welfare of their members, but as their members have multistranded relations with one another—as both capital suppliers and patrons/participants—their interests are diverse and may diverge less from public ones.)

In addition, all four alternative forms depart from the incentive structure of the business corporation. They eliminate or, in the case of cooperatives, limit the opportunities of managers to profit from capital gains and their ability to benefit from increases in the enterprise's income. Thus high-powered incentives to evade regulatory restrictions or create negative public externalities are blunted. There are of course disadvantages. There are no material incentives for innovation or cost minimization comparable to those in private enterprise. And "decision costs" may be higher because conversations about goals or performance are longer and more complex.

The main material incentive for such enterprises is the continuing need to attract new resources without the ability to offer capital shares. The enterprises must convince people to pay for their services (on either a first-party or third-party basis) or to make donations, which will usually mean convincing them of the value of their efforts. As a purely economic matter, these incentives are not high-powered. Donors have limited ability to monitor performance, and large endowments or underserved reputations sometimes allow organizations to escape pressures for accountability.

Granting that the alternative forms avoid the limitations of monological assessment, the question remains how the more complex assessment they make possible is to be organized. To begin with, how do we limit the assessment criteria so that they provide some discipline? If the criteria are too vague and too numerous, it will be hard to generate meaningful conclusions about performance. If the criteria are limited and specified, they will have to be revised to take account of unforeseen consequences—counterproductive adaptation (e.g., "teaching to the test"), collateral consequences, or technological innovations. Once we allow for the need for continuing reconsideration of the criteria, every unflattering measurement can be interpreted as either an indication of poor performance or a symptom that the metric needs revision.

Another problem has to do with learning. The for-profit form creates strong individual incentives for firms to learn, but it also encourages them to hide much of the knowledge they acquire from their competitors and to distort the information they provide shareholders and regulators. The market deals with slow learners by eliminating them, not by helping them learn. The alternative enterprise forms are more conducive to information sharing. The problem is that there is some trade-off in the design of an assessment regime between facilitation of learning and motivation of effective effort. The criteria that have the most diagnostic value, and hence point the way to improvements, may not be those that most readily facilitate rankings or threshold determinations that can justify sanctions, such as withdrawal of resources.

There is no definitive solution to these problems, but responses to them have tended to converge in a distinctive architecture.[16] Assessment takes the form of a kind of deliberative engagement across firms or organizations. The organizational structure is neither a market nor a bureaucracy but a set of shifting and informal networks.

The most distinctive mechanism is peer review. Organizations are assessed by teams of outsiders from organizations performing tasks similar to theirs. The practice is pervasive, but it is most fully developed in medicine, especially with respect to hospitals.[17] Peer review strives to combine learning with comparative assessment. Metrics tend to emphasize diagnosis and are explicitly provisional. A central focus of inquiry is the organization's capacity to adapt to new circumstances, learn from its mistakes, and integrate new knowledge generated elsewhere. Such reviews can also generate rankings and comparisons. Rankings and comparisons have diagnostic value because they indicate where the best practices are to be discovered. But they also can serve accountability purposes.

The term "peer review" connotes a horizontal dimension, but the process has hierarchical elements: it must be organized across firms by a coordinating organization. That organization can be controlled collectively by the firms under review themselves. More commonly it is a nonprofit corporation with the substantial representation of those under review but with the significant, often controlling, representation of other stakeholders.[18]

A further hierarchical dimension arises from the use of the peer-review process as an indicator or requirement by regulators, funders, and customers. In medicine, for example, participation in the Joint Commission on the Accreditation of Hospitals (JCAH) process and minimally satisfactory ratings are conditions of various professional licenses and reimbursement by Medicare and private insurers.

The peer-review process presupposes a willingness to share knowledge across firms and thus is limited in the for-profit sector. True, there is quite a bit of knowledge sharing in the for-profit sector, as many of the hospitals in the JCAH network are for-profit. Nevertheless, for-profit firms will not freely share information on matters on which they are competing intensely. Conversely, it is an advantage for a nonprofit organization that its form lessens this inhibition.

