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What's Socialism Got to do With It?: Cooperatives as an Alternative in Economic Development

My parents first took me to a co-op during my early childhood. I remember it as a place where I got honey straws; a funky food store with strange selections and stranger people. This perception of co-ops as refuges for hippies has persisted relatively unchanged. In contrast, the public perception of inner cities – and what can be done to help them – has changed considerably. The departure of manufacturing jobs has left behind neighborhoods where poverty, crime, and unemployment congregate. There have been heroic efforts to revitalize these areas, but with limited success. There is a perceived trade-off between developing the infrastructure to attracting high-skilled jobs or helping the original inhabitants of the city – a "people vs. place prosperity" (Blair 203, Bolton).

Both are false perceptions: Cooperatives can be dynamic agencies for change, and local populations can benefit while cities achieve economic goals. This paper provides an overview of the benefits that cooperatives can provide urban developers. To do so, I will cover the methods that production cooperatives can address market failures and produce positive social externalities. I will then briefly outline a mechanism for adapting current methods of development funding towards encouraging cooperatives. Finally, I will briefly examine the potential pitfalls – both real and rhetorical.

Cooperatives, or co-ops, propose an economic structure based on cooperation instead of competition. That cooperation is intended to achieve greater efficiency – either in consumption, production, or both (Lutz, Wikipedia).

The workers in a production co-op are typically shareholders or stakeholders, directly participating in the profits of the venture. All members are informed as to the economic state of the co-op. Co-ops also usually draw their members from the local community (Lutz, Porter and Scully, Wikipedia). These aspects are especially useful for local economic development.

Imperfections in the capital market are a significant obstacle for local economic development. Capital investors mistakenly inflate the risk of investing in inner cities. This risk inflation is due to the non-local investor's inability to monitor recipients, control their investment, or outright discrimination(Chami and Fisher, Nienhaus and Brauksiepe, Blair).

This implies that "failed" businesses may have not succeeded because of a mistaken assessment of risk by an absentee owner or investor. Utilizing local residents at all levels will help correct this market failure. Local residents can have a better grasp of the true risk of capital investment than outsiders. Residents who are also stakeholders will also be able to exert more social control to ensure a return on any investment (Nienhaus and Brauksipe).

This principle is utilized with many microloan projects, such as the "Village Banking" project from FINCA International. This project creates councils of neighbors who are the administrators, beneficiaries, and responsible parties for distributing loan monies. Due to this kind of community involvement, these microloans – despite being given to the poorest of the poor – enjoy a phenomenally high repayment rate (FINCA, Chami and Fisher). Their experiences indicate the potential gains from a re-evaluation of risk by those most knowledgeable of local conditions.

Cooperatives could serve similar roles within our cities, both allowing capital to flow to where it will be most productive and monitoring its use (Neinhaus and Brauksiepe). Like the village councils, the co-ops would be both recipients and monitors of capital. Combined with municipally-encouraged loans, this would not only correct the market failure for the co-op itself, but could help coordinate market expectations in a more accurate direction for all businesses in the area (Gaffney).

This type of local involvement can also entice elements of the informal economy to enter the mainstream. Services as in-home daycares, hair care, and even sewing and cleaning all exist in the informal economy, and are existing evidence of an entrepreneurial spirit (Leonard). Co-ops could directly or indirectly enable these informal entrepreneurs to enter the formal economy through training, financial assistance, or even as an umbrella organization for several individuals.

Not all members of a co-op need to have this degree of entrepreneurial spirit to participate (Lutz). Many members of a co-op may benefit from some degree of government involvement. For example, Venezuela's national government has provided a wide variety of initial training for new cooperatives, ranging from basic training in literacy to accounting practices. After a period of initial training and financing, the goal is to avoid direct governmental involvement in the regular business of the co-op (Bowman and Stone). .

This model is easily adapted to the United States. Local governments could utilize the "train the trainer" model common in both the military and corporate world. Implementing this strategy could help provide the training needed to combat structural unemployment from the continuing globalization of the world market ("Rich Man, Poor Man"). This method's differences from typical job training programs create three benefits: a concrete goal of a co-op job, a self-selected pool of applicants, and a delegation of responsibility to neighborhood figures instead of outsiders.

This form of local government involvement also reduces the losses often associated with urban development. Job creation tends to favor in-migrants rather than the original residents (Ihlanfeldt, Blair). Co-ops reduce that loss through their tendency to be based on residency and geographic continuity. Government-created enticements such as "enterprise zones" are often used by businesses simply relocating within the metropolitan area (Ihlanfeldt , 9 Oct 2006 lecture, Blair). By being involved in these early stages, governments can instead promote the creation of import-substitution based co-ops.

By encouraging import-substitution based co-ops, we will decrease the marginal propensity to import. This effect is increased through the profit-sharing nature of coops. Put simply, what one spends at a co-op goes to a neighbor instead of a stranger.

This aspect of co-ops can generate several benefits for the co-op and the community. There is an increasing amount of research demonstrating that the sense of ownership fostered by co-ops directly translates into improved capital efficiency (Porter and Scully, Bowman and Stone). The experience of the Brazilian firm Semco shows that all workers, when fully empowered with decision-making ability and effective information, can realize that corporate and individual self-interest are complimentary (Semler). Being involved at all levels of decision-making also appears to develop an entrepreneurial spirit among employees (Semler). The three year old ROWE program at Best Buy, which allows employees to set their own schedule, decreased turnover, increased job satisfaction, and raised team performance scores (Thottham). All these seem to contribute to a greater sense of community. This may create a social externality: Increased social bonds tend to reduce deviant behavior, including crime (Thio).

The most effective inner-city crime-reduction strategies have involved large-scale cooperation between government agencies. One such program, Operation Ceasefire in Boston, had phenomenal success. Unfortunately, the gains largely disappeared due to the failure of government agencies to continue working together (Duane). A co-op could address this difficulty by creating an active, involved citizenry. Those organized citizens will be better able to pressure government officials and agencies to continue working together. The Anti-Displacement Project of Massachusetts has demonstrated this sort of political strength through their support of changes to state labor laws and an economic stimulus package designed to aid community-based job training (Anti-Displacement Project).

The local nature of co-ops also addresses the transportation problem for poor residents. The availability of transportation is a significant factor for determining wage equality (Sanchez). Simply providing adequate transportation is enough to raise wages an average of 41% (Simon). The nature of co-ops allows them to sidestep transportation issues by creating employment in the community. In turn, this creates more opportunities for work in the community as local residents begin to require – and are able to afford – more supplies and services.

Economic development professionals are already accustomed used to a great deal of outcome uncertainty and governmental expense in their profession (Rubin). A redirection of a portion of these resources should be sufficient to stimulate co-op creation, and with a more concrete return to investment. The site-specific nature of co-ops would suggest that funding models for enterprise zones would be well-adaptable to co-ops. Tax incremental financing could be easily adapted to provide seed money for establishing cooperatives. If direct investment is desired, an instrument could be offered whose returns are based on performance. A similar instrument has recently been introduced on the world market with great success ("Stylish Haircut"). Such an instrument would pay out a percentage if profits were above predicted growth, protecting the local multiplier while permitting external investment.

There are some obvious obstacles to using co-ops for economic development. An initial sense of shared values, community, or initial degree of social control is needed for success (Nienhaus and Brauksiepe). There is a real danger of a co-op becoming too successful and losing the very aspects that provide the positive externalities. Finally, while lessened, there is still the risk of in-migrants taking co-op jobs originally intended for local residents. While real all of these obstacles are simply potential problems to overcome.

There are also several frequently mentioned “straw man” obstacles. There is a fear of socialism that accompanies co-ops. However, within the model proposed above, the profit motive is still present, just shared openly and fairly. There is a concern that co-ops would be inherently unable to survive competition within a capitalist system. These fears can be allayed by the capitalist success of corporations such as Semco. As mentioned above, Semco's corporate ethic contains many of the principles of a modern co-op, but it has proven more resilient than many of its traditionally capitalist counterparts in Brazil (Semler). This indicates that it is the merit of the business – whether based on a cooperative or competitive model – that dictates success in a free market.

There are contentions of fraud with the cooperative initiative in Venezuela (Bowman and Stone). However, the United States can easily apply already existing corporate law to any potential fraud. Also unlike Venezuela, the models proposed here consider only local initiatives instead of a federal program. That physical proximity permits more oversight and greater opportunities to reduce fraud.

There are historical concerns about diseconomies of scale in production and information transmittal (Porter and Scully). Some of the concerns are addressed by improvements in technology. The remainder of these once-valid arguments are surmountable through the structure of the organization, as shown by the long-lived Mondragón co-op in the Basque region of Spain (Lutz).

The last “straw man” is based on historical precedent, and so requires a lengthier treatment. Many of the producer co-ops of the 19th century resulted in failure. This is largely attributed to a Hobbesian analysis of humanity and the utopian nature of these historical co-ops (Gibson-Graham). The presumption is that desire for individual gain will always trump working for a common goal. Yet that analysis does not explain the success of Semco, the ROWE program at Best Buy, or Mondragón. We may gain some insight by examining another set of scenarios where humans typically act contrary to Hobbesian expectations: during a disaster. At those times, we find that instead of panic and greed, there is a surprising outpouring of "kindness and good sense" (Solnit). I suspect that at those times, affected persons' self-interest is synonymous with the self-interest of the community as a whole. There is a common difficulty to overcome or a common goal to achieve. The above model of a co-op, by incorporating the profit motive, provides that shared common goal, which will help rectify this historical straw man.

In conclusion, a modern variant of a production cooperative could address both market failures and social failures more effectively than either the free market or existing methods of economic development. Funding such development would not require significant deviance from either the form or amount of current development methods. While cooperatives have real obstacles to their success, and are not a universal solution, they can avoid many of the difficulties faced by more traditional development methods. This brief overview indicates that we can anticipate greater direct and indirect benefits for existing residents for a similar level of government expenditure and involvement. Finally, unlike many economic development projects, the open nature of these co-ops can provide results that officials can access and evaluate. Anyone in economic development can enjoy that externality.

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