The most developed performance metrics in the financial sector are the traditional accounting norms of profitability and "safety and soundness." Efforts have begun only relatively recently to develop metrics that take account of other social goals. There is, for example, the Global Impact Investing Rating System overseen by the Global Impact Investment System. Such approaches, however, have a long way to go to achieve the sophistication of the hospital regime or to provide the requisites of accountability for a broadened nonprofit financial sector.

Peer-review regimes generate accountability in two distinctive ways. First, such regimes implement accountability directly at the firm level. Practitioners account to peers. This is a somewhat different accountability from that overseen by either public officials or stakeholders. Peer reviewers typically do not hold public office and are not electorally accountable. Although they may have stakes in the industry, they do not have stakes in the firm under review, and they are supposed to be disinterested, not representative in the political sense. Part of the rationale for these regimes is that the duty to explain one's practices and submit to the judgment of peers contributes to responsibility both by forcing articulation and reflection and through mechanisms of pride and shame.

At a second level, the regimes induce accountability by making the organization's operations more transparent to outsiders, including both stakeholders and electorally accountable officials. The review generates reports that can be made available publicly or distributed to stakeholders, and it can generate conclusions in forms that permit comparisons across firms. The outsiders can use this information to make much more plausible judgments than they otherwise could about what support to give the organizations.

Of course, there are many ways in which such regimes can go wrong. One pathology is a tendency for peers to cover for each other through reciprocally lenient evaluation and grade inflation. With luck, the tendency will be limited by counterpressures. Outside funders and regulators may be able to identify the problem and refuse to accept the inflated ratings. Poor performance by the regime may induce entry of new ones that compete on promise of providing more effective signals. Alternatively, the better performers among the firms being evaluated may resent the efforts of the laggards to blur signals and rankings and insist on more rigor, or they may break away and affiliate with a more effective regime.[19]

The key point, for immediate purposes, is that attempts to democratize the financial sector depend at least as much on the development of mechanisms of transparency and responsibility as on a choice among alternative enterprise forms.

Conclusion

The business corporation became more narrowly profit-focused at just the moment when changes in the financial sector generated opportunities to earn large returns by shifting risks to the public sector. Tightened regulation is one response to this situation. But especially in a technologically dynamic industry, regulators have trouble adapting to new contingencies and detecting innovative forms of evasion. So an alternative approach to aligning private and social incentives—a change in enterprise structure—has some appeal. This move is sometimes characterized in terms of economic democracy and could involve democracy in two ways: by enhancing electoral control over the enterprise or by providing more control to people with interests other than profit. All the relevant enterprise forms have disadvantages, however, and it can be argued that the ones affording the most direct democratic control tend to be the least effective. In any event, no matter which nonprofit form is chosen, accountability will depend on effective modes of assessment and information sharing across enterprises.

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Notes

1. In this issue, *Politics & Society* 47, no. 4 (2019): Robert C. Hockett, "Finance without Financiers"; Fred Block, "Financial Democratization and the Transition to Socialism"; Michael A. McCarthy, "The Politics of Democratizing Finance: A Radical View"; and Lenore Palladino, "Democratizing Investment."
2. Claus Offe and Helmut Wiesenthal, "Two Logics of Collective Action," *Political Power & Social Theory* 1 (1980): 67–115.
3. Henry Hansmann, "When Does Worker Ownership Work? ESOPS, Law Firms, Codetermination, and Economic Democracy," *Yale Law Journal* 99 (1990): 1750–860.
4. E.g., Masahiko Aoki, *The Cooperative Game Theory of the Firm* (Oxford: Oxford University Press, 1984).
5. Jeffrey N. Gordon, "The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices," *Stanford Law Review* 59, no. 6 (2010): 1465–568.
6. E.g., Guy Debelle, "Central Bank Independence in Retrospect" (speech at Bank of England conference "Independence: 20 Years On," London, September 28, 2017), https://www.bis.org/review/r170928h.pdf.
7. Nathan Jensen and Edmund Malesky, *Incentives to Pander: How Politicians Use Corporate Welfare for Political Gain* (Cambridge: Cambridge University Press, 2018).
8. A few states have adopted an innovation that allows "limited" outside equity interests in business corporations. James R. Baarda, "'Outside' Cooperative Equity: Obligations, Tradeoffs, and Fundamental Cooperative Character" (conference presentation, NCERA-194 Research on Cooperatives, Annual Meeting, Kansas City, November 2–3, 2004), http://ageconsearch.umn.edu/record/31792/files/cp04ba10.pdf.
9. A variation on the patron-controlled enterprise form that can be found in some water districts and homeowners' associations distributes control (as well as the economic incidents of participation) in accordance with the value of a member's land or housing unit served by the organization. See Robert Ellickson, "Cities and Homeowner's Associations," *University of Pennsylvania Law Review* 130 (1983): 1519–80. Such arrangements minimize the danger of opportunistic redistribution but at the cost of seriously compromising the democratic character of the enterprise. Some argue that the sacrifice of democracy inhibits the solidarity necessary for effective collaboration.
10. Examples include the plywood cooperatives discussed in K. Berman, *Worker-Owned Plywood Companies: An Economic Analysis* (Pullman: Washington State University Press, 1967), 85–92, 93–98, and the garbage collection cooperatives discussed in R. Russell, *Sharing Ownership in the Workplace* (Albany: State University of New York Press, 1985), 100. Sidney and Beatrice Webb argued that successful worker cooperatives would inevitably self-destruct either by selling themselves to outsiders or by bringing in new members as employees. Sidney Webb and Beatrice Webb, "Special Supplement on Co-Operative Production and Profit-Sharing," *New Statesman* (February 14, 1914).
11. Henry Hansmann, "Condominium and Cooperative Housing: Transactional Efficiency, Tax Subsidies, and Tenure Choice," *Journal of Legal Studies* 20 (1991): 25–71.
12. *Federalist*, no. 10 (James Madison).
13. Charles M. Haar, *Mastering Boston Harbor: Courts, Dolphins, and Imperiled Waters* (Cambridge, MA: Harvard University Press, 2005), 170.
14. Robert Caro, *The Power Broker: Robert Moses and the Fall of New York* (New York: Knopf, 1974).

15. Technically, there are two types of nonprofits—"public benefit" or charitable nonprofits and "mutual benefit" nonprofits. The latter are more or less equivalent to cooperatives.
16. For a brief general account, see Charles F. Sabel and William H. Simon, "Democratic Experimentalism," in Justin Dessaultels-Stein and Christopher Tomlines, eds., *Searching for Contemporary Legal Thought* (Cambridge: Cambridge University Press, 2017). For examples, see Charles F. Sabel and Jonathan Zeitlin, "Learning from Difference: The New Architecture of Experimentalist Governance in the EU," *European Law Journal* 14 (2008): 271–327; Kathleen Noonan, Charles F. Sabel, and William H. Simon, "Legal Accountability in the Service-Based Welfare State," *Law & Social Inquiry* 34 (2009): 523–68.
17. See, e.g., Robert J. Marder, *Effective Peer Review: The Complete Guide to Physician Performance Improvement*, 3rd ed. (Middleton, MA: HcPro, 2013).
18. The governing board of the Joint Commission on the Accreditation of Hospitals, e.g., has, in addition to representatives of the American Hospital Association, representatives of the various medical practitioner associations, public members chosen by public officials, and independent members chosen for expertise in particular fields.
19. For an example of a regulatory structure that appears to have dealt with such problems effectively, see Christine Overdevest, "Comparing Forest Certification Schemes: The Example of Ratcheting Standards in the Forest Sector," *Socio-Economic Review* 8 (2010): 47–76.

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